Basics of Accounting for Small and Medium Businesses



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Basics of Accounting for Small and Medium Businesses

Introduction to Accounting

Accounting is the work or process of keeping financial records. It is the systematic recording, reporting, and analysis of the financial activity (transactions) of a person, business, or organisation. In business, it allows companies to analyse their financial performance.

Additionally, accounting allows businesses to examine their results regarding profits, losses, productivity, sales trends, costs, etc.

It is instrumental in companies and other organisations as a means of determining financial stability. It is a systematic process of identifying, recording, measuring, classifying, verifying, summarising, interpreting and communicating financial information. Accountancy is a language you use to communicate the story of your company to people. Typically, the story varies depending on whether they are insiders, outsiders, or tax authorities.

Accounting crucial for decision-making

Without accounting, it would be virtually impossible for businesses to be able to make short-term and long-term decisions. We make most of our commercial decisions after using this type of data. We decide how much to spend on various business functions and reinvesting profits after examining the company's accounts. We sometimes refer to accountancy as 'the language of business.' It measures the results of a company's economic activities.

Accountants convey this data to a wide range of users, including the company's management, shareholders, and creditors. They also convey the data to regulators, such as SARS and CIPC.

Furthermore, investors will never consider purchasing shares in a company without first examining its accounts.

Financial Statements

What Are Financial Statements?

Financial statements are written records that convey the business activities and the financial performance of a company. Tax authorities often audit financial statements, accountants, firms, etc. to ensure accuracy and for tax, financing, or investing purposes.

Financial statements include:

- Balance sheet;
- Income statement;
- Cash flow statement.

Financial statements are written records that convey the business activities and the financial performance of a company.

The balance sheet provides an overview of assets, liabilities, and stockholders' equity as a snapshot in time.

The income statement primarily focuses on a company's revenues and expenses during a particular period. Once expenses are subtracted from revenues, the statement produces a company's profit figure called net income.

The cash flow statement measures how well a company generates cash to pay its debt obligations, fund its operating expenses, and fund investments.

The Accounting equation:

- Assets = Liabilities + Owners' Equity
- Liabilities = Assets – Owners' Equity
- Owners' Equity = Assets – Liabilities

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Practical Exercises

Accounting Equation

Let's assume that you a company called The Saxonwold Shebeen (TSS) (Pty) Ltd. On December 1, 2018, you invested a total of R10,000 in starting TSS. In exchange, the company issues a total of 1,000 shares of common stock. (The stock has no par value and no stated value.)

The effect on the corporation's accounting equation is:

- Assets = Liabilities + Owners' Equity
- +R 10 000 = No Effect + (+ R 10 000)

TSS's assets increase by R 10,000 and shareholders' equity increases by the same amount. As a result, the accounting equation will be in balance. The accounting equation tells us that TSS has assets of R 10,000 and the source of those assets was the stockholders. Alternatively, the accounting equation tells us that the corporation has assets of R 10,000 and the only claim to the assets is from the stockholders (owners). This transaction is recorded in the asset account Cash and the stockholders' equity account Common Stock.

The general journal entry to record the transaction is:

Date	Accounting Name	Debit	Credit
1 Dec 18	Cash		R 10 000
	Share Capital		R 10 000

After the journal entry is recorded in the accounts, a balance sheet can be prepared to show TSS's financial position at the end of December 1, 2018:

- The Saxonwold Shebeen (Pty) Ltd.
- Balance Sheet;
- 01 December 2018.

Assets		Liabilities
Cash	R 10 000	Shareholders' Equity
	R 10 000	Share Capital
Total Assets	R 10 000	Total Liabilities & Equity - R10 000

Notes

Draw up an Income Statement for the financial year ended 28 February 2019. Unless otherwise stated, all the information below relates to that date:

1. Sales – R 2 273 788
2. Stock at the beginning of the year was valued at R 130 000
    a. Closing Stock at the end of the year was valued at R 35 749
    b. Stock Purchases during the year amounted to R 1 236 998
3. Variable Costs and Fixed Costs for the year were: -
    a. Sales commission fees - 8%
    b. Accounting fees - R 9 800
    c. Audit fees - R 6 000
    d. Bank charges - R 21 200
    e. Cleaning - R 7 300
    f. Computer costs - R 2 300
    g. Credit card commission - R 1 800
    h. Electricity - R 26 400
    i. Insurance - R 15 000
    j. Licenses - R 11 300
    k. Local store marketing - R 11 800
    l. Member's salary - R 100 000
    m. Postage and stationary - R 9 200
    n. Salaries - R 252 625
    o. Security - R 1 100
    p. Staff training - R 2 300
    q. Telephone - R 82 300
    r. Uniforms - R 4 800
    s. Vehicle – fuel & repairs - R 31 100
4. Motor vehicles cost R 124 402, this year's depreciation is R 22 954.
5. Equipment cost R 53 145, this year's depreciation is R 10 628.
6. Furniture and fittings cost R 64 311, this year's depreciation is R 10 285.
7. The computer cost R 92 710, this year's depreciation is R 20 130.
8. Interest on overdraft - R 9 312
    a. Loan finance charges - R 24 031
9. Interest received - R 1055
10. An accumulated loss at the beginning of the year (R 10 519).

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XYZ - Income Statement for the year ended 28 February 2019

		Total	%
Total Sales			
Less:- Cost Of Sales (COS)			
+			
=			
-			
Gross Profit (GP)			
Less:- Variable costs (VC)			
Contribution to fixed costs GP – VC			
Less:- Fixed cost (FC)			
Net operating profit before interest & tax	NOPBIT/EBIT		
Add: Other income			
Net profit before interest & tax			
Less:- Cost of financing			
Net profit before taxation			
Less:- Taxation			
Net profit after taxation – NPAT			

Notes

Answers to XYZ - Income Statement for the year ended 28 February 2019

		Total	%
Sales		2 273 788	
Total Sales		**2 273 788**	**100**
Less:- Cost Of Sales (COS)			**58,5**
Opening stock	130 000		
+ Purchases	1 236 998		
Total stock available	**1 366 998**		
- Closing stock	35 749		
Gross Profit (GP)		**942 539**	**41,5**
Less:- Variable costs (VC)		**181 903**	**8**
Sales commission	181 903		
Contribution to fixed costs GP – VC		**760 636**	**33,5**
Less:- Fixed cost (FC)		**735 922**	**32,4**
Accounting fees	9 800		
Audit fees	6 000		
Bank charges	21 200		
Cleaning	7 300		
Computer services	2 300		
Credit card commission	1 800		
Depreciation	63 997		
Electricity	26 400		
Insurance	15 800		
Licenses	11 300		
Local store marketing	11 800		
Member's salary	100 000		
Postage and stationary	9 200		
Rent	59 500		
Repairs and maintenance	15 300		
Salaries	252 625		
Security	1 100		
Staff training	2 300		
Telephone	82 300		
Uniforms	4 800		
Vehicle – fuel and repairs	31 100		
Net operating profit before interest & tax NOPBIT/EBIT		**24 714**	**1,1**
Add: Other income		**1 055**	
Interest received	1 055		
Net profit before interest & tax		**25 769**	**1,1**
Less:- Cost of financing		**33 343**	**1,5**
Interest on overdraft	9 312		
Loan finance charges	24 031		
Net profit before taxation		**(7 574)**	
Less:- Taxation			
Net profit after taxation – NPAT		**(7 574)**	

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XYZ Balance Sheet

Draw up a Balance Sheet for the above company. The company's financial year ends on 28 February 2019. Unless otherwise stated, all the information below relates to that date.

1. Deposits - R 650
2. Petty cash on hand - R 770
3. 32-day investment account - R 21 239
4. Bank overdraft - R 126 581
5. Creditors - R 305 943
6. Current portion of long term loan - R 55 059
7. SARS – VAT payable - R 22 591
8. Nedbank – Balance on credit cards due - R 7 044
9. Member's contribution - R 100
10. Member's loan - R 64 238
11. Debtors - R 397 016
12. Long term loan - R 102 875
13. The fixed assets shown in last year's Balance Sheet (Feb 2018), are shown in this table:

	Cost	Accumulated Depreciation
Depreciation		2 273 788
Motor vehicles	124 402	8 948
Equipment	53 145	17 660
Furniture	64 311	18 403
Computer	92 710	14 646
Total	**334 568**	**59 657**

Notes

Mr Franchise Business - Income Statement for the month ended 30 April 2019

	30 April 2019 Rand
Sales	
Total sales	**200 000**
Less:- Cost of sales COS	**92 000**
Opening stock	30 000
+ Purchases	90 000
= Total stock available	120 000
Less: Closing stock	28 000
Gross profit GP	**108 00**
Less: Variable costs VC	**30 000**
Royalties 10%	20 000
Advertising levy 5%	10 000
Contribution to fixed costs GP – VC	**78 000**
Less: Fixed costs FC	**48 300**
Rent	15 000
Salaries	20 000
Telephone	600
Internet	700
Vehicle rental	4 000
Depreciation	8 000
Net profit before interest and tax NOPBIT	**29 700**
Less: Interest loan	**6 000**
Net profit before tax	**23 700**

Note: *A payment of R 5 000 was made after the declared net profit, to the shareholder's loan*

Mr Franchise Business Balance Sheet

Draw up a Balance Sheet for the above company for the month ended 30 April 2019.

1. Bank - R 8 700
2. Creditors - R 20 000
3. **Shareholders' funds:**
    a. Shareholder's loan - R 100 000
    b. Accumulated profits - R 370 000
4. Debtors - R 80 000
5. The fixed assets shown in **last month's** Balance Sheet, (31st March 2019), are shown in this table:

	Cost	Accumulated Depreciation	Present Value	Depreciation For April 2019 (R's)
Equipment	262 500	62 500	200 000	5 000
Computers	62 500	12 500	50 000	1 000
Furniture & fittings	175 000	25 000	150 000	2 000

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	30 April 2019 (R)	31 March 2019 (R)
Employment Of Capital		
Fixed Assets		
Equipment		200 000
At Cost		262 500
Accumulated Depreciation		62 500
Computers		50 000
At Cost		62 500
Accumulated Depreciation		12 500
Furniture And Fittings		150 000
At Cost		175 000
Accumulated Depreciation		25 000
Current Assets (CA)		110 000
Stock		30 000
Debtors		60 000
32 Day Call Account		0
Bank		20 000
Total Assets		510 000
Shareholders Funds		470 000
Shareholder's Loan		100 000
Total Earned Surplus		370 000
Earned Surplus – Previous Months		370 000
Earned Surplus – This Month		
Long Term Loan		0
Current Liabilities (Cl)		40 000
Bank Overdraft		0
Creditors		40 000
Taxation		0
Short Term Loan		0
Total Capital		510 000

Mr Franchisee Cash flow movement for months: April 2006

Profit per income statement and April 2019	
Plus non-cash expense items	+
	=
Minus amount owed less to creditors	-
	=
Minus amount owed more by debtors	-
	=
Plus amount with which stock levels decreased	+
	=
Minus amount paid back to the shareholder loan	-
Movement in cash balance from 21st March 2019 to 30th April 2019	=

Notes

Income Statement - Mr Supermarket cc

Draw up an Income Statement for the financial month ended 31st March 2017. Unless otherwise stated, all the information below relates to that date.

1. Cash sales - R 4 000 000
   a. Credit sales - R 1 000 000
2. Stock at the beginning of the month was valued at R 1 800 000
   a. Closing Stock at the end of the month - R 2 500 000
   b. Stock purchases during the month amounted to - R 4 800 000
3. Variable Costs and Fixed Costs for the month were:
   a. MSF (Royalties) - 1%
   b. Accounting fees - R 2 000
   c. Bank charges - R 8 000
   d. Cleaning - R 4 000
   e. Computer services - R 3 000
   f. Credit card commission - R 4 100
   g. Electricity & gas - R 39 000
   h. Insurance - R 6 400
   i. Local marketing - R 4 000
   j. Postage and stationary - R 1 100
   k. Rent - R 175 000
   l. Rent deposit for Oct 2017 - R 20 000 to be paid now in March
   m. Repairs & maintenance - R 10 000 invoiced for March
   n. Repairs & maintenance - R 4 000 repairs done in March – no invoice
   o. Salaries – franchisee - R 25 000
   p. Salaries – manager - R 65 000
   q. Smalls - R 9 867
   r. Staff meals - R 4 000
   s. Staff training - R 1 500
   t. Telephone - R 4 800
   u. Telephone - R 2 500 short paid in Feb 2017, pay now
   v. Uniforms - R 2 900
   w. VAT payment due - R 101 000
   x. Wages - R 271 000
4. Equipment cost R 3 400 000 and is depreciated at a rate of 10% per year
5. Furniture and fittings cost R 1 800 000 and are depreciated at a rate of 20% per year
6. Bought a brand new computer on 31st March 2017, cash, R 20 000 depreciation can start in April
7. Interest on overdraft - R 7 000
8. Interest on loan - R 31 000 Total loan repayment R 42 000
9. Expected taxation to SARS - 29% of net profit

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Mr Supermarket cc: Income Statement for the month ended 31st March 2017

		Total	%
Total Sales			
Less:- Cost Of Sales (COS)			
+	+		
=	=		
-	-		
Gross Profit (GP)			
Less:- Variable costs (VC)			
Contribution to fixed costs (GP – VC)			
Less:- Fixed cost (FC)			
Net operating profit before interest & tax	NOPBIT/EBIT		
Less:- Cost of financing			
Net profit before taxation			
Less:- Taxation			
Net profit after taxation – NPAT			
Retained profit / earned surplus			

Notes

Annexure A



Answers to the Question

Mr Supermarket cc: Income Statement for the month ended 31st March 2017

		Total	%
Cash sales	4 000 000		
Credit sales	1 000 000		
Total Sales		5 000 000	100
Less:- cost of sales (COS)		4 100 000	82,0
Opening stock	1 800 000		
+ Purchases	4 800 000		
Total stock available	6 600 000		
- Closing stock	2 500 000		
Gross Profit GP		900 000	18,0
Less:- Variable costs VC		50 000	1,0
Management service fee (Royalty) 1%	50 000		
Contribution to fixed costs (GP – VC)		850 000	17,0
Less:- Fixed cost FC		703 000	14,06
Accounting fees	2 000		
Bank charges	8 000		
Cleaning	4 000		
Computer services	3 000		
Credit card commission	4 100		
Depreciation	58 333		
Electricity & gas	39 000		
Insurance	6 400		
Local marketing	4 000		
Postage and stationary	1 100		
Rent	175 000		
Repairs and maintenance	14 000		
Salaries – franchisee	25 000		
Salaries – manager	65 000		
Smalls	9 867		
Staff meals	4 000		
Staff training	1 500		
Telephone	4 800		
Uniforms	2 900		
Wages	271 000		
Net operating profit before interest & tax	NOPBIT/EBIT	147 000	2,94
Less:- Cost of financing		38 000	0,76
Interest on overdraft	7 000		
Loan finance charges	31 000		
Net profit before taxation		109 000	2,18
Less:- Taxation		31 610	0,63
Net profit after taxation – NPAT		77 390	1,55
Retained profit / earned surplus		77 390	

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For more information on the Entrepreneurial Fundamentals Training contact

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