ACCOUNTING AND FINANCE LEVEL IV

Based on November, 2023 V- II

CASH AND ACCRUAL ACCOUNTING

Module Title:-Establishing and Maintaining a Cash and Accrual Accounting System

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Table of Contents

Acronyms

AR	Account Receivable
GAAP	General Accepted Accounting Principle
IRS	Internal Revenue Service
EHR	Electronic health record
CR	Credit
DR	Debit

Introduction of the module

Accounting and finance filed: Establishing and Maintaining a Cash and Accrual Accounting System in the work place helps to know the Identify relevant information and establish a chart of accounts, Analyze and verify source documents, Set up and maintain a petty cash system, Process and reconcile credit, Manage bank reconciliations and prepare and produce reports, Process invoices, adjustment notes and other general ledger transactions, Manage contra entries, Identify and process bad debts, Manage debt recovery, Prepare trial balance and Financial report Accounting and finance filed.

This module is designed to meet the industry requirement under the Accounting and Finance occupational standard, particularly for the unit of competency Establishing and Maintaining a Cash and Accrual Accounting System

This module covers

- Establish a chart of accounts
- Source documents
- Process Receipts and payments
- Petty cash system
- Credit reconciliation
- Bank reconciliations
- General ledger transactions
- Managing Contra Account
- Prepare trial balance and Financial reports

Learning objectives of the Module:

At the end of the module the trainee will be able to:

- Identify chart of accounts
- Verify source documents
- Process receipts and payments
- Set up petty cash system
- Reconcile credit card

- Bank reconciliation
- General ledger transaction
- Managing Contra Account
- Prepare trial balance and financial reports

Module Instruction

For effective use this modules trainees are expected to follow the following module instruction:
1. Read the information written in each unit
2. Accomplish the Self-checks at the end of each unit
3. Read and use the recommended reference book and materials

Unit One: Establish a chart of accounts

This Unit is developed to provide you the necessary information regarding the following content coverage and topics:

- Consulting business activities
- Identifying existing materials
- Examining business operations
- Chart of accounts and opening balances
- Authorising chart of accounts

This unit will also assist you to attain the learning outcomes stated in the cover page. Specifically, upon completion of this learning guide, you will be able to:

- Consult business activities
- Identify existing materials
- Examine business operations
- Establish Chart of accounts and opening balances
- Authorising chart of accounts

1.1. Consulting Business Activités

What is consulting? Consultants are people who specialize in helping clients resolve their company's most urgent problems, issues, or projects. They work across a huge range of roles and industries and share their gift of analyzing information and identifying the best path for each company to take.

The nature of the business should address the following elements of the business.

- Regular Process. Regular processes separate functioning businesses from mere hobbies
- Economic Activity
- Utility Creation
- Capital Requirement
- Goods And Services
- Anticipated Risk
- Profit-earning Motive
- Satisfaction Of Consumers' Needs

Organizations in many industries use business consulting services to help them solve problems, improve efficiencies, and grow their ventures.

Business consultants partner with companies and small businesses to identify obstacles a company faces in reaching its goals. These consultants are responsible for determining out-of-the-box strategies to help companies overcome their challenges

Business consulting involves providing expert advice and guidance to organizations to help them improve their operations, achieve their goals, and solve complex business problems,

Business consulting services include anything from strategic planning, financial management, and marketing to operations management, IT, and organizational development.

Business Consulting Industries

Business consultants can work in a wide variety of industries. Business consultants work in every industry, as the need for real world expertise and perspective is universal," Anywhere where an organization wants to realize a specific set of outcomes, who is struggling to achieve these goals, would benefit from engaging a consultant to help them."

Some typical industries that seek business consulting services include:

- Health care
- Finance
- Technology
- Retail
- Manufacturing
- Energy and environment
- Public sector

Skills for Business Consulting

To succeed in business consulting, it helps to have the right combination of hard and soft skills. Essential hard skills include:

- Knowledge of business processes
- Data analysis
- Project management
- Technical expertise
- Business writing
- Public speaking

Some key soft skills include:

- Communication
- Problem-solving
- Critical thinking
- Organizational
- Executive presence

Nature of the entity

May include but not limited to:

- association
- not-for-profit groups
- partnership
- private company
- public company
- trust

1.2. Identify Existing Material

The other main grouping of resources we need includes facilities, software, equipment, raw material, information and stock and supplies. Human resource is the most vital resource in an organization because it derives or moves all resources in the organization. This resource can increase the efficiency, economy and effectiveness of other resource. It is this resource that is most difficult to control because human beings are most unpredictable. However, if you are able to manage it properly, it can give wonderful results which no other resource can give. The heart of the issue with human resource is the skills-base of the business

Existing material

- May include but not limited to :
- computer data file
- existing chart of account
- financial statements and other material available from accountant
- source documents such as:
- asset and inventory records
- cash receipts journals
- cash payments journals
- sales and purchases distribution journals
- general ledger

1.3. Examining Business Operations

Business process analysis involves the following steps:

- Identify a Process to Analyze.
- Collect Data About the Process.
- Develop a "To-Be" Plan.
- Implement and Reevaluate.
- **Describe the financial event**.
  - Identify the property.
  - Identify who owns the property.
  - Determine the amount of increase or decrease

1.3.1. Accrual- Versus Cash-Basis Accounting

- **Accrual-Basis**: Under this method, revenues and expenses are recognized as earned or incurred, is standard, normal practice for the overwhelming majority of businesses, large and small, across industries

Advantages to Accrual Accounting:

- Describes accurately sales transactions that are only partially completed, e.g..where customers have received goods and services but not yet paid for them. Such situations are invisible to cash accounting.
- Makes possible the application of the matching concept, the idea that firms report revenues in the same period as the expenses that brought them
- Conforms to GAAP in most countries, as well as IFRS / IASB standards.

- **Cash-Basis Accounting**:
  - The cash basis is much simpler, but its financial statement results can be very misleading in the short run.
  - Revenue is recorded when cash is received (no matter when it is "earned"), and expenses are recognized when paid (no matter when "incurred").
  - The cash basis is not compliant with GAAP.
- **Modified cash Basis Approaches:**
  - The cash and accrual techniques may be merged together to form a modified cash basis system. The **modified cash basis** results in revenue and expense recognition as cash is received and disbursed, with the exception of large cash outflows for long-lived assets (which are recorded as assets and depreciated over time).
  - The revenue recognition and matching principles are used under the accrual basis of accounting.
  - Generally, accepted accounting principles require accrual basis accounting rather than cash basis accounting.

Cash accounting	Accrual accounting
Recognizes revenue when cash has been received	Recognizes revenue when it's earned (eg. when the project is complete)
Recognizes expenses when cash has been spent	Recognizes expenses when they're billed (eg. when you've received an invoice)
Taxes are not paid on money that hasn't been received yet	Taxes paid on money that you're still owed
Mostly used by small businesses and sole proprietors with no inventory	Required for businesses with revenue over $25 million

Figure 1.1. Diagram comparing accrual and cash accounting

Matching principle:

The matching principle dictates that efforts (expenses) be matched with accomplishments (revenues) in the accounting period.

The need for proper matching of revenues and expenses arises because of the existence of accounting periods and of payments and receipts that apply for different accounting periods.

Meaning Adjusting Entries

Adjusting entries are entries made at the end of the period to bring the balances of accounts that do not show their true balance to the true balance to be reported on the financial reports

Adjusting entries are required every time financial statements are prepared. Adjusting entries can be classified:

The Need of Adjusting Entries

- To report all revenues earned during the accounting period.
- To report all expenses incurred to produce the revenues earned in the same accounting period.
- To accurately report the assets on the balance sheet date. Some assets may have been used up during the accounting period.
- To accurately report the liabilities on the balance sheet date. (Expenses may have been incurred, but not yet paid.)

Types of Adjusting Entries

The number of adjustments needed at the end of each accounting period depends entirely upon the nature of the company's business activities.

However, most **adjusting entries fall in to one of the four general categories**:

- Converting assets to expenses
- Converting liabilities to revenue
- Accruing unpaid expenses, and
- Accruing uncollected revenue

Deferrals*:*

Deferrals are previously recorded assets, liabilities, revenues, or expenses that need to be adjusted at the end of the period to reflect revenues earned or expenses incurred in the current accounting period.

Some of the deferred items for which adjusting entry would be made include: prepaid insurance, prepaid rent, office supplies, depreciation, and unearned revenue.

Deferral adjustments are of two types:

1. Prepaid expense (Assets/expense) adjustments
   - ➢ Transfer amounts from asset accounts to expense accounts
2. Unearned revenue (deferred Revenue) Liability/revenue adjustments
   - ➢ Transferring amounts from liability to revenue accounts.

Converting assets to Expenses /Prepaid Expense Adjustments*:*

Prepaid expenses are expenses paid in cash and recorded as assets before they are used or consumed. Prepaid expenses expire with the passage of time or through use and consumption.

- An asset-expense account relationship exists with prepaid expenses.
- Prior to adjustment, assets are overstated and expenses are understated.
- The adjusting entry results in a debit to an expense account and a credit to an asset account.

Example 1: Assume that on November 15, the dental office paid Br 1, 800 for six months of insurance coverage (from November 15 to May 15 of next year). This results in Br300 coverage each full month. By December 31 (the end of the fiscal period), the dentist will have received one and one-half months of coverage (Br 450). Therefore, the following entry would be necessary:

Therefore on November 15, the following entry is made:

Date	Accounts	Debit	Credit
2008 Nov. 15	Prepaid insurance expense	1800.00	
	Cash		1800.00

On November 15, the amount paid represents future benefits (insurance coverage) to the dental office. The adjusting entry is to debit Insurance Expense and credit Prepaid Insurance. On December 31, the following adjusting entry is prepared:

Date	Accounts	Debit	Credit
2008 Dec. 31	Insurance Expense	450.00	
	Prepaid Insurance		450.00

Example 2: Assume that Gonzalez Company purchased Br 1,000 of supplies and debits Office Supplies during the year 2008. The beginning balance of the Office Supplies account was Br 200. At Dec. 31 2008, Br 300 of supplies was on hand. The adjusting entry would, therefore, be:

Date	Accounts	Debit	Credit
2008 Dec. 31	Supplies expense	900.00	
	Supplies		900.00

Converting liabilities to Revenue (Unearned Revenue) Adjustments:

These are cash received before providing products or services. The cash received is debited against the liability account when it is received. Revenues are recorded when the work is done. So, we owe the work - it's a liability. At the end of the period, we reduce the liability to reflect the portion of the work that has been done (this increases a revenue account).

- Unearned revenues are revenues received and recorded as liabilities before they are earned.
- Unearned revenues are subsequently earned by rendering service to a customer.
- A liability-revenue account relationship exists with unearned revenues.
- Prior to adjustment, liabilities are overstated and revenues are understated.
- The adjusting entry results in a debit to a liability account and a credit to a revenue account.

Example: Assume that on December 1, the dental office accepted a Br 2,400 payment from local businesses to provide dental care to their employees over the next three months. The initial entry on December 1 would be as follows:

Date	Accounts	Debit	Credit
2008 Dec. 1	Cash	2400.00	
	Unearned Dental Fees		2400.00

The amount of cash received on December 1 represents what the dental office owes to clients in the future. This is a liability since either the cash received must be returned or the services must be delivered.

From December 1 to December 31, one month of dental service has been provided; Br 800 x 1 month = Br 800 dental fee revenue. The remainder of Br 1,600 (Br 2,400 – Br 800) represents future dental service owed to businesses (a liability). December 31 adjusting entry would be:

Date	Accounts	Debit	Credit
2008 Dec. 31	Unearned Dental Fees	800.00	
	Dental Fees Earned		800.00

Accrual Adjustments

- ✓ Accruals are revenues that have been earned and expenses that have been incurred by the end of the current accounting period, but that will be collected or paid in a future accounting period.
- ✓ Accruals occur when no cash has been received or paid, but the company has undertaken activities that result in earning revenues or incurring expenses.
- ✓ Unlike deferrals, no original entry has been recorded.

Examples:-

a. Interest earned but not yet collected on a loan: Accrued Interest Receivable (Asset) (or simply Interest Receivable) – accrued revenue.
b. Wages earned by employees but not yet paid: Accrued Wages and Salaries Payable (Liability) (or simply Wages and Salaries Payable) – an accrued expense.

Accrual adjustments are of two types:

- accrued revenue and
- accrued expenses

Accruing uncollected Revenue (Accrued Revenue):

- ✓ Accrued revenues are revenues earned, but not yet received in cash.

- ✓ Accrued revenues may accumulate with the passing of time as in the case of interest and rent, or through services performed, but not billed or collected.
  - Accrued revenue requires an asset/revenue adjustment
  - An asset-revenue account relationship exists with accrued revenues.
  - Prior to adjustment, both assets and revenues are understated.
  - The adjusting entry results in a debit to an asset account and a credit to a revenue account

To illustrate, consider a 12% note payable (Br. 1500) due on March 30, 2009 was received by your business. The note was received on October 1, 2008. The interest revenue earned on this note until Dec. 31, 2008 is calculated using the following formula:

Interest = principal * rate * time

Therefore, the interest in this specific case would be,

Interest = 1,500 * 12% per year. * 3/12 year

=Br.45

The adjusting entry to record the interest expense incurred in October is:

Date	Accounts	Debit	Credit
2008 Dec. 31	Interest Receivable	45	
	Interest Income		45

Accruing unpaid Expenses (Accrued Expense)*:*

- ✓ Accrued expenses are expenses incurred, but not yet paid or recorded.
- ✓ Accrued expenses result from the same causes as accrued revenues and include interest, rent, taxes, and salaries.
  - A liability-expense account relationship exists with accrued expenses.
  - Prior to adjustment, both liabilities and expenses are understated.
  - The adjusting entry results in a debit to an expense account and a credit to a liability account.

Example: Accrued salaries: Some types of expenses, such as employee salaries and commissions, are paid for after the services have been performed. Assume that at Wisdom Service Company, salaries were last paid on October 26 (Friday); the next payment of salaries will not occur until November 9 (Friday). Three working days remain in October (October 29-31).

At October 31, the salaries for these days represent an accrued expense and related liability to Wisdom Company. The employees receive total salaries of Br.2,000 for a five-day workweek, or Br.400 per day. Thus, accrued salaries at October 31 are Br.1,200 (Br. 400 x 3), and the adjusting entry is:

Oct. 31	Salaries expense	1,200	
	Salaries payable		1,200
	(To record accrued salaries)		

Depreciation:

- ✓ A portion of their cost is simply allocated to each accounting period.
- ✓ This process is called **depreciation**.
- ✓ Depreciation is an example of a deferred expense. In this case the cost is deferred over a number of years, rather than a number of months. Principles of accounting II will cover depreciation methods in great detail. However, one simple approach is called the straight-line method.
- ✓ Under this method, an equal amount of asset cost is assigned to each year of service life. In other words, the cost of the asset is divided by the years of useful life, resulting in annual depreciation expense.

Example: In January 1, 2000 the company buys a delivery truck for 12,000. They expect the truck to last 5 years. They decide to use the straight line method, with a salvage value (SV) of Br2,000. The depreciable value is Br10,000 (Br12,000 cost - Br 2,000 SV). The annual depreciation expense is Br2,000 (Br10,000/ 5 years).

At the end of 5 years, the company has expensed Br10,000 of the total cost. The Br2,000 salvage value remains on the books.

General Journal

Date	Account	Debit	Credit
Jan. 1, 2000	Delivery Trucks	Br12,000	
	Cash		Br12,000
	To record purchase of delivery truck		
Dec-31	Depreciation Expense	Br2,000	
	Accumulated Depreciation		Br2,000
	To record depreciation expense for the year		

Book Value & Salvage Value

Book value is the difference between the cost of an asset, and the related accumulated depreciation for that asset

Book Value = Cost - Accumulated Depreciation

Book Value = (Br**12, 000 -** Br**10, 000) =** Br**2, 000**

The company will stop depreciating the truck after the end of the fifth year. The truck cost Br12,000, but only Br10,000 in depreciation expense was taken. The remaining book value is equivalent to the salvage value established when the vehicle was purchased. Book value will be used to calculate any gain or loss when the truck is sold or traded

Summery of Adjustment and Their Effects on the Financial Statements

Types of Adjustment	**Before Adjustment**		**Adjusting Entries**
	Balance Sheet	**Income Statement**	
Prepaid Expense (Deferred Expense)	• Asset overstated • Owner's Equity overstated	• Expense Understated • Net Income Overstated	Debit Expense ---- Dr Credit Asset --------Cr
Unearned Revenue (Deferred Revenue)	• Liability overstated • Owner's Equity Understated	• Revenue Understated • Net Income Understated	Debit Liability ---- Dr Credit Revenue -------Cr
Accrued Expense	• Liability Understated • Owner's Equity overstated	• Expense Understated • Net Income Overstated	Debit Expense ---- Dr Credit Liability -----Cr
Accrued Revenue	• Asset Understated • Owner's Equity Understated	• Revenue Understated • Net Income Understated	Debit Asset ---- Dr Credit Revenue ------Cr
Fixed Assets	• Asset overstated • Owner's Equity overstated	• Expense Understated • Net Income Overstated	Debit Expense ---- Dr Credit Contra Asset ----Cr

Alternative Treatment of Deferrals

As an example, recall the illustration of accounting for prepaid insurance -- Prepaid Insurance was debited and Cash was credited at the time of purchase. This is referred to as a "balance sheet approach" because the expenditure was initially recorded into a prepaid account on the balance sheet. However, an alternative approach is the "income statement approach." With this approach, the Expense account is debited at the time of purchase. The appropriate end-of-period adjusting entry "establishes" the Prepaid Expense account with a debit for the amount relating to future periods. The offsetting credit reduces the expense account to an amount equal to the amount consumed during the period.

The balance sheet and income statement methods result in identical financial statements. Notice that the income statement approach does have an advantage if the entire prepaid item or unearned revenue is fully consumed or earned by the end of an accounting period. No adjusting entry is needed because the expense or revenue was fully recorded at the date of the original transaction.

Example: Assume that supplies worth Br 386 are purchased on Nov. 1, the entry would be recorded as follows:

Date	Accounts	Debit	Credit
2008 Dec. 31	Supplies Expense	386	
	Cash		386

If supplies on hand at the end of the year were worth Br 133, the adjusting entry would be as follows:

Date	Accounts	Debit	Credit
2008 Dec. 31	Supplies	133	
	Supplies Expense		133

In both alternatives, the supplies expense would be Br 253 and the asset portion would be Br 133.

Example: assume you have advance collection of rent income for Br 450. If the option of recording deferrals initially as income statement items is used, the entry would be as follows:

Date	Accounts	Debit	Credit
2008 Nov. 1	Cash	450	
	Rent Income		450

If Br 150 has been earned at Dec. 31, 2003, the adjusting entry transfers this amount from the revenue account to a liability account as follows:

Date	Accounts	Debit	Credit
2008 Dec. 31	Rent Income	450	
	Unearned Rent		450

1.4. Chart of accounts and opening balances

Chart of Accounts is a list of all Asset, Liability, Equity, Revenue, and Expense

Accounts included in the company's General Ledger. The number of accounts included in the chart of accounts varies depending on the size of the company. A small family run business may only have twenty total accounts whereas a worldwide company like General Electric will likely have hundreds of accounts.

A numbering system is used in a chart of accounts to make organization and recordkeeping easier.

To set up a chart of accounts, one first needs to define the various accounts to be used by the business. Each account should have a number to identify it. For very small businesses, three digits may suffice for the account number, though more digits are highly desirable in order to allow for new accounts to be added as the business grows. With more digits, new accounts can be added while maintaining the logical order. Complex businesses may have thousands of accounts and require longer account reference numbers. It is worthwhile to put thought into assigning the account numbers in a logical way, and to follow any specific industry standards.

The following numbering system would be similar to that of a midsized business.

101-199 Asset Accounts
201-299 Liability Accounts
301-399 Equity Accounts
401-499 Revenue Accounts
501-599 Expense Accounts

The following are examples of Asset accounts:

101	Cash
102	Petty cash
103	Cash equivalents
104	Short-term investments
106	Accounts receivable
107	Allowance for doubtful accounts
109	Interest receivable
110	Rent receivable
111	Notes receivable
119	Merchandise inventory
124	Office supplies
128	Prepaid insurance
129	Prepaid interest
131	Prepaid rent
141	Long-term Investments
151	Automobiles
152	Accumulated depreciation- Automobiles
153	Trucks
154	Accumulated depreciation-Trucks
159	Library
160	Accumulated depreciation-Library

161	Furniture
162	Accumulated depreciation-Furniture
163	Office Equipment
164	Accumulated depreciation-Office equipment
169	Machinery
170	Accumulated depreciation-Machinery
175	Building
176	Accumulated depreciation-Building
179	Land improvements
180	Accumulated depreciation-Land improvements
183	Land
185	Mineral deposit
186	Accumulated depreciation-Mineral deposit
191	Patents
192	Leasehold
193	Franchise
194	Copyrights
195	Leaseholds improvements
196	Licenses
197	Accumulated amortization

The following are examples of Liability accounts:

201	Accounts payable
202	Insurance payable
203	Interest payable
204	Legal fees payable
207	Office salaries payable
208	Rent payable
209	Salaries payable
210	Wages payable
211	Accrued payroll payable
214	Estimated warranty liability
215	Income taxes payable
216	Common dividend payable
217	Preferred dividend payable
218	State unemployment taxes payable
219	Employee federal income taxes payable
221	Employee medical insurance payable
222	Employee retirement program payable
223	Employee union dues payable
224	Federal unemployment taxes payable
225	FICA taxes payable
226	Estimated vacation pay liability
230	Unearned consulting fees
231	Unearned legal fees
232	Unearned property management fees
235	Unearned janitorial revenue
238	Unearned rent
240	Short-term notes payable
245	Notes payable
251	Long-term notes payable
253	Long-term lease liability
255	Bonds payable
258	Deferred income tax liability

The following are examples of Equity accounts:

301	Owner's Capital
302	Owner's Withdrawals
307	Common stock, par value
308	Common stock, no par value
309	Common stock, stated value
310	Common stock dividend distributable
311	Paid-in capital in excess of par value, Common stock
312	Paid-in capital in excess of stated value, No-par common stock
313	Paid-in capital from retirement of common stock
314	Paid in capital, Treasury stock
315	Preferred stock
316	Paid-in capital in excess of par value, Preferred stock
318	Retained earnings
319	Cash dividends
320	Stock dividends
321	Treasury stock, Common
322	Unrealized gain-Equity
323	Unrealized loss-Equity

*A firm will have a varying number of these accounts depending on the number of products or services the firm manufactures or offers.

The following are examples of Expense accounts:

501	Amortization expense
502	Depletion expense
503	Depreciation expense-Automobiles
504	Depreciation expense-Building
505	Depreciation expense-Furniture
506	Depreciation expense-Land improvements
507	Depreciation expense-Library
508	Depreciation expense-Machinery
509	Depreciation expense-Mineral deposit
510	Depreciation expense-Office equipment
511	Depreciation expense-Trucks
520	Office salaries expense
521	Sales salaries expense
522	Salaries expense
523	"Blank" wages expense
524	Employees' benefits expense
525	Payroll taxes expense

530	Cash over and Short
531	Discounts lost
532	Factoring fee expense
533	Interest expense
535	Insurance expense-Delivery equipment
536	Insurance expense-Office equipment
540	Rent expense
541	Rent expense-Office space
542	Rent expense-Selling space
543	Press rental expense
544	Truck rental expense
545	"Blank" rental expense
550	Office supplies expense
551	Store supplies expense
552	"Blank" supplies expense
555	Advertising expense
556	Bad debts expense
557	Blueprinting expense
558	Boat expense
559	Collection expense
561	Concessions expense
562	Credit card expense
563	Delivery expense
564	Dumping expense
566	Equipment expense
567	Food and drinks expense
568	Gas and oil expense
571	General and administrative expense
572	Janitorial expense

573	Legal fees expense
574	Mileage expense
576	Miscellaneous expense
577	Mower and tool expense
578	Operating expense
579	Organization expense
580	Permits expense
581	Postage expense
582	Property taxes expense
582	Repairs expense
584	Selling expense
585	Telephone expense
587	Travel and entertainment expense
590	Utilities expense
591	Warranty expense
595	Income taxes expense

The journal entry rules for the accounts are as follows:

For Asset accounts you debit increases and credit decreases.

For Liability accounts you credit increases and debit decreases

For Revenue accounts you credit increases and debit decreases

For Expense accounts you debit increases and credit decreases

1.5. Authorizing chart of accounts

May include but not limited to:

- accountants
- debtors
- directors
- managers
- owners
- Staff members Relevant persons includes,

The true test of the chart of accounts is that it produces correct accounting information. The only way to run this test is by posting several transactional documents (invoices, shipments, payments, etc.) into a new client and checking the accounting entries and reports are as you expect.

Self Check 1.1.

Part one- True/False Questions

1. Accrual accounting records revenues and expenses when cash is received or paid.
2. The cash basis of accounting recognizes revenues when cash is received and expenses when they are paid.
3. Cash accounting is more commonly used by large corporations due to its accuracy in financial reporting.
4. Accrual accounting is required for companies with average revenues of $25 million or more over three years.
5. The main drawback of cash accounting is that it accurately portrays a company's liabilities incurred but not yet paid.

Part Two - Choice Questions

1. Which of the following is an example of a soft skill important in business consulting?
   A) Data analysis B) Project management C) Communication D) Technical expertise
2. Which industry may benefit from engaging a business consultant?
   A) Only the healthcare industry B) Only the technology industry C) Any industry struggling to achieve specific outcomes D) Only the retail industry
3. In accrual accounting, revenue is recorded:
   A) When cash is received B) When a sale is made, regardless of when cash is received C) When an invoice is sent D) Only when the money is in the bank
4. What is the primary advantage of accrual accounting over cash accounting?
   A) Simplicity in tracking cash flow B) Immediate recognition of cash transactions C) Matching revenues with expenses in the same period D) Easier comprehension for individuals without an accounting background
5. The chart of accounts typically includes categories such as:
   A) Only Liability and Expense accounts B) Only Asset and Revenue accounts C) Asset, Liability, Equity, Revenue, and Expense accounts D) Only Revenue and Expense accounts

Part Three – Short Answer

1. Define what Chart of Accounts is____
____
____
____

2. Briefly Explain Accrual & Cash Accounting System____
____
____
____
____
____
____

3. List some typical industries that seek business consulting services

Unit Two: Source of Documents

This Unit is developed to provide you the necessary information regarding the following content coverage and topics:

- Verifying source documents
- Discrepancies

This unit will also assist you to attain the learning outcomes stated in the cover page. Specifically, upon completion of this learning guide, you will be able to:

- Verify Source documents
- Identify Discrepancies

2.1. Verifying Source Documents

Accounting Source of Documents refers to the origin or the place from where the accounting information or data is obtained. It is important to identify and document the source of each transaction or event in order to maintain accurate and reliable financial records. Here are some common examples of accounting sources of documents:

- **Sales Invoices**: These are generated when a company sells goods or services to its customers. Sales invoices provide details such as the date of sale, description of the items sold, quantity, price, and terms of payment.

➢ **Parts of an invoice**

What does an invoice contain? Clearly label an invoice so a customer knows what it is. All invoices should include the same basic information:

- ➢ **Invoice date**: This shows the customer the date the invoice was created.
- ➢ **Customer information:** Clearly state the customer's name, business (if applicable), address, and phone number on the invoice.
- ➢ **Seller information**: Include your business's name, address, email address, and
- ➢ **Goods and/or services purchased**: List out the exact products or services, quantities, and prices the invoice is for. A good description will alleviate potential confusion.
- ➢ **Total amount due**: After adding up the total and sales tax (if applicable), include the total amount the customer owes you. If they paid part of the total at the time of purchase, make sure to account for that according to the payment terms of the seller.

Example: ABC Company sells 100 units of product X to XYZ Company for $10,000. The sales invoice issued by ABC Company serves as the source document for recording this transaction.

Essential Documents You Need to Verify an Invoice

- Valid trade license number mentioned on the invoice
- Quoted estimate for the same service/product
- Purchase Order Issued
- Duly signature delivery note with specifications
- Payment receipt for all the reimbursable expenses claimed

Cheque A Payment Requisition confirms that the purchase has been supplied by the vendor according to the agreed upon terms and conditions, and that the authorized signing authority has approved the vendor charges

Purchase Invoices: These are received by a company when it purchases goods or services from its suppliers. Purchase invoices contain information about the date of purchase, description of the items purchased, quantity, price, and terms of payment. Example: XYZ Company purchases raw materials worth $5,000 from ABC Supplier. The purchase invoice received from ABC Supplier serves as the source document for recording this transaction.

Bank Statements: These are provided by banks to account holders and show the details of all transactions related to the bank account. Bank statements include information about deposits, withdrawals; interest earned, and bank charges. Example: ABC Company receives its monthly bank statement from XYZ Bank. The bank statement serves as the source document for reconciling the company's cash balance and recording any bank-related transactions.

Payroll Records: These documents provide information about employee compensation, including wages, salaries, bonuses, and deductions. Payroll records typically include details such as employee names, hours worked, pay rates, and tax withholdin Example: XYZ Company maintains payroll records for its employees, which serve as the source documents for recording salary expenses and payroll tax liabilities.

Receipts: These are issued by a company to its customers as proof of payment received. Receipts contain details such as the date of payment, amount paid, purpose of payment, and the name of the payer.

Example: ABC Company receives a cash payment of $1,000 from a customer for services rendered. The receipt issued by ABC Company serves as the source document for recording this cash inflow.

It is essential to retain and organize these source documents as they provide evidence and support for the financial transactions recorded in the accounting system.

Types of source documents

Invoices: Issued by a seller to a buyer, detailing the products or services provided, quantities, prices, terms of payment, and other relevant information.

Example: A company receives an invoice from its supplier for the purchase of raw materials.

Receipts: Acknowledgment of payment received, providing details such as date, amount paid, purpose of payment, and mode of payment.

Example: A customer pays cash at a store and receives a receipt as proof of payment.

Bank Statements: Records provided by a bank summarizing all transactions in a specified period, including deposits, withdrawals, and checks issued, and bank charges.

Example: A company receives its monthly bank statement detailing all transactions for the month.

Purchase Orders: Issued by a buyer to a seller, specifying the goods or services required, quantities, prices, delivery date, and other terms.

Example: A company sends a purchase order to a supplier to request specific quantities of inventory.

Credit Notes: Issued by a seller to a buyer, indicating a reduction in the amount payable due to returned goods or overpayment.

Example: A vendor issues a credit note to a customer for returned defective merchandise.

Contracts: Legally binding agreements between parties specifying terms, conditions, obligations, and rights are regarding a transaction or service.

Example: A company enters into a contract with a service provider for IT support.

Benefits of Source Documents:

Accuracy: They ensure accurate recording of transactions by providing detailed information about each business activity.

Audit Trail: Source documents create a trail that auditors can follow to verify the accuracy and completeness of financial records.

Legal Compliance: They help in complying with legal and regulatory requirements by providing evidence of transactions.

Financial Analysis: Source documents facilitate the analysis of financial performance and decision-making by providing a clear record of transactions.

Accurate and timely recording of transactions using source documents is crucial for maintaining reliable financial records and ensuring transparency and accountability within a business.

Verifying source documents is an essential aspect of accounting that involves reviewing and confirming the authenticity, accuracy, and relevance of the documents used to record financial transactions. These source documents serve as evidence of the transactions and form the basis for entries into the accounting system. Verifying those helps ensure the integrity and reliability of the financial information.

Here are some key steps and considerations in verifying source documents in accounting:

Relevance and Completeness: Check if the documents pertain to the business's transactions and are complete in terms of necessary information like dates, amounts, descriptions, parties involved, etc. For instance, invoices should include details of goods or services sold, prices, terms of payment, and the parties involved.

Accuracy: Verify the accuracy of the information within the documents. For example, cross-check numerical figures, such as totals, quantities, and prices, against other supporting documents or information.

Authorization and Approval: Ensure that the documents are properly authorized and approved as per the company's internal control procedures. For instance, invoices should be approved by authorized personnel before payment.

Validity and Authenticity: Confirm that the documents are genuine and not altered or forged. This involves checking for signs of tampering or inconsistencies in the documents.

Match and Reconciliation: Match source documents against other supporting records to ensure **consistency and accuracy**. For instance, matching purchase orders with corresponding invoices and delivery receipts.

Timeliness: Ensure that the documents are timely and recorded in the correct accounting period to accurately reflect the financial position and performance of the business.

Example: Suppose a company receives an invoice from a supplier for the purchase of raw materials. To verify this source document:

Check the invoice for completeness: Ensure it includes details like invoice number, date, supplier's details, description of materials, quantity, unit price, total amount, and any applicable taxes or discounts.

Verify the accuracy of the invoice by comparing it with the purchase order issued to the supplier. Check if the quantities, prices, and items match between the two documents.

Confirm that the invoice is authorized by an appropriate authority within the company.

Ensure that the goods have been received by cross-referencing the invoice with the receiving report or goods receipt.

Validate the authenticity of the invoice by confirming the supplier's details and checking for any discrepancies or signs of alterations.

By systematically verifying source documents, accountants can enhance the accuracy and reliability of financial records, which in turn supports better decision-making and financial reporting within the organization.

2.2. Discrepance

Discrepancies in source documents within accounting refer to inconsistencies, errors, or variations found between different supporting materials used in financial record-keeping. These source documents serve as the foundation for accounting entries and are vital for maintaining accurate and reliable financial records. Discrepancies can arise due to various reasons, and they can significantly impact the integrity and reliability of financial information if not identified and rectified promptly.

Common types of discrepancies in source documents:

Data Entry Errors: Mistakes made during the input of financial data into accounting systems can lead to discrepancies. This might involve typographical errors, transposition of digits, or incorrect recording of numbers, dates, or amounts.

Timing Discrepancies: Differences in the timing of transactions between source documents can occur, especially when transactions are recorded at different points or periods. For instance, a sale might be recorded on a sales receipt immediately, but the corresponding revenue might be recorded later in the accounting system.

Missing Documentation: Sometimes, source documents required for transactions might be missing or incomplete. This absence can create discrepancies as there may not be sufficient evidence or details to support the recorded entries.

Duplicate Entries: Accidentally recording the same transaction more than once can cause discrepancies in accounting records, leading to inflated figures or imbalance in financial statements.

Calculation Errors: Errors in arithmetic or calculations within source documents can result in discrepancies. These errors might involve incorrect totals, subtotals, or computations of discounts, taxes, or percentages.

Resolving discrepancies in source documents is crucial for ensuring accurate financial reporting. Here are steps that can be taken to address and rectify these issues:

Reconciliation: Regularly compare and reconcile different sets of records, such as bank statements with cash book records or sales invoices with sales registers, to identify and rectify any discrepancies.

Audit Trails: Maintain clear audit trails that allow for the tracking of transactions from their source documents to their entries in the accounting system. This aids in identifying the origins of discrepancies.

Verification and Cross-Checking: Implement robust verification processes and cross-checking mechanisms to ensure accuracy in data entry and calculations. This may involve multiple layers of review by different personnel.

Documentation Review: Ensure that all necessary source documents are available, complete, and accurately recorded to support transactions. Missing or incomplete documents should be followed up and completed promptly.

Addressing discrepancies in source documents is essential to maintain the accuracy, reliability, and integrity of financial records. Regular monitoring, reconciliation, and adherence to proper accounting procedures are crucial in minimizing and resolving these discrepancies to ensure the accuracy of financial reporting.

Self-Check. 2.1.

Part one- True or False Question

1. Reconciliation involves comparing different sets of records to identify discrepancies.
2. Missing documentation doesn't impact the reliability of financial records.
3. Data entry errors may include incorrect recording of numbers or amounts.
4. Regular verification and cross-checking are not necessary for accuracy in accounting.
5. The primary purpose of source documents is to facilitate tax audits.

Part two- Multiple-Choice Questions

1. Which of the following is not typically included in an invoice?

   A) Invoice date B) Seller's email address C) Description of goods/services D) Payment method E) Total amount due
2. What is the purpose of maintaining clear audit trails in accounting?

   A) Tracking employee payroll B) Identifying the source of discrepancies C) Issuing credit notes D) Approving purchase orders E) Monitoring bank statements
3. Which discrepancy in source documents involves recording the same transaction more than once?

   A) Calculation errors B) Data entry errors C) Timing discrepancies D) Missing documentation E) Duplicate entries
4. How can discrepancies in accounting records due to timing differences be resolved?

   A) By cross-checking calculations B) By maintaining missing documents C) Through regular reconciliation D) By issuing credit notes E) By verifying trade license numbers
5. What is the primary reason for verifying source documents in accounting?

   A) To increase taxes B) To confirm the date of receipt C) To maintain accurate financial records D) To issue payment requisitions E) To generate payroll reports

Part three - Blank Space Questions

1.__________ errors involve mistakes made during the input of financial data into accounting systems, such as typographical errors or incorrect recording of numbers.

2. Differences in the timing of transactions between source documents can cause __________, especially when entries are recorded at different points or periods.

3. Regularly comparing and reconciling different sets of records, such as bank statements with cash book records, helps in identifying and rectifying __________ in financial records.

4.__________ involves the accidental recording of the same transaction more than once, leading to inflated figures or imbalances in financial statements.

5. Maintaining clear __________ allows for the tracking of transactions from their source documents to their entries in the accounting system, aiding in identifying the origins of discrepancies.

Unit Three: Process receipts and payments

This Unit is developed to provide you the necessary information regarding the following content coverage and topics:

- Receiving and payment of banking money
- Receipts and payments on cash basis
- Filing receipts and payments
- Cash register against purchases

This unit will also assist you to attain the learning outcomes stated in the cover page. Specifically, upon completion of this learning guide, you will be able to:

- Receive and payment banking money
- Record receipts and payments on cash basis
- File receipts and payments
- Cash register against purchases

3.1. Receiving and payment of banking money

Effectively managing receipts and payments involves a systematic approach to handling financial transactions, ensuring accuracy, compliance, and providing essential data for decision-making and financial health assessment within an organization.

The receiving and payment of banking money are fundamental processes in the financial operations of banks. These processes involve various methods and channels through which money is received into or paid out of bank accounts. Here's a detailed overview of both aspects:

Receiving of Banking Money

Cash Deposits: Customers can deposit cash directly into their bank accounts through tellers, ATMs, or cash deposit machines.

Cheque Deposits: Banks accept cheques deposited by customers, which are credited to their accounts after clearance.

Electronic Transfers

Direct Deposits: Employers use direct deposit to pay employees' salaries directly into their bank accounts.

Electronic Funds Transfers (EFT): Customers transfer money electronically between accounts, within the same bank or between different banks.

Mobile Banking:

Mobile Wallets: Customers can receive money through various mobile payment apps linked to their bank accounts.

Peer-to-Peer (P2P) Transfers: Instant transfers between individuals using mobile banking applications.

International Transactions:

Inward Remittances: Receipt of funds from abroad through wire transfers, SWIFT transfers, or international payment systems like PayPal.

Payment of Banking Money:

Withdrawals:

ATM Withdrawals: Customers can withdraw cash from their accounts using ATMs.

Over-the-Counter Withdrawals: Withdrawals made by customers at bank branches through tellers.

Electronic Payments:

Online Bill Payments: Customers pay bills (utilities, credit card bills, etc.) through online banking platforms.

Electronic Funds Transfers: Initiating payments to other accounts or entities using electronic means.

Debit Cards and Payment Apps:

Point-of-Sale (POS) Payments: Customers can make payments at merchants using their bank-issued debit cards.

Mobile Payment Apps: Payment through mobile apps linked to bank accounts for various services and purchases.

International Transactions:

Outward Remittances: Sending money abroad through wire transfers, SWIFT transfers, or international payment systems.

Key Considerations:

Clearance and Settlement: Cheques and electronic transfers undergo a clearance process before funds are made available, ensuring security and authenticity.

Transaction Fees: Banks may charge fees for certain transactions, depending on the type and mode of transfer.

Regulatory Compliance: Banks must adhere to regulatory guidelines and anti-money laundering (AML) procedures while handling incoming and outgoing funds.

The smooth functioning of these processes is crucial for individuals, businesses, and the overall economy. They facilitate commerce, enable financial transactions, support businesses' liquidity needs, and provide individuals with access to their funds for various purposes.

In essence, the receiving and payment of banking money encompass a wide array of methods and services that allow individuals and businesses to manage their finances efficiently while adhering to regulatory standards and ensuring security in transactions.

3.2. Receipts and payments on cash basis

Receipts and payments on a cash basis refer to an accounting method where transactions are recorded when cash is actually received or paid out, regardless of when the transaction was actually incurred or earned. This approach is straightforward and tracks the flow of actual cash into and out of an entity.

Receipts: Any income or revenue is recorded when the cash is physically received. For instance, if a company sells a product and receives cash payment immediately, that sale is recorded as revenue at the time of the cash receipt.

Payments: Any expenses or outflows are recorded when the cash is disbursed. For example, when a company pays for supplies with cash, that expense is recorded at the time of payment.

This method is different from the accrual basis of accounting. In accrual accounting, transactions are recorded when they occur, regardless of when the cash is exchanged. This means revenue is recognized when it's earned and expenses are recognized when they are incurred, irrespective of when the actual cash changes hands.

The table below shows the format/specimen of a receipts and payments account

Name____________________________

RECEIPTS AND PAYMENTS ACCOUNT

For the year ended_________

Receipts	$	Payments	$

Preparation of Accounts

A receipts and payments account is prepared by extracting receipts and payments from the cash book for the entire year.

In a cash book, each item is recorded separately in chronological order. However, the items in a receipts and payments account are recorded in classified form under different headings.

To prepare a receipts and payments account, follow these steps:

Step 1: Write the title of the account and use the format shown in the specimen.

Step 2: Write the opening cash and bank balances at the top on the left-hand side.

Step 3: Add up all the receipts with different dates under the same head.

Step 4: Add up all the payments made on different dates under the same head. You can also use a separate sheet for this.

Step 5: Write the sums of each head of receipts on the left-hand side and the total of each head of payments on the right-hand side.

Step 6: Deduct all payments from all receipts and find the closing balance.

Example 1

A library and debating society was formed on 1st January 2017. The receipts and payments for the year ended 31 December 2017 are as follows:

Receipts:

Subscription: $1350.00

Donations: $2600.00

Entrance fees: $480.00

Locker rent: $785.00

Investment: $1100.00

Payments:

Library books: $1210.00

Rent for library hall: $240.00

Office expenses: $35.00

Postage and stationery: $72.00

Furniture purchased: $934.0

Required: Show the receipts and payments account for the year ended 31 December 2017.

Solution

Library and Debating Society
Receipt and Payment Account
For the Year Ended 31 December 2017

Receipts	$	Payments	$
Subscription	1,350	Library Books	1,210
Donations	2,600	Rent of Library Hall	240
Entrance	480	Office Expenses	35
Locker Rent	785	Postage and Stationary	72
		Furniture	934
		Investment	1,100
		Balance	1,624
	5,215		5,215

3.3. Filing receipts and payments

Filing receipts and payments involves organizing and documenting financial transactions within a system to maintain records accurately. Here's a step-by-step guide on how to effectively file receipts and payments:

Create a System: Establish a filing system that works for you. This could be physical folders, digital folders, or accounting software.

Separate Receipts and Payments: Differentiate between receipts (incoming money) and payments (outgoing money) for better organization.

Sort by Date: Arrange receipts and payments chronologically. This helps in tracking and finding specific transactions easily.

Categorize Transactions: Classify transactions based on their nature or purpose. Common categories include utilities, office supplies, travel expenses, etc.

Assign Unique Identifiers: Use codes or unique identifiers for each receipt/payment. This can be helpful when cross-referencing or retrieving information later.

Record Details: For each transaction, note down pertinent details like date, amount, payee/payer information, purpose, and any relevant notes.

Backup Documents: Make copies or digital scans of receipts and payment records for safekeeping and as a backup in case of loss or damage.

Regular Review: Set aside time regularly (e.g., monthly or quarterly) to review and reconcile receipts and payments against bank statements or financial records. This helps catch any discrepancies or errors.

Dispose of Unnecessary Records: Safely dispose of receipts or payment records that are no longer needed, keeping in mind any legal or compliance requirements for record retention.

Maintain Security: Ensure that sensitive financial information is securely stored, especially in digital formats, by using encryption or password protection.

Audit Trail: Keep a clear audit trail by documenting any changes, corrections, or adjustments made to the filing system or records.

Compliance and Regulations: Stay updated with relevant tax laws and financial regulations to ensure proper filing and documentation.

Whether you're managing personal finances or handling a business's financial transactions, these steps will help maintain an organized and efficient filing system for receipts and payments, aiding in better financial management and record-keeping.

3.4. Cash Register against Purchases

A cash register is a mechanical or electronic device used in retail stores or businesses to record and track sales transactions. When a customer makes a purchase, the cashier rings up the items, and the cash register calculates the total amount due based on the prices of the items and any applicable taxes. The customer then pays the amount owed, and the cashier processes the payment.

The cash register typically generates a receipt for the customer, detailing the items purchased, their prices, the total amount paid, and any change due. Additionally, the cash register keeps a record of all transactions made during a specific period, which helps in managing sales, inventory, and accounting.

The process of using a cash register against purchases involves:

Item Scanning/Ringing Up: The cashier scans the items or manually enters their prices into the cash register.

Calculating the Total: The cash register tallies up the prices of all items, adds taxes if applicable, and calculates the total amount due.

Payment: The customer pays the total amount due using cash, credit/debit card, or other payment methods.

Recording the Transaction: The cashier finalizes the transaction on the cash register, indicating the payment method used and issuing a receipt to the customer.

Updating Records: The cash register records the transaction details, keeping a record of the sale for accounting purposes and inventory management.

The 5-step process for balancing cash registers

1. Determine your ideal starting amount.
2. Keep one employee per register.
3. Run an X read.
4. Conduct the physical count.
5. Don't forget the cash drop

Self- Check 2.1

Part one -True or False Questions

1. In cash basis accounting, transactions are recorded when cash is received or paid, regardless of when the transaction occurred.

2. Cash registers in retail stores help track sales transactions but do not generate receipts for customers.

3. Filing receipts and payments involves organizing financial transactions only in physical folders; digital filing methods are not effective.

4. Over-the-Counter Withdrawals can be conducted only through ATMs in banking transactions.

5. Mobile Wallets are incapable of receiving money through various mobile payment apps linked to bank accounts.

Part two - Multiple-Choice Questions:

1. Which of the following is NOT a method of receiving banking money?

a) Electronic Funds Transfers b) Direct Deposits c) Point-of-Sale (POS) Payments d) Inward Remittances

2. What is the key difference between cash basis accounting and accrual basis accounting?

a) Recording transactions based on cash flow versus transactions based on credit

b) Recording transactions when earned versus recording transactions when paid

c) Recording transactions only in digital formats versus recording transactions in physical folders

d) Recording transactions in chronological order versus recording transactions under specific categories

3. Which step is NOT part of the process for filing receipts and payments?

a) Regular Review b) Disposing of Necessary Records c) Assigning Unique Identifiers d) Sorting by Date

4. What process does a cash register perform during a retail transaction?

a) Inventory restocking b) Calculating the number of customers c) Tracking sales transactions and generating receipts d) Managing employee schedules

5. What is the purpose of conducting an X read in balancing cash registers?

a) To determine the number of items sold

b) To finalize the sales transactions

c) To conduct a physical count of cash in the register

d) To update inventory records

Part three- Short-Answer Questions:

1. Explain the difference between receipts and payments in accounting.

2. Describe the key steps involved in preparing a receipts and payments account using the given example of a library and debating society.

3. How does a cash register contribute to effective sales management and accounting in a retail business setting?

Unit Four: Establish and replenish a petty cash system

This Unit is developed to provide you the necessary information regarding the following content coverage and topics:

- record authorization expenditure
- Reconciling and reimbursing expenditure

This unit will also assist you to attain the learning outcomes stated in the cover page. Specifically, upon completion of this learning guide, you will be able to:

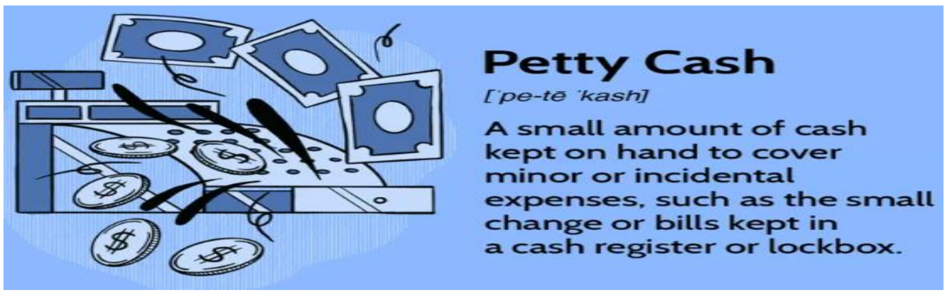
- Prepare expenditure authorisation.
- Reconcile and reimbursing expenditure

4.1. Preparing expenditure authorization record

Petty Cash Fund

A petty cash fund is used to provide small amounts of cash for common expenditures for which the company does not write a check or purchase on account. Examples include employee birthday cakes, office supplies or postage due on mail.

Petty cash funds are typically operated on an imprest basis, meaning that when cash is expended from the fund, it is replaced by a receipt in the same amount. The balance of an imprest fund should always equal the balance established for the fund.



The operation of petty cash fund involves:

1. Establishing the fund,
2. Making payments from the fund, and
3. Replenishing the fund.

To illustrate, assume Z-Mart establishes a petty cash fund on November 1 and designates one of its office employees as the petty cashier. A ETB75 check is drawn, cashed, and the proceeds given to the petty cashier. The entry to record the setup of this petty cash fund is;

Nov. 1 Petty Cash 75

Cash 75

To establish a petty cash fund

After the petty cash fund is established, the Petty Cash account is not debited or credited again unless the amount of the fund is changed. (A fund should be increased if it requires reimbursement too frequently. On the other hand, if the fund is too large, some of its money should be re-deposited in the Cash account.)

Assume that Z-Mart's petty cashier makes several November payments from petty cash. During November the following petty cash receipts were found in the petty cash box.

November 7	Delivery expense	5.00
November 9	Miscellaneous expense	46.50
November 18	Merchandise inventory	15.05
November 24	Supplies expense	4.75

Nov. 27	Miscellaneous Expenses	46.50	
	Merchandise Inventory	15.05	
	Delivery Expense	5.00	
	Office Supplies Expense	4.75	
	Cash		71.30
	To reimburse petty cash		

Increasing or decreasing a petty cash fund. A decision to increase or decrease a petty cash fund is often made when reimbursing it. To illustrate, assume Z-Mart decides to *increase* its petty cash fund from ETB75 to ETB100 on November 27 when it reimburses the fund.

The entries required are to (1) reimburse the fund as usual (see the preceding November 27 entry) and (2) increase the fund amount as follows.

Nov. 27	Petty Cash	25	
	Cash		25
	To increase the petty cash fund amount.		

- Petty cash fund is replenished when the amount in the petty cash fund reaches its minimum level and at the end of accounting period regardless of the amount in the fund.

Authority to incur expenditure

Authority to incur expenditure means a delegated responsibility by the Clerk to the constituency office Manager to enable the manager authorize expenditure; Sample 1Sample 2.

Ideally, all government expenditure transactions should be classified in four ways:

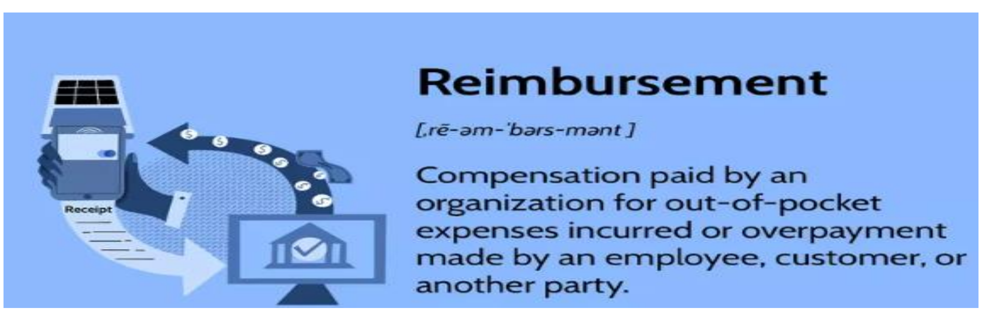
1. by administrative responsibility--the ministry, department, or spending agency that undertakes the expenditure;
2. by economic category--defined by Government Financial Statistics standards;
3. by function (e.g., health, education)--defined by the United Nations; and
4. by program (e.g., by policy goals and objectives)

4.2. Reconciling and reimbursing expenditure

Reconciliation involves checking and verifying that two sets of records match. The goal is to make sure that your records are accurate, that income and spending in your accounts are the same as in your books, and to spot any mistakes, fraud, wrong doing.

Reimbursement

is when a business pays back an employee, client, or other people for money they spent out of their pocket or for overpaid money. Some examples are getting money back for business costs, insurance premiums, and overpaid taxes. In contrast to regular pay, however, reimbursement is not taxed.



Steps to Reconcile

- Review expenditures that you don't recognize or appear unusual.
- Compare transactions to source documents as needed.
- Review infrequent transactions.

Investigate and resolve differences

Assume that Z-Mart's petty cashier makes several November payments from petty cash. During November the following petty cash receipts were found in the petty cash box.

November 7	Delivery expense	5.00
November 9	Miscellaneous expense	46.50
November 18	Merchandise inventory	15.05
November 24	Supplies expense	4.75

Nov. 27 Miscellaneous Expenses .46.50
Merchandise Inventory 15.05
Delivery Expense 5.00
Office Supplies Expense 4.75
Cash 71.30
To reimburse petty cash

Increasing or decreasing a petty cash fund. A decision to increase or decrease a petty cash fund is often made when reimbursing it. To illustrate, assume Z-Mart decides to *increase* its petty cash fund from ETB75 to ETB100 on November 27 when it reimburses the fund.

The entries required are to (1) reimburse the fund as usual (see the preceding November 27 entry) and (2) increase the fund amount as follows.

Nov. 27 Petty Cash 25
Cash 25
To increase the petty cash fund amount.

- Petty cash fund is replenished when the amount in the petty cash fund reaches its minimum level and at the end of accounting period regardless of the amount in the fund.

Self-Check 3.1.

Part one -True/False Questions:

1. Petty cash funds are typically operated on an imp rest basis.
2. Petty cash funds are typically operated on an imp rest basis, meaning that when cash is expended from the fund, it is replaced by a receipt in the same amount.
3. The petty cash account is not debited or credited again unless the amount of the fund is changed.
4. After the petty cash fund is established, the Petty Cash account is not debited or credited again unless the amount of the fund is changed
5. Reconciliation involves checking and verifying that two sets of records match, aiming to ensure accuracy and identify any discrepancies.

Part two- Multiple-Choice Questions:

1. Which step(s) are involved in the operation of a petty cash fund?

a) Establishing the fund c. replenishing the fund

b) Making payments from the fund d. All of the above

2. When are petty cash funds typically replenished?

a) When the fund reaches its maximum level

b) When the fund reaches its minimum level and at the end of the accounting period

c) Only when the amount in the fund is substantial

d) At the beginning of each month

3. What does the term "reimbursement" refer to in the context of business transactions?

a) Taxed payment for regular services

b) Paying back an employee or individual for expenses incurred

c) Additional salary provided irregularly

d) None of the above

Part three- Short Answer Questions:

1. Define "authority to incur expenditure" in a business setting.
2. What is the purpose of reconciling financial records in accounting?

3. Explain the concept of an imp rest system in relation to petty cash funds.

Unit Five: Process and reconcile credit

This Unit is developed to provide you the necessary information regarding the following content coverage and topics:

- Processing credit card transactions
- Processing credit card payments

This unit will also assist you to attain the learning outcomes stated in the cover page. Specifically, upon completion of this learning guide, you will be able to:

- Process credit card transactions
- Process credit card payments

5.1. Processing credit card transactions

Processing credit card transactions refers to the handling of electronic transfers of funds when a customer uses a credit card to make a purchase or payment. This process involves various steps, including authorization, authentication, and settlement, to ensure that the transaction is valid and the funds are transferred securely from the customer's credit card account to the merchant's account.

Importance: Processing credit card transactions is vital for businesses as it enables them to accept payments from customers using credit cards, which is a widely preferred and convenient payment method. It expands customer reach, boosts sales, and enhances the overall customer experience. Efficient transaction processing also ensures security, reduces the risk of fraud, and maintains trust between merchants and customers.

Characteristics:

Security: Robust security measures are implemented to safeguard sensitive cardholder data and prevent fraudulent activities.

Speed: Transactions are processed swiftly to provide a seamless payment experience for both customers and merchants.

Authorization: Each transaction undergoes authorization checks to validate the availability of funds and the legitimacy of the transaction.

Accuracy: Precise processing ensures that the correct amount is charged and credited to the respective accounts.

Integration: Integration with payment gateways and financial institutions is necessary for the smooth flow of transactions.

The payment processor passes transaction details to the card associations that communicate the appropriate debits with the issuing banks in their network.

The issuing bank charges the cardholder's account for the amount of the transactions.

Credit Card Transaction Types

- Purchase. Also referred to simply as a charge or sale, a purchase is the basic credit card transaction type that everyone is familiar with. ...
- Pre-Authorization.
- Capture.
- Refund.
- Void.
- Verification.

Example: An example of processing credit card transactions is when a customer visits an online store, selects items to purchase, enters their credit card details during the checkout process, and submits the order. The merchant's payment gateway verifies the card information, requests authorization from the customer's bank, and upon approval, completes the transaction by transferring funds from the customer's credit card account to the merchant's account.

5.2. Processing credit card payments

Processing credit card payments involves several steps to securely authorize, validate, and complete a transaction between a customer, merchant, acquiring bank, and the issuing bank. Here is an overview of the process:

It's crucial for merchants to comply with Payment Card Industry Data Security Standard (PCI DSS) requirements to safeguard sensitive cardholder information and ensure a secure payment processing environment. Additionally, advances in technology continually improve the efficiency, speed, and security of credit card payment processing

Initiation of Payment: The customer initiates a purchase by selecting products or services and proceeding to the checkout page on the merchant's website or at a physical point of sale.

Data Input: The customer enters their credit card information, including the card number, expiration date, CVV (Card Verification Value), and sometimes additional information such as billing address.

Encryption and Transmission: To ensure security, the entered payment information is encrypted using SSL (Secure Socket Layer) or TLS (Transport Layer Security) technology. The encrypted data is then transmitted to the payment gateway.

Payment Gateway: The payment gateway acts as a mediator between the merchant's website and the acquiring bank. It securely transmits the encrypted payment data to the acquiring bank.

Authorization Request: The acquiring bank (merchant's bank) receives the payment information from the payment gateway and forwards an authorization request to the credit card network (such as Visa, Mastercard, American Express, etc.).

Authorization Process: The credit card network forwards the authorization request to the issuing bank (cardholder's bank). The issuing bank verifies the card details, checks the available credit or funds, and assesses any risk factors.

Authorization Response: Based on the verification process, the issuing bank sends an authorization code (if approved) or a decline response to the credit card network, which is then passed back through the acquiring bank to the payment gateway.

Payment Gateway Response: The payment gateway receives the response from the acquiring bank and transmits it securely back to the merchant. If the transaction is approved, the customer's order is confirmed, and the merchant can proceed with providing the goods or services.

Capture and Settlement: After authorization, the merchant initiates the capture process, where the authorized transaction is finalized for settlement. Settlement involves transferring funds from the issuing bank to the acquiring bank, typically done in batches at the end of the day.

Funding and Reconciliation: The acquiring bank deposits the funds (minus any applicable fees) into the merchant's account, usually within a few business days. Merchants reconcile their transactions to ensure accuracy between the sales recorded and funds received.

Payment Processing Fees: Throughout this process, various entities involved (such as banks, payment gateways, and credit card networks) charge fees to the merchant, usually based on a percentage of the transaction value or a flat fee per transaction.

Credit card procession in 8 simple steps

- Making the purchase.
- Entering the transaction.
- Transmitting the data.
- Authorizing the transaction.
- Responding to processor and merchant.
- Completing the transaction.
- Submitting batch closure.
- Depositing the funds.

Credit card processing in 8 simple steps

Figure 5.1 Credit card

Self-Check 4.1.

Part One- Match

Columan A	**Columan B**
1. Data Encryption and Transmission	A. This step involves securing the entered payment details using SSL
2. Authorization Request	B. The acquiring bank sends a request to the credit card network after receiving payment information from the payment gateway.
3. Capture and Settlement	C. After authorization, the merchant finalizes the authorized transaction, which involves transferring funds from the issuing bank to the acquiring bank, typically done in batches.
4. Funding and Reconciliation	D. The acquiring bank deposits funds (minus applicable fees) into the merchant's account and merchants reconcile their transactions for accuracy.
5. Payment Gateway Response	E. This step involves the payment gateway receiving a response from the acquiring bank and securely transmitting it back to the merchant, confirming the transaction for goods or services.

Part two - Short Answer

1. What is the process of credit card transaction?

2. What is the process of credit card payment? List the step.

3. Demonstrate the steps involved in verifying receipts:

Unit Six: Bank Reconciliation

This Unit is developed to provide you the necessary information regarding the following content coverage and topics:

- Receipts Verification
- Verifying bank entries
- Statement bank Reconciling Report

This unit will also assist you to attain the learning outcomes stated in the cover page. Specifically, upon completion of this learning guide, you will be able to:

- Verify receipts of statement
- Verifying bank entries
- Statement bank Reconciling Report

6.1. Verifying receipts of statement

Verifying receipts or statements is crucial for maintaining accurate financial records and protecting yourself against fraud or discrepancies. If you have specific concerns or encounter issues with a particular receipt, seeking assistance or clarification from the appropriate sources is advisable

Verifying receipts or statements typically involves reviewing the details on the document to ensure accuracy and authenticity.

Here are steps you might take to verify receipts or statements:

Check Basic Information: Verify that the receipt contains basic information such as the date of the transaction, the name and address of the business, a description of the items or services purchased quantities, prices, and any applicable taxes or fees.

Compare to Purchase Records: If you have records of your own purchases (such as online order confirmations, receipts, or invoices), cross-reference the details on the receipt with your records to confirm they match.

Look for Signatures or Seals: In some cases, especially for official receipts or statements, there might be signatures, stamps, or seals that authenticate the document. Verify these if applicable.

Check for Errors: Look for any errors or discrepancies in the receipt, such as incorrect prices, quantities, or unexpected charges.

Verify Payment Information: Ensure that the payment method used (credit card number, cash, etc.) matches the information on the receipt. If there are any issues, it's essential to contact the merchant or the relevant financial institution.

Confirm Legitimacy: If the receipt appears suspicious or if you're unsure about its authenticity, consider reaching out to the merchant or service provider to verify the transaction.

Digital Verification: In the case of digital receipts or statements, confirm the legitimacy of the sender or the platform through which you received the document. Be cautious of phishing attempts or fraudulent emails.

Keep Records: Maintain a record of verified receipts and statements for your financial records and potential future reference or disputes.

Consult Experts: If necessary, seek advice from financial advisors, consumer protection agencies, or legal professionals if you suspect fraudulent activity or encounter difficulties in verifying the receipts or statements.

The following are the steps involved in verifying receipts:

- Gathering and Examining Documents
- Obtaining Statements and Conducting Interviews
- Seeking assistance from computers
- Making a Personal Information Request
- Gathering information from third parties

6.2. Verifying Bank Entries

Verifying bank entries involves reconciling your bank statement with your own records to ensure accuracy and identify any discrepancies. Banking practices in some countries rely heavily on magnetic media processing, electronic fund transfers, and direct bank involvement in settling outstanding debts. For these countries, the bank statement serves as the source document for all banking activity.

Bank statement processing consists of:

- Understanding transaction codes
- Working with bank statements
- Updating the reconciliation table
- Reconciling bank statements
- Posting bank statement transactions
- Reconciling bank statements manually
- Printing bank statement reports

The system accepts and clears transactions in the following tables:

- Accounts Receivable Ledger (F0311)
- Account Ledger (F0911)
- Account Ledger for Reconciliation worktable (F0911R)

The system also uses the following tables for bank statement information:

- Bank Statement Header (F0916)
- Bank Statement Detail (F0917)

The following illustrates how to process your bank statement

Collect Records: Obtain your bank statement and your own financial records, such as a check register, accounting software, or receipts.
Compare Entries: Go through each transaction on your bank statement and compare it to the corresponding entry in your records. Ensure that amounts, dates, and descriptions match.
Tick off Matched Entries: As you verify each transaction, mark or tick off the ones that match between your records and the bank statement. This helps keep track of completed reconciliations.

Identify Discrepancies: If you find any discrepancies (such as missing transactions, incorrect amounts, or unfamiliar charges), investigate further. It could be an error on your part or the bank's.

Check Outstanding Transactions: Note any outstanding checks or transactions that haven't cleared your bank yet. These items might not appear on the current bank statement but should be accounted for in your records.

Consider Deposits and Credits: Verify that deposits, direct deposits, interest credits, and any other credits match between your records and the bank statement.

Note Service Charges and Fees: Identify and verify any bank fees, service charges, or penalties. Ensure they are correctly applied and match your expectations.

Reconcile Differences: If you find discrepancies, try to reconcile them. Sometimes discrepancies arise due to timing differences between when transactions were recorded in your records versus when they were processed by the bank.

Contact the Bank: If you can't resolve discrepancies on your own, contact your bank. They can provide additional information or help clarify any issues with your account.

Update Records: Once you've completed the verification process and resolved any discrepancies, update your financial records to reflect the accurate information.

Perform Regular Checks: Make it a habit to regularly reconcile your bank statements (monthly is typical) to detect any errors or fraudulent activities promptly.

Remember, accurate record-keeping is essential for managing your finances effectively. Verifying bank entries regularly helps ensure that your financial records align with your bank's records and that any discrepancies are addressed promptly.

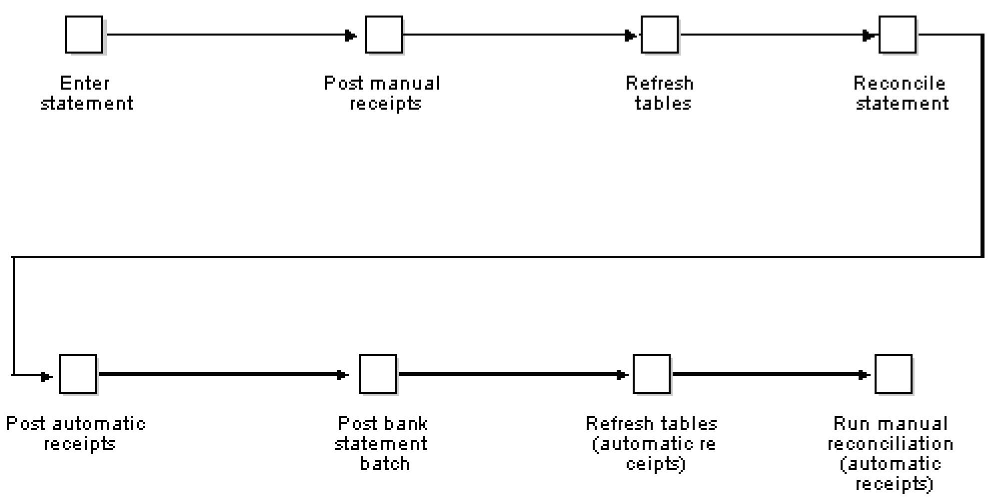


Figure 6.1.How to Process Your Bank Statements

6.3.Statement of Bank Reconciling Report

Bank Statement: bank statement is a monthly report showing the bank's record of the checking account. The bank statement provides the following information about customers' cash accounts:

1. The balance at the beginning of the month
2. Additions in the form of deposits and credit memos
3. Deductions in the form of checks and debit memos and
4. The final balance at the end of the month

Canceled checks are checks the bank has paid and deducted from the customer's account during the month. Other deductions also often appear on a bank statement include:

- Service charge and fees assessed by the bank
- Customer's cheeks deposited that are uncollectible
- Corrections of previous errors
- Withdrawals through automatic teller machines (ATM) and
- Periodic payments arranged in advance by the depositor.

Except for service charges the bank notifies the depositor for each deduction with a debit memorandum when the bank reduces the balance. There are also other transactions that increases the depositors account such as amounts the bank collects on behalf of the depositor and corrections of previous errors. Credit memoranda notify the depositor of all increases when they are recorded.

- **CM (credit memo)** increases or credits to the account, such as notes or accounts left with the bank for collection
- **DM (debit memo)** Decrease or debits to the account, such NSF checks, automated teller withdrawals, and service charges.

Bank Reconciliation

The bank statement and the cheek book are both records of a depositor's checking account transactions. The balance of checking account reported on the bank statement is rarely equal to the balance in the depositor's accounting records. This is usually due to:

1. Time lags – a delay by either party in recording transactions and
2. Errors- by either party in recording transaction.

The process of bringing the difference between the balance of a checking account according to the depositor's records and the balance reported on the bank statement in to agreement is called **Bank reconciliation**. It is a listing of the items and amounts that causes the cash balance reported in the bank statement to differ from the balance of the cash account in the ledger.

Among the factors causing the bank statement balance to differ from the depositor's book balance are:

1. **Outstanding cheeks**: check written by the depositor, deducted/appear in the checkbook but not in the statement.
2. **Deposit in transit** (also called outstanding deposits): these are deposits made and recorded by the depositor but not recorded on the bank statement. E.g. Night deposits, deposits by mail etc
3. **Service charges and other bank fees:** banks charge a fee for providing checking accounts. This fee, called a service charge. Other charges that a bank may make include fees for imprinting checks, fees for collecting money for the depositor and fees for the use of ATMs.
4. **Errors** –it is not uncommon for depositors to make (1) arithmetic errors when making entries in a cheek book and (2) errors due to transpositions and slides by depositors. The bank will also make errors.
5. **Bank collections** – some banks collect notes or securities for the depositor and enter the amounts directly in the depositor's account. Such collections appear on the bank statement but not in the checkbook.
6. **NSF (Not sufficient funds) checks** – when a check is deposited, it is counted as cash. If the balance in the customer's account is not large enough to cover the check, the check is called NSF. The bank initially credits the depositor's account for the amount of deposited check. When the bank learns the check is uncollectible, it debits (reduces) the depositor's account for the amount of that check.

The bank statement is reconciled by the following steps

a) Deposit in transit – added to the bank statement balance
b) Outstanding checks – subtracted from the bank statement balance
c) Any interest earned and any collection made by the bank for the depositor- added to the check book balance.
d) Any charge appearing on the bank statement – subtracted from the checkbook balance
e) NSF – subtracted from the checkbook balance.

Format for bank reconciliation

Bank balance according to bank statements--xxx
Add: additions by depositor not on bank statement--------------------xx
Bank errors---xx xx
xxx
Deduct: Deductions by depositor not on bank statements--------------xx
Bank errors---xx xx
Adjusted balance--xxx
Bank Balance according to depositors records-------------------------------------xxx
Add: additions by bank not recorded by depositor-------------------- xx
Depositor errors---xx xx
Xxx
Deduct: deductions by bank not recorded by depositor------------- xx

Depositor errors---xx xx

Adjusted balance --**xxx**

Illustration of bank reconciliation

The bank statement for Hope Company, recorded, indicates a balance of Br3359.78 as on July 31. The balance in cash in bank in Hope Company's ledger as of the same date is Br2, 234.99. The following are reconciling items:

1. Deposit of July 31 not recorded on bank statement Br816.20
2. Check out standing: No 812,Br1061.00;No 878,Br435.39;883,Br48.60
3. Note plus interest of Br8 collected by bank (credit memorandum), Not recorded on cash receipts journal Br408.00
4. Bank service charges (debit memorandum)not recorded on Cash repayments journal Br3.00
5. Check No 879 for Br732.26 to Taylor Company on account, Recorded in cash payments journal as Br723.26

The bank reconciliation based on the bank statements and the reconciling items is as follows

Hope Company

Bank reconciliation

July 31, 2010

Balance per bank statement		Br3,359.78
Add: deposit of July 31, not recorded by bank		816.20
		4,175.98
Deduct outstanding checks:		
No 812	1,061.00	
No 878	435.39	
No 883	48.60	1,544.99
Adjusted Bank balance		**Br2,630.99**
Balance per depositors records		Br2,234.99
Add: Note and interest collected by bank		408.00
		2,642.99
Deduct: Bank service charges	3.00	
Error in recording check no 879	9.00	12.00
Adjusted cash book balance		**Br2,630.99**

The entries for Hope Company, based on the bank reconciliation above are as follows:

July 31	Cash in bank	408.00	
	Notes receivable		400.00
	Interest income		8.00
31	Miscellaneous Expense	3.00	
	Account payable	9.00	
	Cash in bank		12.00

Self Check 6.1.

Part One - True or False

1. Bank reconciliation is the process of aligning the balance of a checking account according to the depositor's records with the balance reported on the bank statement.
2. Outstanding checks are those written by the depositors that appear in the checkbook but not on the bank statement.
3. Service charges and fees assessed by the bank are only communicated through credit memos on the bank statement.
4. NSF checks stand for "New Security Fund" checks, indicating newly issued checks by the depositor.
5. Bank reconciliation is only necessary when errors occur; it is not a regular financial practice.

Part two- Multiple-Choice

1. Which of the following is NOT a factor causing the bank statement balance to differ from the depositor's book balance?

A) Outstanding checks B) Deposit in transit C) Bank collections D) Bank holidays

2. What does a credit memorandum on a bank statement signify?

A) Increase or credits to the account B) Decrease or debits to the account

C) Outstanding checks D) Service charges

3. How is NSF (Not Sufficient Funds) checks handled by the bank?

A) Initially credited to the depositor's account B) Automatically cleared by the bank

C) Not reported on the bank statement D) Considered as service charges

4. What does a debit memorandum on a bank statement indicate?

A) Increase or credits to the account B) Service charges and fees

C) Outstanding checks D) Deposit in transit

5. Bank reconciliation involves:

A) Making the bank statement balance match the checkbook balance

B) Identifying discrepancies between the bank statement and the checkbook

C) Adjusting the bank statement without considering errors

D) Skipping over outstanding checks and deposits in transit

Operation Sheet

Title - Bank Reconciliation Statement and Transaction

Purpose

The bank statement for Geda Company for June 30, 2015, indicates a balance of birr 9,143.11. All cash receipts are deposited each evening in a night depository, after banking hours. The accounting records of the company indicate the following summary data for cash receipts and payments for June:

Cash balance as of June 1, 2015------------------------------------- birr 3,943.50

Total cash receipts for June 2015-------------------------------------birr 28,971.60

Total amount of checks issued (payment) in June 2015-----------birr 28,388.85

Comparing the bank statement and the company's records the following reconciling items were identified:

A. The bank had collected for Geda Company birr 1,030 on a note left for collection. The face amount of the note was birr 1,000.
B. Deposit in transit was birr 1,852.21.
C. Checks outstanding totaled birr 5,265.27.
D. A check written for birr 139 had been incorrectly charged by the bank as birr 157.
E. A check for birr 30 was wrongly recorded as birr 240 by the company. The check was for the payment of accounts payable.
F. Bank Service Charge during the period is Br 18.20.

Instruction:

Task 1: Prepare bank reconciliation for June 2015.

Task 2: Journalize the entries that should be made by Geda Company

Unit Seven: Process General Ledger Transactions

This Unit is developed to provide you the necessary information regarding the following content coverage and topics:

- Issuing invoices
- processing Account Receiving
- Processing Account Payable

This unit will also assist you to attain the learning outcomes stated in the cover page. Specifically, upon completion of this learning guide, you will be able to:

- Issuing invoices
- process Account Receiving,
- Process Account Payable

7.1.Issuing Invoices

Efficient management of invoicing and payments is crucial for maintaining healthy cash flow and ensuring that the company's financial records are up-to-date and accurate. Additionally, following best practices and maintaining good communication with debtors can help in improving the collection process and reducing the instances of overdue payments.

Issuing invoices is a fundamental aspect of conducting business transactions. An invoice is a document that outlines the details of a sale or service provided by a business to its customer.

Issuing invoices and managing payments from debtors involves several steps:

Issuing Invoices: When goods or services are provided, an invoice detailing the products or services, costs, payment terms, and due dates is sent to the debtor.

Receiving Payments: Debtors will make payments based on the terms agreed upon in the invoice. This can be done through various methods like checks, bank transfers, credit/debit cards, or online payment platforms.

Processing Payments: Upon receiving payments, the accounting or finance team verifies the payment details against the outstanding invoices. They reconcile the payments with the invoices to ensure accuracy.

Banking Payments**:** Once payments are processed and verified, they are deposited into the company's bank account. This involves physically depositing checks or initiating electronic transfers to the business bank account.

Recording Transactions: All transactions related to issued invoices, received payments, and banking activities need to be accurately recorded in the company's accounting system. This includes updating accounts receivable for invoices issued and marking invoices as paid upon receipt of payments.

Follow-up on Overdue Payments: If payments are not received by the due date, it may be necessary to follow up with debtors. This involves sending reminders, making phone calls, or initiating more formal collection processes if necessary.

Reconciliation and Reporting: Regularly reconciling accounts receivable with the general ledger helps ensure accuracy in financial records. Reporting on outstanding invoices, payments received, and aging reports helps in understanding the financial health of the business.

It typically includes information such as:

Invoice Number: A unique identifier for each invoice.

Date: The date when the invoice is issued.

Seller Information: Name, address, contact details of the company or individual issuing the invoice.

Customer Information: Name, address, contact details of the customer.

Description of Goods or Services: A detailed list of the products sold or services provided, including quantities, prices, and any applicable taxes or discounts.

Total Amount Due: The sum total of the invoice, including any taxes or additional fees.

Payment Terms: The deadline for payment, accepted payment methods, and any

3 main steps involved in invoice processing

- Capture, general ledger (GL) code, and match supporting documents such as a purchase order and/or delivery receipt.
- Send invoices to authorized approvers to approve or reject invoices.
- Authorize and submit invoices for payment in a financial system.

Figure 6.1 Invoice processing work flow

7.2. Processing Account Receiving

The entry will be: Cash A/c Dr. Debtor is personal account as per the traditional accounting concept. And the golden rule for personal account is, 'debit the receiver and credit the giver'.

Congratulations on receiving payments from your debtors! It's always a positive milestone when outstanding debts are settled. Managing accounts receivable and ensuring timely payments is crucial for the financial health of any business. If you have any further questions or need advice on managing your finances or handling debtor payments, feel free to ask!

Here's an example of a simple payment received from debtors template:

You're Company Letter head

Date

Debtor's Name

[Debtor's Address

City, State,

Dear Debtor's Name

Subject: Receipt of Payment for Outstanding Debt

I am writing to confirm the receipt of your recent payment dated [Payment Date] in the amount of [Payment Amount] towards the outstanding balance on your account.

Details of Payment: Invoice Number: [Invoice Number] Payment Date: [Payment Date] Payment Amount: [Payment Amount]

We acknowledge the receipt of the above-mentioned payment and confirm that your account has been credited accordingly.

Should you have any questions regarding this payment or if you require further assistance, please do not hesitate to contact our accounts department

7.3. Processing Account Payable

Payment is the performance of an obligation to pay money. A person under such an obligation is called a debtor, and a person to whom the obligation is owed is called a creditor. The obligation may arise in various ways, but it is most commonly the result of a commercial transaction or contract between the parties

Creditor

The term creditor can mean different things depending on the situation, but it typically means a financial institution or person who is owed money.

If you're the person who owes the money to a creditor, you may be referred to as a debtor or borrower.

Once a borrower and lender agree on terms for financing and sign a loan agreement, they're entering into a contract. That contract often specifies the repayment agreement terms of the loan and the expected payment amounts.

You may hear the terms lender and creditor used interchangeably. The same goes for borrower and debtor. But you'll more likely hear creditor and debtor used during legal proceedings where a creditor is trying to collect on an outstanding balance, such as during a bankruptcy case.

Ultimately, if a debtor can't repay the funds borrowed, the creditor typically has the right to attempt recovery of what is owed, which is when repossession, foreclosure and debt collectors can come into play.

Examples of common creditors

There are several types of creditors, such as real creditors, personal creditors, secured creditors and unsecured creditors.

Real creditors: A real creditor is a financial institution, such as a bank or credit card issuer, that has a right to be repaid.

Personal creditors: These are friends or family you owe money.

Secured creditors: These lenders have a legal right — often through a lien — to property you used as collateral to secure the loan.

Unsecured creditors: A credit card issuer is a good example of this type of creditor. You may owe money, but it's unsecured debt, meaning you haven't agreed to give the creditor any property — such as a car or home — as collateral to secure your debt.

Examples of common debts

- **Mortgage:** A mortgage is a loan you take out from a financial institution to purchase a house. In this case, the creditor would be the financial institution that provides the borrower with the mortgage loan.
- **Auto loans:** Similar to a mortgage, an auto loan is a loan that someone takes out in order to purchase a vehicle.
- **Student loans:** Students who cannot afford the cost of tuition on their own can apply for financial aid, including student loans to cover expenses such as tuition, housing and books. When the time comes to repay the student loan, payments are made to the creditor.
- **Credit cards:** Credit cards offer a revolving credit line with a specified credit limit. The credit card issuer that extended the credit line could be the creditor if you have an outstanding balance.
- **Personal loans:** A personal loan is a loan — often unsecured — that can help you pay for a big project like home improvements or to consolidate debt. If you have an outstanding balance on the personal loan, the creditor is likely the lender that issued the loan.

7.4.1. Raising and allocating adjustments

Each year organizations determine budgets for pay adjustments. The process used to determine the size of the budget involves several considerations:

- How much the organization can afford,
- What competitors for talent are budgeting?
- What the current position of pay structures and pay rates are compared to the prevailing market rates,
- What the organization's desired competitive posture is (pay above, at or below market and by how much) and
- What the relationship is between current individual pay rates and what individuals should be paid relative to their pay range.

7.4.2. Raising credit notes and entering other transactions

A credit note can be raised for the full amount of an incorrect invoice (meaning it is now written off), and then another invoice issued to correct any mistakes A credit note is a financial document issued by supplier companies to reduce the amount owed to them by the buyers. It helps firms maintain a proper paper trail and is issued when the goods are returned, the price is under dispute, or when there are invoicing errors.

A credit note is a financial document issued by supplier companies to reduce the amount owed to them by the buyers. It helps firms maintain a proper paper trail and is issued when the goods are returned, the price is under dispute, or when there are invoicing errors.

The journal entry passed when a credit note is issued: Creditors' Account – Dr. To Goods Returned Account – Cr. A debit note is issued to the seller of goods by the purchaser while returning goods purchased while a credit note is issued to the purchaser of goods or the customer by the seller of goods.

Self Check 7.1

Part one -Matching

Columan A

1. Invoice Number
2. Credit Note
3. Secured Creditor
4. Debtor
5. Payment Terms

Columan B

A. financial document issued by supplier companies to reduce the amount owed to them by the buyers.

B. The date when an invoice is issued.

C. A unique identifier for each invoice.

D. Lenders with a legal right, often through a lien, to property used as collateral.

E. Specifies the deadline for payment, accepted payment methods, and any applicable discounts.

Part two -Multiple-Choice

1. What is the primary purpose of issuing a credit note?
a) To increase the amount owed by buyers.
b) To maintain a proper paper trail for financial transactions.
c) To correct invoicing errors and reduce the amount owed by buyers.
d) To issue refunds to buyers.
2. Which of the following is an example of unsecured debt?
a) Mortgage
b) Auto Loan
c) Student Loan
d) Credit Card
3. What does a debit note signify in a transaction?
a) Reduction in the buyer's account balance.
b) An increase in the seller's account balance.
c) Goods returned to the buyer.
d) Goods returned to the seller.

4. Which factor is NOT considered when determining the budget for pay adjustments?
a) Organization's desired competitive posture.
b) Current individual pay rates relative to their pay range.
c) Prevailing market rates.
d) Organization's annual revenue.
5. What does the term "creditor" refer to in financial contexts?
a) Someone who owes money to a financial institution.
b) A person or entity to which money is owed.
c) An individual seeking a loan from a bank.
d) An entity responsible for managing financial records.

Part three Short Answer

1. What are the common creditors?

____
____
____
____
____
____

2. What are the common Debtors?

____
____
____
____
____

Unit Eight: Managing Contra Account

This Unit is developed to provide you the necessary information regarding the following content coverage and topics:

- Concept of contra deals
- Completing reporting procedures
- Verifying bad debt
- communication with debtors
- collect monies

This unit will also assist you to attain the learning outcomes stated in the cover page. Specifically, upon completion of this learning guide, you will be able to:

- Concept of contra deals
- Complete report procedures
- Verify bad debt
- communication with debtors
- collect monies

8.1. Concept of contra deals

Contra deals are a tried and tested marketing method that businesses have been using for years. Similar to bartering, contra deals, also known as contra partnerships, occur when two parties exchange goods or services, usually without handing over a payment.

Contra Deals means the provision of goods or services other than programme material in return for advertising airtime or sponsorship credits in on-air programmer features but

Contra Partner

A Contra-Partnership is essentially a give and take relationship. They are business deals which do not include monetary interactions. Including, prizes.

The contra meaning is closely related to the traditional concept of bartering or trading. This means that a customer and supplier might be the one and the same, with both parties trading goods or services of equal value.

Contra mean in payment

The contra account is a holding account designed for situations where money comes into your bank account and then goes straight back out, or vice versa. For example, a bounced cheque or money paid to the business in error and then refunded.

- Cash account to Bank account.
- Bank account to Cash account.
- Bank account to Bank account.
- Cash account to Cash account

Some transactions that can lead to contra entry are provided below.

- Opening of a bank account.
- Depositing cash into bank.
- Withdrawal from bank.

At the end of the accounting period adjusting entry is made. All the adjusting entry is affects for permanent and temporary accounts and these entries posted to the ledger. After posting this entry the permanent and temporary accounts are increase or decrease. For example 1:

At January 1, 2006 the supplies amount is birr 2000. During the year the supplies is used birr 700. Then, the adjusting entry at Dec 31, 2006 is:

Supplies expense-----------------------------700

Supplies--700

After journalizing the adjusting entry it must be posted.

Supplies	
Jan 1, 2000	Dec 31, 700
Bal. 1300	

Supplies expense	
Dec 31, 700	

Then a supply is an asset account it is decrease, and supplies expense is an expense account it is increases. Example 2:

At January 1, 2006 the equipment amount is birr 50,000. During the year the depreciation of equipment is birr 2000. The adjusting entry at Dec 31 is:

Depreciation expense of equipment----------------------------2000

Accumulated depreciation for equipment----------------------------------2000

The contra entry of equipment is accumulated depreciation. Then, accumulated depreciation is deducted from the amount of equipment in the balance sheet

Uncollectible Receivables

Regardless of the care used in granting credit and the effectiveness of collection procedures used, a part of the claims against customers usually proved to be uncollectible. This could be because of bankruptcy, closing of the debtors business of failure of repeated attempts to collect. In any way, the operating expense incurred because of the failure to collect receivables is called an expense /a loss from uncollectible accounts/ doubtful accounts or bad debt Expense.

There are two methods of accounting for receivables that are believed to be uncollectible.

a) The allowance method (reserve method)
b) The direct write-off (direct charge-off method)

A) **The allowance method**: This method provides in advance for uncollectible receivables. The advance provision or estimation for future uncollectibility is made by an adjusting entry at the end of the fiscal year. It reduces the value of receivables to the amount of cash expected to be realizable from customers in future. It matches current expense with current revenue.

Example: ABC-company started its operation on January 1, 2001 and chooses to use the calendar year as its fiscal year. The accounts receivable, has a balance of Br. 200,000 at the end of the period in total.

At this period no specific accounts are believed to be wholly uncollectible. But it seems likely that some will be collected only in part and that others are likely to become worthless.

Assume based on a careful study, it is estimated that a total of Br. 8000 will eventually proved to be uncollectible. Then,

i) What are the expected realizable accounts Receivable?

ii) Journalize the entry to record the estimated bad debt expense

iii) What do you think will be the effect of not recording such corrections?

Solution:

i) Net realizable value = Br. 200,000 - Br. 8000 = Br. 192,000

ii) Bad debt expense........................ Br. 8000

Allowance for uncollectible.................... Br. 8000

The bad debt expense is reported on the income statement but the allowance for uncollectible is reported on the balance sheet as contra of accounts receivable.

iii) The effect is understating expenses and overstatement of net income, capital and asset amounts.

Note that the Br. 8000 reduction in accounts receivable cannot yet be identified with a specific customer accounts in the subsidiary ledger and should, therefore, not be credited to accounts receivable but to allowance for doubtful account, which is a contra asset account.

Write-offs to the allowance account.

When an account is believed to be uncollectible, the amount is transferred from the allowance for doubtful account to the accounts receivable.

Estimating uncollectible

The estimates of uncollectibles at the end of the fiscal period are based on past experiences and forecasts of future business activities. It is based on either:

a) The amount of sales for the entire period (called an income statement approach) or
b) The amount and age of receivables account at the end of the fiscal period. (called balance sheet approach).

a) Income statement approach:

Formula:

Estimated Bad debt expense = Net credit sales * Percentage of estimated to be uncollectible.

- The amount of this estimate is added to whatever balance exists in the allowance for doubtful account.

Examples: Assume net credit sales on December 31, 2001 for ABC organization is Br.200, 000, estimated uncollectible 1.5%

Required: Record the entry

Bad debt expenses (200,000 * 1.5%) 3000

Allowance for uncollectible 3000

c) **Balance sheet approach**: The process of analyzing the receivable accounts in terms of the length of time past due is sometimes called aging of the receivable. The due date of the account is the base point for determining age. In this method accounts are categorized individually based on the length of time they have been outstanding and apply the expected percentage of uncollectible.

Example: At the end of 2001 accounts receivable ledger of ABC company has the balance of Br.200,000 which can be categorized as follows:

Age group	amount (a)	Estimated percentage of uncollectible (b)	Estimated amount of uncollectible C = a * b
Not yet due	Br. 80,000	0.5%	Br. 400
1-30 days past due	25,000	1%	250

31-60 days past due	20,000	2%	400
61-120 days past due	60,000	5%	3000
More than 120 days past due	15,000	20%	3000
	Br.200,000		Br.7050

The Br.7050 amount is the desired balance of allowance account after adjustment; and to be deducted from accounts receivable to determine the net realizable value. Assuming that the allowance for uncollectible account had no balance, the entry to record this new amount is:

Bad debt expense............................. Br.7050

Allowance for uncollectible......................Br.7050

Note that if the allowance account has a debit or credit balance before adjustment, it must be considered accordingly when the base of the estimation is the balance sheet approach.

B**) Direct write off, method**

Under this method of accounting for receivables no valuation of allowance for accounts receivable is used. The business recognizes no uncollectible account expense until specific receivables are determined to be worthless. Thus, receivables are not stated at net realizable value. This method lacks to follow the matching principle.

The entry to record the write-off the uncollectible account is:

Bad debt expense xxx

Accounts receivable xxx

8.2. Completing reporting procedures

Reporting and documentation

Reporting is oral communication between care providers that follows a structured format and typically occurs at the start and end of every shift or whenever there is a significant change in the resident. Documentation is a legal record of patient care completed in a paper chart or electronic health record (EHR).

Financial Reporting procedures

Financial reporting aims to track analyses and report your business income. This helps you and any investors make informed decisions about how to manage the business. These reports examine resource usage and cash flow to assess the financial health of the business

A simple reporting procedure will help you obtain important information about health and safety issues in the workplace identify problems when they arise, and address them. Safety reporting procedures make it simpler for you and your workers to manage safety

5 steps of Financial Reporting

Defining the accounting cycle with steps: (1) Financial transactions, (2) Journal entries, (3) Posting to the Ledger, (4) Trial Balance Period, and (5) Reporting Period with Financial Reporting and Auditing.

Process documentation

Process documentation involves outlining each step needed when completing tasks or processes. It's an internal document of the lifecycle of your processes. Documenting processes is more about how each task is implemented rather than what the task impacts.

Your firm essentially is a conglomeration of intertwined processes—if the exact "how" aren't written down in a document staff members can reference, steps can get lost. Your processes are repeatable and fundamental to your success, so documenting processes serves as a guide for you and your staff to reference as needed.

8.3.Verifying bad debt

Bad debt is an amount of money that a creditor must write off if a borrower defaults on the loans. If a creditor has a bad debt on the books, it becomes uncollectible and is recorded as a charge-off. Bad debt is a contingency that must be accounted for by all businesses that extend credit to customers, as there is always a risk that payment won't be collected. These entities can estimate how much of their receivables may become uncollectible by using either the accounts receivable (AR) aging method or the percentage of sales method.

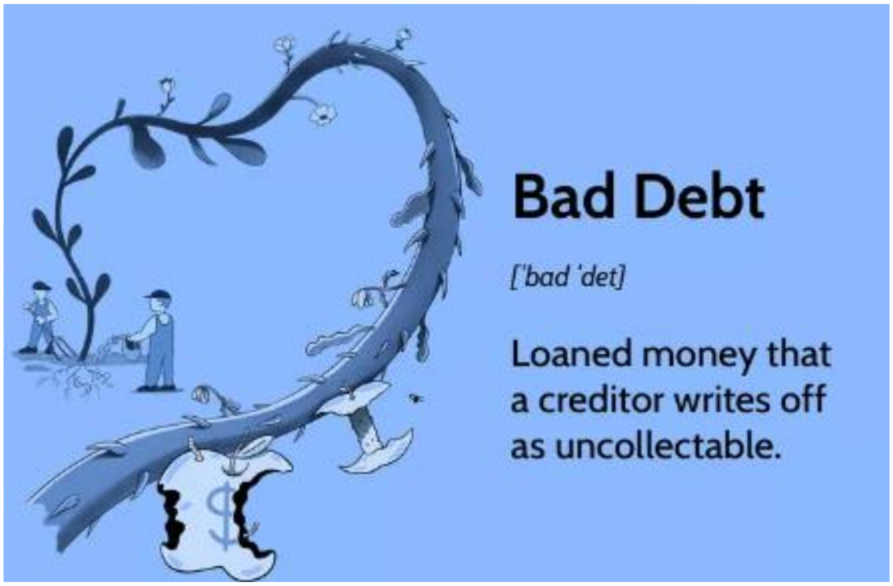


Figure 8.1. Bad debt

Simply put, a bad debt is a type of expense that occurs after repayment by a customer (when credit has been extended) is no longer considered to be collectable. In other words, bad debt is an irrecoverable receivable. Any businesses that extend credit to their customers must account for the possibility of bad debt, as there's always a chance that your customer's circumstances will change and they won't be able to complete payment as agreed.

Bad debts happen

There are a broad range of reasons why you may end up dealing with a bad debt. In some cases, you may have simply extended credit to an unsuitable customer. If this is the case, you should look to tighten up your credit policy to stop it from happening in the future. It could also be the result of fraud wherein your business has been deliberately targeted by criminals. In most cases, however, the reason is simple: the customer simply cannot pay your bill due to insolvency or bankruptcy.

How to record a bad debt

There are two main ways that you can record a bad debt in accounting. These methods are as follows:

- Bad debt write-off
- Bad debt provision

It’s important to note that the bad debt write off method doesn’t adhere to the matching principle associated with generally accepted accounting principles (GAAP). Therefore, if you’re using GAAP for accounting, you’ll need to use the bad debt provision method instead. Most businesses based in the UK use international financial reporting standards (IFRS) instead of GAAP, but it’s important to remember that the way you record bad debt expenses may differ depending on the country you’re based in.

Here’s a little more information about these accounting methods of recording bad debt expenses:

Bad debt write-off method

Bad debt write-offs are used when you have a specific and recognizable bad debt on your accounts, i.e. you know that the debt is irrecoverable. In the bad debt write-off method, you’ll debit the bad debt expense for the amount of the write off and credit the accounts receivable asset account for the same amount.

Bad debt provision method

A bad debt provision or allowance, also known as a provision for doubtful debts, is an accounting method that requires you to estimate the amount of bad debt that you’ll need to write off in any given period. In essence, you’ll charge an estimated amount of accounts receivable to bad debt expense, before debiting the bad debt expense for the estimated amount of the write-off. Finally, you’ll credit the same amount to the bad debt provision contra account.

Important to understand bad debts

Thriving businesses can run into difficulty at the drop of a hat, and reliable customers who always pay their debts can become problematic non-payers within a relatively short space of time. As a result, it’s always important to be prepared to deal with bad debt expenses. Furthermore, businesses are judged by potential investors on their financial statements, which means that a bad debt could make your business look like it isn’t doing as well as it is in reality. Consequently, it’s important to classify bad debts as bad debts so that investors can see that all your accounts are in good order.

How to Record Bad Debts

Recording bad debt involves a debit and a credit entry. Here's how it's done:

- A debit entry is made to a bad debt expense

- An offsetting credit entry is made to a contra asset account, which is also referred to as the allowance for doubtful accounts

The allowance for doubtful accounts nets against the total AR presented on the balance sheet to reflect only the amount estimated to be collectible. This allowance accumulates across accounting periods and may be adjusted based on the balance in the account.

Payments received later for bad debts that have already been written off are booked as bad debt recovery.

Methods of Estimating Bad Debt

We've established that bad debts must be recorded. But what amounts are listed on corporate financial statements? This involves estimating uncollectible balances using one of two methods. This can be done through statistical modeling using an AR aging method or through a percentage of net sales. We've highlighted the basics of each below.

Accounts Receivable Aging Method

The AR aging method groups all outstanding accounts receivable by age, and specific percentages are applied to each group. The aggregate of all groups' results is the estimated uncollectible amount. This method determines the expected losses to delinquent and bad debt by using a company's historical data and data from the industry as a whole. The specific percentage typically increases as the age of the receivable increases to reflect rising default risk and decreasing collectability.

Let's say a company has $70,000 of accounts receivable less than 30 days outstanding and $30,000 of accounts receivable more than 30 days outstanding. Based on previous experience, 1% of AR less than 30 days old will not be collectible, and 4% of AR at least 30 days old will be uncollectible.

This means the company must report an allowance and bad debt expense of $1,900. This is calculated as:

($70,000 x 1%) + ($30,000 x 4%)

If the next accounting period results in an estimated allowance of $2,500 based on outstanding accounts receivable, only $600 ($2,500 - $1,900) will be the bad debt expense in the second period.

Percentage of Sales Method

A bad debt expense can be estimated by taking a percentage of net sales based on the company's historical experience with bad debt. This method applies a flat percentage to the total dollar amount of sales for the period. Companies regularly make changes to the allowance for doubtful accounts so that they correspond with the current statistical modeling allowances.

Using the example above, let's say a company expects that 3% of net sales are not collectible. If the total net sales for the period are $100,000, the company establishes an allowance for doubtful accounts for $3,000 while simultaneously reporting $3,000 in bad debt expense.

If the following accounting period results in net sales of $80,000, an additional $2,400 is reported in the allowance for doubtful accounts, and $2,400 is recorded in the second period in bad debt expense. The aggregate balance in the allowance for doubtful accounts after these two periods is $5,400.

9.4. Communicating with debtors

Communicating with debtors requires a tactful and respectful approach to ensure a positive outcome. Here are some key tips for effectively communicating with debtors:

Be clear and concise: Clearly state the purpose of your communication. Explain the debt owed, including any specifics such as the amount, due date, and any interest or penalties accrued.

Choose the right channel: Use appropriate communication channels such as phone calls, emails, or letters. Consider what might be most effective based on previous interactions or the debtor's preferred method of communication.

Maintain professionalism and empathy: Remain professional and courteous at all times, even if the debtor becomes confrontational. Show empathy and understanding towards their situation, which can help in finding a mutually acceptable resolution.

Listen actively: Allow debtors to explain their circumstances or reasons for non-payment. Listening attentively can provide insight into their situation and help in finding a solution.

Offer solutions: Be flexible and ready to negotiate a payment plan or alternative arrangements that work for both parties. This could involve reducing the total owed, setting up a payment schedule, or exploring other options.

Follow up: If an agreement is reached, ensure to follow up with written confirmation outlining the terms agreed upon. Follow up on agreed payment dates or milestones to maintain transparency and accountability.

Know your rights and regulations: Familiarize yourself with debt collection laws and regulations to ensure that your communication and collection efforts are compliant with legal requirements.

Document all communication: Keep detailed records of all interactions with debtors, including dates, times, and summaries of discussions. This documentation can be valuable in case of disputes or legal action.

Remember, effective communication is key to resolving debts amicably. By approaching debtors with understanding and a willingness to find solutions, you increase the chances of reaching a mutually beneficial agreement

8.5.Collect monies

Collecting money can involve various strategies and measures depending on the context and situation. Here are some general steps and methods you might consider when undertaking measures to collect money:

Establish Clear Payment Terms: Ensure that your payment terms are clearly defined and communicated to your clients or customers from the outset. This includes specifying payment due dates, accepted payment methods, late fees, etc.

Invoice Promptly and Accurately: Send invoices promptly after goods or services are delivered. Make sure the invoices are accurate, detailing the services rendered or products sold, along with the amount due and payment due date.

Follow Up Politely: If a payment becomes overdue, follow up with polite reminders. Sometimes, delays can occur due to oversight or other reasons. Sending gentle reminders via email, phone calls, or letters can prompt payment.

Offer Payment Plans or Options: Depending on the situation, you might consider offering payment plans or alternative payment options to make it easier for the debtor to settle their dues.

Use Collection Agencies: If the debt remains unpaid despite reminders, consider engaging a collection agency. They specialize in recovering debts and can take more aggressive measures to collect the money owed.

Consider Legal Action: If all other attempts fail, consider taking legal action through small claims court or hiring a lawyer to escalate the matter. This could involve sending a formal demand letter or filing a lawsuit to recover the owed amount.

Negotiate: In some cases, it might be beneficial to negotiate with the debtor to reach a settlement that is agreeable to both parties. This could involve compromising on the total amount owed or establishing a new payment schedule.

Maintain Records: Keep detailed records of all communications, invoices, and any agreements made regarding payment. These records can be crucial if legal action becomes necessary.

Evaluate and Learn: After successfully collecting the money or resolving the issue, take time to evaluate the situation. Consider what worked well and what could be improved in your collection process to avoid similar situations in the future.

Remember, while collecting money is important, maintaining good relationships with clients or customers is also essential. Striking a balance between firmness in collecting dues and professionalism in communication is crucial to preserve business

Debt recovery

Debt recovery and debt collection are similar terms with one small, but very important distinction. The difference is who is trying to retrieve a debt.

Debt collection is when a creditor attempts to recover consumer credit and loans that have not been paid back by a customer.

Debt recovery is when a loan – such as a credit card balance – continues to go unpaid, and the creditor hires a third party, known as a collection service, to focus on collecting the money.

Debt recovery is sometimes called loan recovery, but the purpose of both is exactly the same: find a way to make you pay back the money you borrowed

Debt (or loan) recovery is important because it is directly correlated to your credit score. If a debt recovery service is contacting you, it means there is a record that you have defaulted on a loan and currently have delinquencies. These delinquencies get reported to the credit bureaus, damaging your credit score, which can potentially hurt any future loan opportunities.

There are several steps in the debt recovery process, and it is important to know what to expect when a debt recovery agent contacts you. In fact, because financial debt can be a sticky situation, legislation has been established to guide the debt recovery process and ensure that consumers are protected from harassing debt recovery practices.

Cost of Collections

The cost of collections

Collections are an expensive and labor intensive process. It's a needed investment because the business' cash flow is at stake, and the sooner overdue debt is collected, the healthier the business. A structured and diligent collections process can be the difference between a thriving and a dying business when you consider the data:

- An account that is 90 days past due has a 69.6% chance of being paid
- An account that is 180 days past due has a 52.1% chance of being paid
- After one year of delinquency, the chance of collecting payment falls to 22.8%

Although typically a last resort, businesses will turn to collections agencies to reclaim their debt. Debt collectors only get paid when they recover an outstanding debt, and when they do, it comes at a cost of anywhere from 25%-45% of the total amount owed.

One of the best ways to manage your collections comes before you even extend credit. Having a thorough and clear credit assessment process can minimize the risk in your collections process. Assessing credit risk takes into account the payment performance history of customers, allowing the business to be selective about whom they extend credit to. If there is an intelligent credit risk management process, then collection of accounts receivable should be less demanding.

The key to successful collections is clarity in the process and frequent, open communications with customers. The collections process can be a sensitive time for customer communications, and the more you offer consistency and professionalism in the process, the more your customers will want to work with you and take care of their debts. At the end of the day, the success of business is all about how it takes care of its customers.

Self-Check

Part one - True or False

1. Bad debt write-off method strictly follows the matching principle associated with Generally Accepted Accounting Principles (GAAP).

2. The accounts receivable aging method groups all outstanding accounts receivable by age and applies specific percentages to each group to estimate uncollectible amounts.

3. Debt recovery and debt collection are interchangeable terms describing the same process of retrieving unpaid debts.

4. Engaging a collection agency typically incurs a fixed fee, regardless of the amount they successfully recover.

5. Maintaining detailed records of communications, invoices, and agreements regarding payment is considered unnecessary in debt collection processes.

Part two -Multiple-choice

1. Which accounting method requires estimating the amount of bad debt that needs to be written off in a specific period?

A) Bad Debt Write-off Method

B) Bad Debt Provision Method

C) Bad Debt Recovery Method

D) Bad Debt Reserves Method

2. What does the AR aging method primarily use to estimate uncollectible balances?

A) Sales forecasting

B) Customer satisfaction surveys

C) Age of outstanding accounts receivable

D) Inventory turnover rates

3. Which step is crucial for effective communication with debtors?

A) remaining confrontational

B) Showing empathy

C) Avoiding any follow-up

D) Keeping communication brief and unclear

4. What is the primary purpose of documenting all communication during debt collection?

A) For legal compliance

B) To increase workload

C) To intimidate debtors

D) For entertainment purposes

5. Which statement accurately reflects the impact of a comprehensive credit assessment process on the collections process?

A) It increases the risk in collections.

B) It encourages indiscriminate extension of credit.

C) It minimizes the risk in collections.

D) It has no impact on the collections process.

Unit Nine: Prepare Trial Balance and Financial Reports

This Unit is developed to provide you the necessary information regarding the following content coverage and topics:

- Validating transactions reports
- Reports and reconciling debtors and creditors
- Reporting trial balance

This unit will also assist you to attain the learning outcomes stated in the cover page. Specifically, upon completion of this learning guide, you will be able to:

- Produce transactions reports
- Reports and reconciling debtors and creditors
- Reporting trial balance

9.1. Validating transactions reports

Validating transaction reports is a crucial aspect of financial management and auditing. It involves reviewing and verifying the accuracy, completeness, and legitimacy of transactions recorded in financial statements or reports. The process typically includes several steps:

Review Documentation: Examine supporting documents such as invoices, receipts, contracts, purchase orders, bank statements, and other relevant records to ensure they exist and are accurate.

Accuracy Check: Verify that the transactions are accurately recorded in the accounting system. This involves confirming the amounts, dates, accounts involved, and proper categorization.

Authorization Confirmation: Ensure that transactions have been authorized by the appropriate individuals according to company policies and procedures. This might involve cross-referencing signatures, approval emails, or other authorization records.

Matching Transactions: Match transactions between different documents or records (e.g., purchase orders with invoices, bank statements with company records) to confirm consistency and completeness.

Compliance Review: Check whether transactions comply with relevant laws, regulations, accounting standards, and company policies.

Identifying Anomalies: Look for any unusual or irregular transactions that might indicate errors, fraud, or inconsistencies. Investigate and resolve these discrepancies.

Reconciliation: Conduct reconciliations between different sets of records (e.g., bank statements versus cash book) to ensure they align and any differences are accounted for and explained.

Report Generation: Compile findings and discrepancies into a comprehensive report summarizing the validation process, highlighting any issues discovered, and providing recommendations for corrective actions.

Follow-Up and Resolution: Communicate identified discrepancies or issues to the relevant stakeholders and work towards resolving them. This may involve collaborating with different departments or individuals within the organization.

Continuous Monitoring: Establish processes for ongoing monitoring and validation of transactions to prevent errors and detect irregularities in a timely manner.

Proper validation of transaction reports is essential for maintaining accurate financial records, ensuring compliance, and safeguarding against errors and fraud. It helps in making informed business decisions and maintaining the credibility of financial statements.

Transaction validation is the process of determining if a transaction conforms to specific rules to deem it as valid. Validators check if transactions meet protocol requirements before adding the transactions to the distributed ledger as part of the validating process.

9.2. Reports and reconciling debtors and creditors

Reconciling debtors (accounts receivable) and creditors (accounts payable) involves ensuring that the amounts recorded in a company's financial records match the amounts owed or owed by the company to its customers (debtors) and suppliers (creditors) respectively.

Here's an example illustrating how to reconcile debtors and creditors:

Reconciliation of Debtors (Accounts Receivable):

Step 1: Gather Information

Collect all invoices, receipts, and records of transactions between the company and its customers.

Step 2: Compile a List

Create a list of all outstanding invoices and their respective amounts owed by each customer.

Step 3: Verify Records

Compare the list of outstanding invoices with the company's accounts receivable ledger. Ensure that each invoice is accurately recorded and matches the amount owed by the customer.

Step 4: Follow-Up

Contact customers with outstanding invoices to confirm the amounts owed and to address any discrepancies or late payments.

Step 5: Reconciliation

Once all discrepancies are resolved and payments are verified, update the accounts receivable ledger to reflect the accurate amounts owed by each customer.

Example:

Let's assume a company named XYZ Corp. has outstanding invoices from three customers:

Customer A owes $5,000

Customer B owes $7,500

Customer C owes $3,000

Upon reconciling the accounts receivable ledger, it's found that Customer A's payment was not recorded, leading to an underreporting of $5,000. Customer B's payment was made for $7,000 instead of $7,500, resulting in a discrepancy of $500. Customer C's outstanding amount matches the recorded value.

Reconciliation Outcome:

Customer A's account updated to show $0 owed.

Customer B's account adjusted to reflect the remaining balance of $500.

Customer C's account remains unchanged at $3,000.

Reconciliation of Creditors (Accounts Payable):

Step 1: Gather Information

Collect all invoices, bills, and records of transactions between the company and its suppliers.

Step 2: Compile a List

Create a list of all outstanding bills and their respective amounts owed to each supplier.

Step 3: Verify Records

Compare the list of outstanding bills with the company's accounts payable ledger. Ensure that each bill is accurately recorded and matches the amount owed to each supplier.

Step 4: Follow-Up

Contact suppliers to confirm the amounts owed and to address any discrepancies or overdue payments.

Step 5: Reconciliation

Once all discrepancies are resolved and payments are verified, update the accounts payable ledger to reflect the accurate amounts owed to each supplier.

Reconciling debtors and creditors is crucial for maintaining accurate financial records and ensuring that the company's liabilities and receivables are correctly recorded, helping in financial planning, budgeting, and decision-making processes.

The balance in the prepaid insurance account, before adjustment at the end of the year is $ 7225. Journalize the adjusting entry required under each of the following alternatives for determining the amount of the adjustment.

A. the amount of insurance expired during the year is $4900

B. the amount of unexpired insurance applicable to future periods is $2325.

2. A business enterprise pays weekly salaries of $ 12000 on Friday for a five-day week ending on that day. Journalize the necessary adjusting entry at the end of the fiscal period, assuming that the fiscal period ends on

A. Monday

B. Wednesday

3. The balance of the supplies account, before adjustment at the end of the year, is $ 2750. The inventory of supplies at the end of the year was determined to be $600. Journalize the adjusting entry required at the end of the year to recognize supplies used during the year.

Solution

1. A. Insurance Expense----------------------------------4900

Prepaid insurance --------------------------------4900

B. Insurance expense (7225-2325) -----------------4900

Prepaid insurance --------------------------------4900

2. Daily salary=12000 ÷5=2400

A. Since Monday is the first day of the week, the amount of salary is $ 2400. If we assume Monday is the last day of the fiscal period, the following adjusting entry is need:

Salary Expense-----------------------------2400

Salary payable--------------------2400

B. Wednesday is the third day of the week. So the amount of salary to be paid as of this day is 2400x3= 7200. If we assume Wednesday is the last day of the fiscal period, the following adjusting entry is needed.

Salary expense----------------------------7200

Salary payable-------------------7200

3. Supplies expense (2750-600) -------------- 2150

Supplies --------------------------------2150

1. What term is used to describe a delay of the recognition of an expense already paid or of revenue already received?
2. What term is used to describe an expense that has not been paid or revenue that has not been received?
3. Where would (a) accrued expenses and (b) accrued revenues, both due with in a year, appear on the balance sheet?
4. Classify the following items as (a) prepaid expenses, (b) unearned revenue, (c) accrued expense, or (d) accrued revenue
    1. Utilities owed but not yet paid
    2. Fees received but not yet earned
    3. Salary owed but not yet due
    4. Storage fees earned but not yet received
    5. Fees earned but not yet received
    6. Taxes owed but payable in the following period
    7. Life insurance premiums received by an insurance company

8. Property taxes paid in advance
9. A two-year premium paid on a fire insurance policy
10. Tuition collected in advance by a university.

Solution

1. Deferral
2. Accrual
3. Current asset section
4. 1. Accrued expense
   2. Unearned revenue
   3. Accrued expense
   4. Accrued revenue
   5. Accrued revenue
   6. Accrued expense
   7. Unearned revenue
   8. Prepaid expenses
   9. Prepaid expenses
   10. Unearned revenue

9. 3. Reporting trial balance

The Trial Balance report is the sum of debits and credits for every account of your business on an accrual basis. It allows you to identify discrepancies in your account totals, produce financial statements and ensure that your accounts balance for a given period of time.

Trial balance include

A trial balance includes all your business accounts that have credits or debits during a given reporting period. It includes the amounts credited or debited to each account, the dates of the reporting period, the account numbers, and the totals for all credits and debits entered during that time.

Trial balances vary depending on your business, but may include:

- Income
- Assets
- Liabilities and expenses
- Accounts receivable
- Accounts payable

- Gains
- Losses

A trial balance should not be confused with an actual balance sheet. While a trial balance is used for internal management purposes, a balance sheet is an essential component of your company's financial statements.

A balance sheet should be prepared annually and distributed to investors or relevant financial institutions. And while a trial balance is prepared purely for your internal controls, a balance sheet is required to manage your company's finances.

How often should businesses create trial balances?

You should try to create a trial balance at least once every reporting period. This ensures that your books are correct and that you can withstand a financial audit.

In addition, any time you suspect an error in your books, you should quickly put together a trial balance to check that your debits and credits are correctly balanced.

Who uses a trial balance?

Accounting and bookkeeping professionals might use a trial balance to perform an internal audit of the company's finances. While modern accounting software can minimize data entry errors and similar mistakes, trial balances still have their uses among internal company leadership.

For example, senior management may appreciate regular trial balance reports, as they put the company's most important information in one place. Similarly, accounting teams might use trial balances when performing periodic reviews or when an error is suspected.

Trial balance format

While there are no formal requirements for a trial balance, it typically consists of at least three columns. The first column on the far left will include the names of each account listed on your general ledger. The next two columns will include your credit and debit balances.

You'll record your credit balances in the center column (the credit column), while your debit balances are recorded in the far right column (the debit column). The total credit balance will appear at the bottom of the columns.

When you prepare your trial balance, include as much detail as possible, such as the date of the accounting period. This information will help you stay organized if you need to refer to your previous trial balances.

Trial balance example

Here is what a trial balance might look like for Company X. The far left column will include the account names used in the company's accounting system:

- Cash Account
- Accounts Receivable
- Loans
- Revenue
- Employee Expenses
- Cost of Inventory

The credit column will include the credit balances for each of these accounts:

- Cash Account: $5,000
- Accounts Receivable: $15,000
- Accounts Payable: N/A
- Revenue: $100,000
- Employee Expenses: N/A
- Cost of Inventory: N/A
- Total: $120,000

The debit column will include the debit balances for these accounts:

- Cash Account: N/A
- Accounts Receivable: N/A
- Accounts Payable: $20,000
- Revenue: N/A
- Employee Expenses: $40,000
- Cost of Inventory: $60,000
- Total: $120,000

In this example, the debits equal credits ($120,000 and $120,000), which suggests that the debit and credit entries are accurate.

Types of trial balances

Trial balances come in three different types:

- Unadjusted trial balance

- Adjusted trial balance
- Post-closing trial balance

Each trial balance will follow the same format as above, but they are used in slightly different circumstances.

Unadjusted trial balance

An unadjusted trial balance is done before adjusting journal entries are completed. This is a quick spot-check that records transactions. You can use this trial balance as a starting point to analyze your accounts before adjusting your journal entries.

These are some common examples of errors that can creep into your records without being detected by your trial balance:

- Duplication error: Transactions are recorded more than once
- Omissions: Transactions haven't been recorded in the books
- Errors of reversal: Transactions are recorded backward (credit and debit entries are flipped)
- Compensating error: Transactions contain two errors that happen to match
- Data entry errors: Transactions are recorded in the wrong account or as the wrong amount

Limitations aside, a trial balance can still be a valuable tool for evaluating your company's finances, and it can be helpful when you examine your company's financial statements.

How to prepare a trial balance

Preparing a trial balance is simple once you know the steps.

1. Calculate the account balances for your ledger accounts

Your business transactions are initially recorded in your general ledger. Each transaction will receive its own journal entry connected to the corresponding account name.

Depending on your accounting system, you may need to combine multiple expenses and sources of income. For example, your accounts payable account may contain multiple smaller entries, which you'll need to total before transferring this data to your trial balance.

You'll also need to close each balance to ensure that you focus on a specific time — usually, the duration of your accounting cycle, whether monthly or quarterly. It's also possible to look at your balance for a shorter period.

2. Record credit and debit balances on your trial balance

Next, you'll transfer the closing balances from your ledger to your trial balance. Make sure that the accounts listed on your trial balance are the same as on your general ledger.

You'll record the total credit amounts in the left column (i.e., the column immediately to the right of your account names) and your total debit balance in the column on the far right.

Be careful! This is where you can make the mistake of recording items in the wrong column or even the wrong account. This will significantly alter the accuracy of your completed trial balance and cost you valuable time chasing down your mistake.

3. Calculate the total in your credit column

Calculate your total credits. If you've followed the above method, you can simply and quickly calculate all of the credit balances in your credit entry column. If you're preparing your trial balance with a spreadsheet software program like Microsoft Excel, you can insert a formula that will perform the calculation for you.

4. Calculate the total in your debit column

Perform the same calculation for your debit column. Again, this is simply a sum of all the debits of your accounts for that period.

5. Compare your debit and credit totals

Look at your completed totals. Ideally, your credit and debit balances should be identical. This indicates your books are correctly balanced. If you get two different numbers, don't panic. Finding discrepancies like this is why you created a trial balance, and discovering the error now can save you time and headaches later on.

6. Look for errors

You'll need to discover why when your numbers don't add up. First, check the trial balance for the most common errors. This check might reveal a basic manual data entry mistake or entries made in the wrong column or account.

Once you discover your error, repeat steps three through five to see whether your numbers now match. Repeat this process as necessary until you get matching totals.

7. Close your trial balance

Once you complete the process, you can close your trial balance. Save the document itself, this can be helpful if you need to perform the process again for a longer period.

Again, if you create your trial balances using spreadsheet software, you can save time by keeping a template that includes the basic mathematical formulas.

ORACLE
US Primary Ledger

Trial Balance Report

Report Date 4/2/21 5:34 PM

Report Parameters	
Ledger or Ledger Set	US Primary Ledger
Ledger Currency	USD
Currency Type	Total
Accounting Period	03-21
Amount Type	Period to date balance type.
Balancing Segment	Company Equals to 101
Summarize By	Natural Account

ORACLE
US Primary Ledger

Trial Balance Report

Report Date 4/2/21 5:34 PM
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Account	Description	Beginning Balance (USD)	Debits (USD)	Credits (USD)	Ending Balance (USD)
64210	Computer Supplies	151,093.19	0.00	0.00	151,093.19
64220	Expense Software	15,904.62	0.00	0.00	15,904.62
64300	Legal Fees Assigned Cost	188,230.01	0.00	0.00	188,230.01
64510	Communications costs	183,515.43	0.00	0.00	183,515.43
65110	Professional Fees All others	221,448.67	0.00	0.00	221,448.67
65410	Recruiting expenses	265,728.86	0.00	0.00	265,728.86
65600	Contractor Expenses	4.31	0.00	0.00	4.31
68120	Depreciation Building and Improvements	126,710.82	0.00	0.00	126,710.82
68160	Depreciation Computers and Software	232,628.89	0.00	0.00	232,628.89
68170	Depreciation Office Equipment	12,370.91	0.00	0.00	12,370.91
	Total for Company 101 US 1 LE 1 BU 1	0.00	195,868.40	195,868.40	0.00

Prepare adjusting entries on January 31 for each item below

A. office supplies used $64,290. Acquisitions of office supplies were recorded in the inventory of office supplies ledger account.

B. Rent Revenue received in advance, $ 16200. Advance rent received is credited to the Rent Revenue ledger account.

C. Royalty revenue accrued from licensing a patent, $4,500.

1. On June 30, the end of its fiscal year, an enterprise owed salaries of $ 12,500 for an incomplete payroll period. On the first payday on July, salaries of $ 20,900 are paid; (a) is the $ 12,500 a deferral or an accrual as of June 30?

   (b) Which of the following types of accounts will be affected by the related adjusting entry: (1) assets (2) liability, (3) revenue, (4) expense?

2. On January 2, an enterprise receives $ 24,000 from a tenant as rent for the current calendar year. The fiscal year of the enterprise is from April 1 to March 31.

   (a) Which of the following types of accounts will be affected by the adjusting entry as of March 31: (1) assets (2) Liabilities, (3) revenue, (4) expense?

   (b) How much of the $ 24,000 rent should be allocated to the current fiscal year ending March 31?

Solution

1. A. Office Supplies Expense……………………………….64,290

   Office Supplies…………………………………… 64,290

   B. Unearned Rent………………………………………16,200

   Rent Revenue…………………………………….. 16,200

   C. Royalty receivable……………………………………..4,500

   Royalty revenue………………………………….. 4,500
2. A. Accrual

   B. Liabilities and Expense
3. A. Liabilities and Revenue

   B. $6,000

After prepared unadjusted trial balance the adjustment journal entry is made. Then, the adjusted trial balance is prepared.

The following pages explain each type of adjustment and show examples. Each example is based on the October 31 trial balance of Pioneer Advertising Agency.

Pioneer Advertising Agency

Unadjusted trial balance

October 31, -----

	Debit	**Credit**
Cash	$15,200	
Advertising Supplies	2,500	
Prepaid Insurance	600	
Office Equipment	5,000	

Notes Payable		$ 5,000
Accounts Payable		2,500
Unearned Revenue		1,200
C. R. Byrd, Capital		10,000
C. R. Byrd, Drawing	500	
Service Revenue		10,000
Salaries Expense	4,000	
Rent Expense	900	
Total	**$28,700**	**$28,700**

An analysis of the accounts shows the following.

1. Insurance expires at the rate of $100 per month.

2. Supplies on hand total $800.

3. The office equipment depreciates $200 a month.

4. One-half of the unearned revenue was earned in October.

Prepare the adjusting entries for the month of October.

Solution

1. Insurance Expense-----------------------------100

    Prepaid Insurance--100

    (To record insurance expired)

2. Advertise Supplies Expense---------------------- 2,000

    Advertise Supplies-- 2,000

    (To record supplies used)

3. Depreciation Expense-------------------------- 200

    Accumulated Depreciation—Office Equipment----------- 200

    (To record monthly depreciation)

4. Unearned Revenue--------------------------- 600

    Service Revenue--- 600

Pioneer Advertising Agency

Adjusted trial balance

October 31, -----

	Debit	Credit
Cash	$15,200	
Advertising Supplies	500	
Prepaid Insurance	500	
Office Equipment	5,000	
Accumulated Depreciation—Office Equipment		200
Notes Payable		$ 5,000
Accounts Payable		2,500
Unearned Revenue		600
C. R. Byrd, Capital		10,000
C. R. Byrd, Drawing	500	
Service Revenue		10,600
Salaries Expense	4,000	
Rent Expense	900	
Insurance expense	100	
Advertise supplies expense	2000	
Depreciation expense for office equipment	200	
Total	**$28,900**	**$28,900**

Self check 9.1.

Part one -True or False:

True/False: Adjusting entries are made to update accounts at the end of an accounting period to ensure that financial statements are accurate.

True/False: The unadjusted trial balance is prepared after adjusting entries have been made.

True/False: Prepaid Insurance is an asset account.

True/False: The balance in the Accounts Payable account would be decreased by the adjusting entry.

True/False: Accumulated Depreciation is a contra-asset account.

Part two - Multiple Choices:

1. Which account will be affected when an adjusting entry is made for the depreciation expense of office equipment?

(a) Assets

(b) Liabilities

(c) Revenue

(d) Expenses

2. What is the purpose of an unadjusted trial balance?

(a) To prepare financial statements

(b) To adjust financial records

(c) To determine net income

(d) To verify mathematical accuracy

3. Which account would be affected by an adjusting entry for earned but previously unearned revenue?

(a) Assets

(b) Liabilities

(c) Equity

(d) Expenses

4. What is the purpose of an adjusting entry for prepaid insurance that has expired?

(a) To increase an asset account

(b) To decrease a liability account

(c) To recognize an expense

(d) To recognize unearned revenue

5. What effect does an adjusting entry for supplies used have on the financial statements?

(a) Decreases assets and decreases equity

(b) Decreases assets and increases equity

(c) Decreases liabilities and decreases equity

(d) Decreases liabilities and increases equity

Operation Sheet

Title – Maintain and establish Accrual Accounting

Purpose - adjustments

1. Explain how the adjustments impact the total equity of the company.

2. Describe the impact on the company's financial statements due to the adjustments made

References

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