FINANCIAL ACCOUNTING PRINCIPLES FOR LAW PRACTITIONERS

LEARNING UNIT

1 THE NATURE AND FUNCTION OF ACCOUNTING

Contents

Acronyms

CF	Conceptual Framework for Financial Reporting
IFRS	International Financial Reporting Standards
IASB	International Accounting Standards Board
FRSC	Financial Reporting Standards Council (South African Body)
SAICA	South African Institute of Chartered Accountants
The Rules	Rules of the Attorneys' Profession
IAS 1	Presentation of Financial Statements

1. Introduction

Accounting is the bookkeeping method, which generates a financial record of all the business transactions entered into by a business (entity). An accounting system generates the financial records of the business and produces a summary of the income and expenses (statement of profit or loss) and assets and liabilities (statement of financial position). Therefore, the accounting system generates financial information in the format of financial statements.

As the physical and digital worlds have integrated over time, today's accounting information systems are typically computer-based methods with special accounting software. Whether the accounting information is computerised or written up by hand the principles of the debits, credits and the double-entry system are still relevant and form the basis for the accounting system. This module deals with the financial accounting concepts and principles that are relevant to law practitioners as well as the accounting and recording of transactions that are specific to the practice of a law practitioner.

1.1 What is accounting?

Accounting is a process consisting of the following three activities:

The first activity involves identifying those events that are evidence of economic activity (transactions) relevant to the particular business or entity.

and

The second relates to the recording of the monetary value of the economic events (transactions) in order to provide a permanent history of the financial activities of the business. Recording involves keeping a chronological diary of measured events in an orderly and systematic fashion. This means that economic events are also classified and summarised.

and

The third activity encompasses the communication of the recorded information to interested users. The information is communicated through the preparation and distribution of accounting reports, the most common of which are known as financial statements.

1.2 The nature of accounting

Accounting is a means of communication used to convey specialised information about the finances of an entity. If the recipient of this specialised information (the user of financial information) does not understand it, the information, which is conveyed, will have no value.	Accounting uses words and figures to convey financial information to the users of such information. These words and figures are known as the ➢ concepts, ➢ principles, and ➢ procedures of accounting.
This knowledge will ultimately result in an understanding of the message contained in financial statements	
Every person involved in an entity uses financial information to a greater or lesser extent. Financial resources are limited, or ''scarce'', and if we are to spend them we must plan properly. Each of us also needs to know something about accounting to manage our personal financial affairs. Knowledge of accounting is thus also useful in this area.	Accounting is a *"language"* used to convey financial information to interested parties, i.e. users of the information.

1.3 Forms of ownership and users of financial statements

The four main forms of *ownership* are: ➢ sole traders, ➢ partnerships, ➢ close corporations ➢ companies	Many users, who analyse the information for various decision-making purposes, require financial information. The following are the most *common users*: ➢ Investors ➢ Creditors ➢ Employees ➢ Government ➢ Management
***Users* of financial information –** Are divided into the following two categories: ➢ *Internal* users, such as management or employees ➢ *External* users, such as investors, creditors, or government	**The *fields* of accounting –** ➢ *Financial accounting* is concerned with the provision of financial information to mainly external parties, ➢ *Management accounting* is concerned with the provision of financial information to people within the entity.

Financial Accounting is concerned with the recording of transactions and the preparation of the financial statements for the entity as a whole. International Financial Reporting Standards (IFRS) govern financial accounting reporting, which consists of adhering to external international standards. These standards ensure the comparability of financial statements between entities and countries.

Management Accounting provides financial information for specific purposes. Managers use this information in their decision-making, which leads to the attainment of the objectives of the entity. Without this financial information, it would be difficult for management to manage the business effectively.

In this module, we will be concentrating on financial accounting.

1.4 Internal controls

Rules 54.14.7.1 (54.14.7.1.1 to 54.14.7.1.4) for the Rules of the South African Legal Practice Council (hereafter referred to as the Rules) require that internal controls are implemented to ensure compliance with the rules and to ensure that trust funds are safeguarded.

Internal controls are the mechanisms, rules, and procedures put in place by an entity to ensure the integrity of financial and accounting information, promote accountability and prevent fraud. Internal control further ensures that the financial information provided by such a system is complete, accurate and reliable, that the assets of the entity are protected against loss or fraud, that management policies are implemented and that all parts of the system function properly. The success of any accounting system depends on a good system of internal control. An attorney's practice is particularly dependent on such a system for its continued existence.

Internal control systems must be designed to suit the type of entity concerned, for example, a sole proprietor, a partnership, or a personal liability company.

1.4.1 Built-in control measures

Built-in control measures include:

- numbered source documents
- dates on source documents
- control accounts in respect of clients (also debtors or trade receivables) and trust creditors (also known as trust payables)
- separate bank accounts (business and trust bank accounts)
- the keeping of petty cash according to the imprest[1] system.
- the accurate analysis of all income and expenses
- a monthly trial balance which ensures that all accounts are properly balanced
- the reconciliation of bank accounts with bank statements
- the reconciliation of business creditors (also known as trade payables) with creditor statements
- a non-current asset register.

1.4.2 Internal control systems/procedures

Internal control procedures include separation of duties, access controls, physical audits, standardised documentation, trial balances, periodic reconciliations, and approval authority.

---

[1] The imprest system is a financial accounting method for paying out and subsequently replenishing a fund such as petty cash. At any point in time the cash on hand plus the value of the petty cash vouchers for expenses paid should be equal to the original fixed imprest petty cash amount.

Examples of internal control procedures are:

- efficient banking of all cash received
- all payments must be made by EFTs (electronic fund transfers)
- proper authorisation for all transactions
- proper demarcation (limits) of authorisation
- the separation of duties (e.g. the person who issues receipts may not record them in the relevant cash receipts journals)
- an internal checking system (e.g. at least two staff members to check important transactions; rotation of staff etc.)
- the keeping of registers for receipt books, invoice/debit notebooks and credit notebooks
- the keeping of unused receipt books, invoice/debit notebooks and a credit note
- the review of receipts against deposits
- the initialling of changes and receipts
- cash to be banked regularly
- only authorised signatories are allowed to sign on behalf of the entity
- no cash to be issued.

1.5 Financial frameworks

Rule 54.6 requires that a law firm shall keep in the official language of the Republic such accounting records, which record both business account transactions and trust account transactions. The rules also require the preparation of financial statements, which reflect fairly the state of affairs and business of the firm and explain the transactions and financial position of the firm. The financial statements must also comply with an acceptable financial framework as applied in South Africa.

The financial frameworks that are acceptable in terms of the Rules are:

- the International Financial Reporting Standards (known as "IFRS"), and
- the International Financial Reporting Standards for Small and Medium Entities (known as "IFRS for SME's")

The International Accounting Standards Board (IASB) issues these frameworks from time to time.

1.5.1 The Conceptual Framework

Accounting, as a specialised medium of communication (refer 1.2 above), has its own specific language (language of business) or jargon. If each business were to prepare financial statements and reports according to its own **accounting rules** and its own interpretation of accounting theory and principles, there would be chaos in the world of economics and business.

The conceptual financial framework is a group of interrelated objectives and theoretical principles that serve as a frame of reference for financial accounting and more specifically for general purpose financial reporting. The objective of the conceptual framework is to provide information that is useful to potential and existing investors, lenders, and other creditors.

All general-purpose financial statements must have the same objectives and must be based on the same fundamental theoretical principles. The objective of general purpose reporting is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders, and other creditors in making decisions about providing resources to the entity. These decisions involve buying, selling, or holding equity and debt instruments, and providing or settling loans and other forms of credit. Potential and existing investors are interested in the returns they expect, while creditors and other lenders are interested in principal repayments and interest payments they expect.

The objective of creating standardised **accounting rules**, called **accounting standards**, for particular issues (e.g. for the treatment of taxation in financial statements, etc.) is to limit the variety of available accounting practices and the elimination of undesirable alternatives. The accounting standards are not always rigid rules. Some standards allow more than one desirable alternative.

1.5.2 Accounting standards and statements

In South Africa, the Financial Reporting Standards Council[2] (FRSC) plays an important role in the development of IFRS. The standardised accounting rules of the International Financial Reporting Standards[3] (IFRS) and the International Accounting Standards[4] (IAS) are the documented generally accepted accounting standards and practices as prepared by the International Accounting Standards Board (IASB), approved by the FRSC for use in South Africa and thereafter issued by the South African Institute of Chartered Accountants (SAICA).

The objective of creating accounting standards for particular issues (e.g. for the treatment of interest paid in financial statements), is to limit the variety of available accounting practices, but without striving for strict uniformity or creating a set of rigid rules for all circumstances. The ultimate aim of accounting standards is to encourage widespread use of particular standards in financial reporting and to eliminate undesirable alternatives.

1.5.3 Accounting policies

Transactions of a repetitive nature frequently occur, and the requirement of consistency means that an entity must establish an accounting policy, which determines how such transactions will be treated.

LBL	*An accounting policy is thus a set of decisions about how the entity will treat the same type of transactions in order to ensure consistent performance.*	

In the case of transactions that can be dealt with in various ways, it is necessary that the entity disclose the accounting policy it adopted in its notes to the financial statements. For example,

[2] Financial Reporting Standards Council – http://www.thedtic.gov.za/wp-content/uploads/FRSC-Rules_Procedure.pdf

[3] International Financial Reporting Standards – https://www.ifrs.org/

[4] International Accounting Standards

an entity has to indicate what basis it has used to deal with the depreciation of property, plant and equipment.

1.5.4 Fundamental theoretical principles that all general financial statements must be based on in terms of the IAS

(a) Underlying assumptions

In accordance with the conceptual framework for financial reporting and the framework for the preparation and presentation of financial statements issued by the IASB, the financial statements are prepared on the *accrual basis* and based on the assumption that the business is a *going concern*.

(i) Going concern

A business is a going concern when it will continue to trade in the foreseeable future, and is not likely to cease trading imminently and have its assets liquidated (sold off). The elements of the financial statements, i.e. assets, liabilities, owners' equity, income and expenses will thus be included in the financial statements at their original cost less depreciation/impairment and not at liquidation values (forced selling values).

(ii) Accrual basis

The effect of transactions and events on a business's resources must be included in the periods in which those transactions and events occurred and not when the cash flow took place. Expenses incurred to produce income must be included in the same financial period, even if they occurred in different periods. This is referred to as the "matching of costs with revenue".

(b) Fundamental qualitative characteristics

The information in the financial statements must be useful to the users of the statements. To be useful, the information should be **relevant** and **faithfully** presented.

(i) Relevance

Only relevant information needs to be disclosed separately in the financial statements. The relevance of the information is based on the **nature** and **materiality** of the information.

(ii) Faithful representation

Financial information must faithfully represent transactions and other events. The following characteristics will ensure faithful representation:

Materiality

Information that is significant enough is disclosed separately. Minor items are included in the financial statements but are not separately disclosed.

Nature

In certain instances, the nature of the information alone is sufficient to determine its relevance, for example, where information, irrespective of its materiality, can affect the decisions of the user.

Completeness
All the information that a user needs in order to be able to understand the economic events and transactions should be included in the financial statements.

Neutrality
Reliable information should be neutral (without bias) in that it should not present information in a manner that will achieve a predetermined result.

Free from error
The faithful representation of information does not imply that the information is accurate. It implies, however, that the event or transaction is free from error and that the process followed to provide the reported information was without errors.

(c) Enhancing qualitative characteristics

The enhancing qualitative characteristics improve decision-usefulness of financial reports. The conceptual framework also recognises that the enhancing qualitative characteristics cannot make information useful if that same information is irrelevant or not faithfully represented.

Comparability
Information should be comparable between different entities or time periods.

Verifiability
Independent and knowledgeable observers are able to verify the information.

Timeliness
Information is available in time to influence the decisions of users.

Understandability
Information shall be classified, presented clearly and concisely.

(d) The cost versus the benefit of financial reporting

The cost of providing financial reporting must be justified by the benefits of reporting that information.

1.6 Financial statements

The objective of financial statements is to provide information about the financial position, financial performance, and cash flows of an entity that is useful to a wide range of users in making economic decisions. To meet that objective, financial statements provide information about an entity's:

- assets
- liabilities
- equity
- income and
- expenses, including gains and losses contributions by and distributions to owners (in their capacity as owners)
- cash flows. [IAS 1.9]

In terms of IFRS, a complete set of financial statements of an entity should comprise the following:

a statement of financial position →	which reflects all assets, liabilities and equity of an entity *at* a particular *date*
a statement of profit or loss and other comprehensive income →	which reflects the financial performance of the entity, indicating a net profit or loss *for* a specific *period*
a statement of changes in equity →	which reflects the movement in: **(a)** the capital and current accounts of the partners in a partnership; or **(b)** the shareholding and retained profits or losses of a company *for* a specific *period*
a statement of cash flows →	which reflects the actual cash movements in and out of the entity *for* a specific *period*
notes to the financial statements →	which reflect the accounting policy of the entity and expand on the line items in the statement of financial position and the statement of profit or loss and other comprehensive income

Before we can discuss the basics of accounting, we need to know what the statement of financial position and the statement of profit or loss and other comprehensive income consist of.

In terms of the Conceptual Framework, the information that must be used in the preparation of financial statements is grouped into elements according to their economic characteristics, which make up the financial statements. These elements are grouped under two headings, namely, the elements that pertain to the *financial position* in the statement of financial position and the elements that pertain to the *financial performance* in the statement of profit or loss and other comprehensive income.

Statement of financial position at the **beginning** of the period	+	Statement of financial **performance**	+	Contributions by and distributions to equity holders	=	Statement of financial position at the **end** of the period
Assets minus liabilities equal equity		Income minus expenses				Assets minus liabilities equal equity

1.6.1 The statement of financial position

The statement of financial position provides information about the following:

- The economic resources available to the entity to generate future benefits.
- The financial structure of the entity with emphasis on own and borrowed capital, which may also be used to predict future borrowing needs.
- The liquidity position of the entity. Liquidity is an entity's potential ability to pay its short-term debts. In other words, it is the availability of cash and other items, which can easily be converted into cash to pay short term debt. This information may also be used to predict the availability of cash, after the settling of debts for the same period.
- The solvency of the entity's position. Solvency refers to the extent to which an entity's assets exceed its liabilities. It may also be used to predict the availability of cash over longer periods to meet debts as they fall due.
- The elements that are directly related to the financial position are assets, liabilities and equity.

(a) Assets

Assets are defined as a present economic resource controlled by the entity as a result of past events. An economic resource is a right that has the potential to produce economic benefits.

The asset definition identifies all cash accounts as assets because the economic benefits have already flowed to the entity. In other words, bank accounts, savings accounts, petty cash accounts and cash float accounts are classified under assets if the balances are favourable.

There are also items, which are expected to result in future economic benefits flowing to the entity i.e. trade receivables (also called debtors or client accounts). Debtors are individuals/firms, which owe money to the entity. The money they owe is expected to flow to the entity in future (a potential inflow) when the debtors pay their accounts.

All items that an entity has control over or can be resold will be regarded as assets. These include inventory, vehicles, property, equipment, furniture, etc. Stationery and other consumables are meant to be consumed by the entity within one year and are therefore treated as expenses during the year. At year-end, if there are material consumables and stationery on hand, it is considered to be inventory, and a stocktake will be done to determine a value for the statement of financial position.

(b) Liabilities

Liabilities are debts. If you have a liability in financial terms, it means that you owe money to someone or some entity. A liability is defined as a present obligation of the entity to transfer an economic resource as a result of past events. Examples of liabilities are mortgages, loans from owners, loans from banks and other external parties, accounts payable (creditors) and bank overdrafts.

(c) Owners' equity

Equity is defined as the residual interest in the assets of the entity after deducting all its liabilities. Equity represents the interest of the owners in the net assets of an entity, which means the part of the assets against which there is no claim from other parties.

Equity differs from liabilities in that **liabilities are obligations** which must be settled out of the assets of the entity, whilst **equity is not an obligation** which has to be settled. Equity is not a claim against assets; it is what is left over after all liabilities are deducted from assets.

There are two methods by which the owner's equity in an entity can be calculated.

- The first method is to make use of the *basic accounting equation*. If you have the total value of the assets of the entity, as well as the total value of the liabilities of the entity, then you can calculate the owner's equity by subtracting the liabilities from the assets. The figure you arrive at should indicate how much money the owner(s) may withdraw from the entity if the business activities were to be terminated on that day.

Equity	=	Assets	—	Liabilities	Notes
– or +		– or +		– or +	A decrease in an account is a – and an increase in an account is shown as a +

- Equity can also be expressed in terms of the basic accounting equation given below:

Assets	=	Equity	+	Liabilities	Notes
– or +		– or +		– or +	A decrease in an account is a – and an increase in an account is shown as a +

Refer to Learning unit 2.4 for a discussion of the accounting equation and illustrated examples.

The second method that can be applied to calculate the value of the owner's equity in the entity is to *do the following calculation*:

- In the case of a *sole proprietor or a partnership*:
  Capital contributions by the owner/partners, **plus** profits (past and current) of the entity, **minus** drawings by the owner/partners.
- In the case of a *company*:
  Issued share capital, **plus** accumulated reserves, **plus** retained earnings (accumulated profits **minus** accumulated losses).

1.6.2 The statement of profit or loss and other comprehensive income

Profit is used as a measure of performance or as the basis for other measures such as return on investments or earnings per share. The elements that are directly related to the financial performance are income and expenses. Profit for the year is calculated by subtracting the expenses from the income of an entity. *[Profit = Income less expenses]*

(a) Income

Income is defined as increases in assets or decreases in liabilities that result in increases in equity, other than those relating to contributions from holders of equity claims. The entity earns income through its normal everyday business operations.

For instance in the case of the sale of goods, the inflow of assets will be the money banked in the bank account and the increase in profit is an increase in equity. Income consists of revenue and gains. Revenue arises from the ordinary business activities of the entity and examples are sales, fees, interest, dividends and rental income. Gains *may or may not* arise from ordinary business activities of the entity. An example of a gain that arises from the ordinary business activities is a profit on the sale of depreciable non-current assets such as machinery. Examples of gains that do not arise from ordinary business activities are profit on the sale of office buildings and profit on the sale of non-current assets.

Revenue and gains

Revenue and gains arising from ordinary business activities	Gains not arising from ordinary business activities
➢ sales, ➢ fees, ➢ interest received, ➢ dividends, ➢ rental income ➢ profit on the sale of depreciable non-current assets such as machinery	➢ profit on the sale of office buildings, and ➢ profit on the sale of non-current assets.

(b) Expenses

Expenses are defined as decreases in assets, or increases in liabilities, that result in decreases in equity, other than those relating to distributions to holders of equity claims. Expenses are costs incurred by the business in order to run the business for the financial accounting period.

Expenses consist of losses as well as those expenses that arise in the course of the ordinary activities of the entity. Examples of expenses are advertisements, purchases of trading stock, salaries and wages, stationery, depreciation and losses on the sale of non-current assets.

1.7 The double-entry principle

An account consists of a left-hand side and a right-hand side and is presented in a "T" format. The left-hand side is referred to as the debit side and the right-hand side is referred to as the credit side. The name of the "T-account" is written across the centre at the beginning of each account (i.e. Motor vehicles).

Dr (debit side)	**……. Account**	**(credit side) Cr**
Left-hand side (LHS)		**Right-hand side (RHS)**

The double-entry principle states that for every debit entry into an account, there must be a corresponding credit entry into another account. With each entry referring to its corresponding entry in the other account.

The double-entry principle is easily demonstrated using the following accounting equation:

Assets	**=**	**Equity**	**+**	**Liabilities**
A	**=**	**E**	**+**	**L**

The accounting equation should *always* balance.

Take note of the following important points:

- A minimum of 2 accounts must always be used.
- The equation must always remain in balance (i.e. each debit must have a corresponding credit)
- A transaction can occur on one side of the equation only, for example:
  - An entity purchases equipment for cash. You will credit the asset – bank (decrease cash) and debit the asset – equipment (increase equipment)
  - A debtor settles his account owed to the entity. You will credit the asset – debtors control by the amount paid (reduce debtor) and debit the asset – bank (increase cash).

The reality for a financial accounting student is that the double-entry rules are not a concept to understand – They are *rules to be learnt*.

When analysing a transaction, *always ask the following four questions*:

1. Which two accounts are involved in the transaction?
2. Do the accounts form part of assets, equity or liabilities?
3. Did the assets, equity or liabilities increase or decrease?
4. Which one of the accounts must be debited and which one must be credited?

1.8 What is a contra account

As a general rule, we use the opposite or *contra account* to describe the transaction. In this transaction, the *contra account* is *capital*. The source of this increase to the bank account is *capital* - the owner investing in the business. If we were to describe each transaction occurring within the T-account above as "bank," it would not adequately describe why our bank account increased or decreased. All transactions would just be listed as "bank."

Using the opposite or *contra account* gives us a much better description of the transaction.

1.9 Word search

1.9.1 Find the accounting terms

T	F	R	T	L	M	A	T	E	R	I	A	L	I	T	Y
C	D	E	P	R	E	C	I	A	T	I	O	N	Q	R	I
X	E	E	U	S	A	D	P	R	O	F	I	T	Z	J	M
G	B	R	B	H	C	N	G	E	P	U	N	U	Q	W	L
C	I	P	M	T	C	O	S	E	U	R	C	E	C	K	I
R	T	R	Q	A	O	G	H	A	R	N	O	F	A	C	A
W	M	O	E	M	U	R	Y	P	C	I	M	V	I	O	B
I	H	P	X	H	N	R	S	D	H	T	E	F	N	Z	I
D	Z	E	P	F	T	D	R	L	A	U	I	A	V	B	L
G	C	R	E	D	I	T	O	R	S	R	Q	O	E	A	I
M	Z	T	N	G	N	Z	R	T	E	E	W	C	N	N	T
O	K	Y	S	T	G	J	A	S	S	E	T	R	T	K	Y
K	J	F	E	V	F	V	F	U	H	T	U	E	O	F	H
N	Y	F	S	E	Q	U	I	T	Y	O	S	D	R	M	A
E	Q	U	I	P	M	E	N	T	J	A	D	I	Y	O	O
C	Q	V	D	O	U	B	L	E	-	E	N	T	R	Y	A

Accounting	Property	Creditors	Expenses
Debit	Equipment	Journal	Profit
Credit	Furniture	Ledger	Materiality
Transaction	Debtors	Depreciation	Purchases
Income	Inventory	Equity	Bank
Asset	VAT	Liability	Double-entry

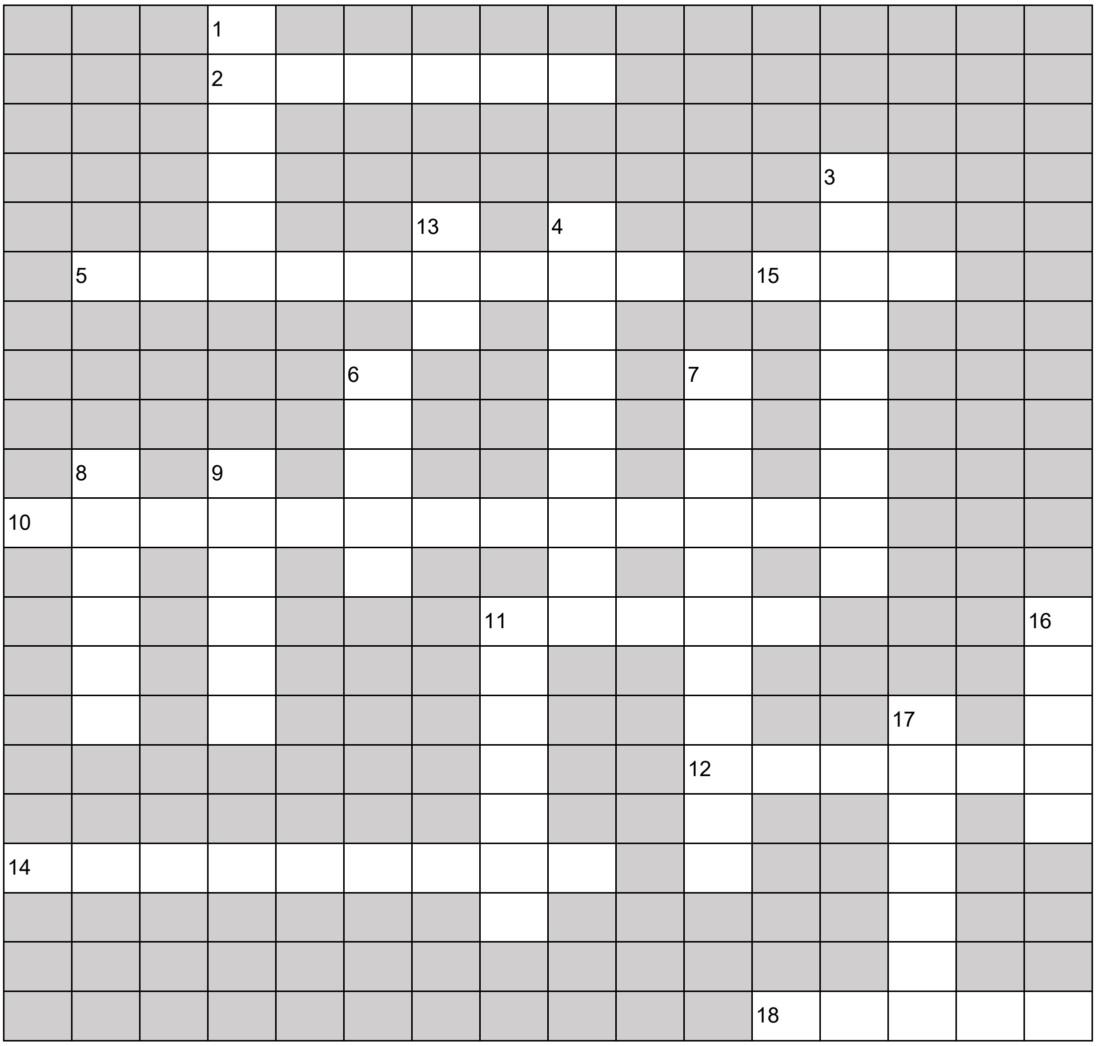
1.9.2 Solution

T	F	R	T	L	M	A	T	E	R	I	A	L	I	T	Y
C	D	E	P	R	E	C	I	A	T	I	O	N	Q	R	I
X	E	E	U	S	A	D	P	R	O	F	I	T	Z	J	M
G	B	R	B	H	C	N	G	E	P	U	N	U	Q	W	L
C	I	P	M	T	C	O	S	E	U	R	C	E	C	K	I
R	T	R	Q	A	O	G	H	A	R	N	O	F	A	C	A
W	M	O	E	M	U	R	Y	P	C	I	M	V	I	O	B
I	H	P	X	H	N	R	S	D	H	T	E	F	N	Z	I
D	Z	E	P	F	T	D	R	L	A	U	I	A	V	B	L
G	C	R	E	D	I	T	O	R	S	R	Q	O	E	A	I
M	Z	T	N	G	N	Z	R	T	E	E	W	C	N	N	T
O	K	Y	S	T	G	J	A	S	S	E	T	R	T	K	Y
K	J	F	E	V	F	V	F	U	H	T	U	E	O	F	H
N	Y	F	S	E	Q	U	I	T	Y	O	S	D	R	M	A
E	Q	U	I	P	M	E	N	T	J	A	D	I	Y	O	O
C	Q	V	D	O	U	B	L	E	-	E	N	T	R	Y	A

Notes

1.10 Accounting crossword puzzle

1.10.1 Crossword puzzle



1.10.2 Crossword clues

Across

2. The residual interest in the assets of the entity after deducting all its liabilities. (6)
5. Any items that are bought with the intention of selling the item to a customer. (9)
10. An instructed attorney acting on an instructing attorney's behalf. (13)
11. An accounting entry that either increases an asset or expense account or decreases a liability or equity account. (5)
12. A tax that governments impose on income generated by businesses and individuals. (6)
14. All transactions with credit suppliers will be recorded in the .... ledger. (9)
15. The acronym for Value Added Tax. (3)

Down

1. A complete collection of all the accounts and transactions of a company. (6)
3. A present obligation of the entity to transfer an economic resource as a result of past events. (8)
4. A qualitative characteristic of accounting information that makes a difference in decision-making. (9)
6. What money must be deposited in a separate banking account? (5)
7. A concept or convention within accounting relating to the importance/significance of an amount, transaction, or discrepancy. (11)
8. A set of rules or procedures, which are followed by an entity to prepare its financial statements. (6)

18. Any items sold to customers in the normal course of business.	**9.** An accounting entry that either increases a liability or equity account or decreases an asset or expense account. (6) **11.** All transactions with credit customers will be recorded in the .... ledger. (7) **13.** Acronym for "Basic Accounting Equation". (3) **16.** A present economic resource controlled by the entity because of past events. (5) **17.** A .... is a detailed record of all the transactions done by a business. (7)

Word Bank

Policy	Credit	Correspondent	Equity	Liability
Income	Debit	VAT	Debtors	Ledger
Purchases	Relevance	Creditors	Asset	Sales
Trust	Materiality	Journal		

Notes

1.10.3 Solution

			1 L												
			2 E	Q	U	I	T	Y							
			D												
			G									3 L			
			E			B		4 R				I			
	5 P	U	R	C	H	A	S	E	S		15 V	A	T		
						E		L				B			
					6 T			E		7 M		I			
					R			V		A		L			
	8 P		9 C		U			A		T		I			
10 C	O	R	R	E	S	P	O	N	D	E	N	T			
	L		E		T			C		R		Y			
	I		D				11 D	E	B	I	T				16 A
	C		I				E			A					S
	Y		T				B			L			17 J		S
							T			12 I	N	C	O	M	E
							O			T			U		T
14 C	R	E	D	I	T	O	R	S		Y			R		
							S						N		
													A		
											18 S	A	L	E	S

1.11 Flashcards

A flashcard is a card containing a small amount of information, i.e. a question or a statement, with the answer or description on the back. A flashcard can be used as an aid to learning by increasing your retention of information. (Print out the pages with the flashcards, cut out the shapes and stick the statement and answer back to back. Use the flashcards to test your knowledge.)

The following flashcards relate to accounting transactions:

(a) Identify how each of the following transactions affects the assets, liabilities or equity of the business.

1. The owner pays capital into the bank.	*Increase in Assets* *Increase in Equity*

2. Goods are purchased on credit terms.	*Increase in Assets* *Increase in Liabilities*
3. Goods are purchased for cash.	*Assets increase and decrease*
4. Equipment is sold for cash.	*Assets increase and decrease*
5. Accounts payable is settled in cash.	*Decrease in Assets (Bank)* *Decrease in Liabilities*
6. Accounts receivable is settled in cash.	*Assets increase (Bank) and decrease*
7. The owner takes cash for personal use.	*Decrease in Equity (Drawings)* *Decrease in Assets (Bank)*

8. The owner pays a liability of the business from personal funds.	***Decrease in Liabilities*** ***Increase in Equity (Loan to Owner)***

9. Equipment is purchased using cash.	***Assets increase and decrease (Bank)***

10. Employee wages are settled in cash.	***Decrease in Assets (Bank) and Decrease in Equity***

11. Purchased supplies on account.	***Increase in Assets and Increase in Liabilities***

12. Received cash for performing a service.	***Increase in Assets and Increase in Equity (Revenue)***

(b) What are the following general ledger accounts used for?

1. Accounts receivable Trade receivables Debtors	***Amounts due from customers or clients***

2. Accounts payable Trade payables Creditors	*Amounts owed to suppliers for goods and services purchased*

(c) Identify whether the following accounting entry is a debit or as credit

1. The owner of the business invests R100 000, is the accounting entry to the capital account a debit or a credit?	*Credit*

2. Rent is prepaid for an office for the business, is the accounting entry to the prepaid rent account a debit or a credit?	*Debit*

3. Office equipment is purchased on account from a supplier, is the double-entry to the equipment account a debit or a credit?	*Debit*

4. Stationery is purchased for cash, is the double-entry posting to the stationery on hand account a debit or a credit entry?	*Debit*

5. The business carried out work for a customer and was paid in cash, is the entry to the revenue account a debit or a credit?	*Credit*

6. Work was completed and invoiced to a customer for payment within 30 days. Is the posting to accounts receivable a debit or a credit?	***Debit***

7. Insurance for the next year was paid in advance in cash, is the double-entry bookkeeping entry to the cash account a debit or a credit?	***Credit***

8. Cash was paid to a supplier for goods supplied by them on credit terms, is the entry to accounts payable a debit or credit entry?	***Debit***

9. Cash was received on account from a customer for partially completed work, is the entry to the cash account a debit or a credit?	***Debit***

Notes

FINANCIAL ACCOUNTING PRINCIPLES FOR LAW PRACTITIONERS

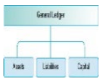
LEARNING UNIT

2 DOUBLE-ENTRY SYSTEM AND SOURCE DOCUMENTS

Contents

NB	*The key to success in accounting is practice, practice and more practice.*

The following concept cards are available for this learning unit:

CONCEPT CARDS 	○ *Effect of transactions on specific types of accounts* ○ *The accounting cycle (x2)* ○ *Overview of the recording of transactions*

Learning outcomes

After working through this learning unit, you should be able to:

- define cash transactions
- define source documents
- explain the difference between internal source documents and external business documents
- explain the applicable source documents involved in different cash transactions
- complete different business documents

Key concepts

- Double-entry system
- Accounting equation
- Assets
- Liabilities
- Owners' equity
- Recordkeeping
- Accounting cycle
- Cash transactions
- Source documents
- Internal source documents
- External source documents
- Purchase order
- Sales order
- Delivery note
- Goods received note
- Cash slips
- Cash register rolls
- cash invoices
- receipts
- delivery note
- Petty cash voucher
- credit card slip
- deposit slip
- internet banking: Notice of payment (EFT)

Acronyms

BAE	Basic accounting equation
LPA	Legal Practice Act 28 of 2014
LPC Rules	Legal Practice Council Rules

2. Introduction

The financial records of an entity only deal with transactions that are measured in monetary terms. The duality of the financial accounting system better known as the double-entry system is a method whereby the transactions are recorded systematically to show the giving and receiving of value.

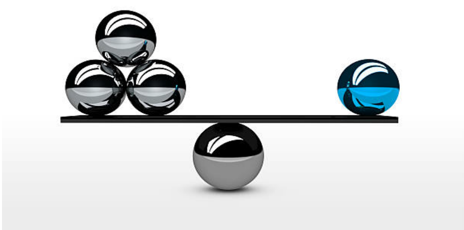
The accounting cycle details the formal accounting process. The steps discussed in this learning unit are as follows (indicated by yellow shading):

Transactions	The accounting process starts once a transaction has taken place.
Source documents	Source documents provide the evidence for a transaction having taken place
Books of prime entry	The source document is prepared and the information is entered into the books of prime entry
Ledger accounts	The entries from the books of prime entry are posted to the general ledger, creditors' ledger, and debtors' ledger.
Trial balance	The trial balance is drawn up from the accounts in the general ledger
Financial statements	The financial statements are drawn up from the trial balance

Please remember the following points at all times:

RECAP

- *Total debits in the transaction must equal the total credits in that transaction!*
- *For every debit, there must be a credit!*
- *Debits are on the left, credits are on the right!*
- *The equation must balance!*



2.1 The double-entry system

The double-entry system implies that there are two sides or aspects to every business transaction and this translates to –

LBL	*For every debit there must be a corresponding credit*	See Lessons Debit.Credit

See the following example:

- If you buy a pair of soccer boots for R250.
  – You receive the pair of boots (Side 1)
  – The store gives you the boots (Side 2)
- If you pay R250 to the shop assistant.
  – The shop assistant receives the cash (Side 1)
  – You give the cash to the shop assistant (Side 2)

LBL	*When an entity receives cash – the bank account is debited* *When an entity pays cash – the bank account is credited*	See Lessons Bank account

This means that every transaction of the entity will result in an amount being recorded in at least *TWO* accounts. *Luca Pacioli* introduced the rules of the *Double-Entry* System in 1494. The double-entry principle provides a logical method of recording transactions. In using the double-entry system the monetary (money value) of each transaction must be entered on the debit side of one ledger account as well as on the credit side of another ledger account. The entry in one ledger account refers to the corresponding entry in the other ledger account.

As the entries in the two ledger accounts have been entered on opposite sides, the use of the double-entry system allows for cross references. Each transaction is entered in two separate accounts on opposite sides, and it is therefore possible to check and control the arithmetical and accounting accuracy of the work. If each transaction is recorded so that the debit and credit entries are equal, the same sum of all the debits to the account must equal the sum of all the credits. This can be explained by way of the accounting equation.

The rules will be applied as follows:

– All *asset* and *expense* accounts must be increased on the left (debit) side of the account and decreased on the right (credit) side of the account.

Dr	**ASSETS & EXPENSES**	**Cr**

+ (increase)	- (decrease)

– All *liability* and *income* accounts must be increased on the right (credit) side of the account and decreased on the left (debit) side of the account.

Dr	LIABILITIES & INCOME	Cr
- (decrease)		+ (increase)

In short, a ledger is a book/record containing a set of individual accounts in which transactions of the same kind are grouped together.

An account looks like a T-form with the **left** side called the **debit** side and the **right** side called the **credit** side. An example follows:

Debit (abbreviated to **Dr**)	**Account name**	**Credit** (abbreviated to **Cr**)
The debit side of the account is the side that shows gains in value		The credit side of the account is the side that shows value given

In this learning unit, we will be discussing the general ledger**, which** contains all the assets, liabilities, owners' equity, income and expense accounts of the business.

As part of your preparation for this learning unit you must *know* the following categories of items in the general ledger and what they are –

LBLL PAUSE II	*What is an asset?*	*Assets are resources owned by the business, which have economic value and a business uses to generate income.*	See Lessons Assets
LBLL PAUSE II	*What is a liability?*	*Liabilities are creditors' interest or interests of parties other than the owner(s). Liabilities are therefore the debts of the business.*	See Lessons Liabilities
LBLL PAUSE II	*What is an expense?*	*An expense is a cost related to the day-to-day running of a business. An expense is a debit.*	See Lessons Expenses
LBLL PAUSE II	*What is income?*	*Income is the revenue a business receives from selling services and goods to clients or customers and returns on investments.*	See Lessons Income
LBLL PAUSE II	What is equity?	Equity is the interest which the owner has in the business and which the entity therefore owes to him.	See Lessons Equity

2.2 Summary of types of accounts and impact of transactions

The following table summarises the effect of the transactions on the specific types of accounts:

	Assets	= Liabilities	+ Owner's Equity	+ Income	- Costs and Expenses	- Drawings
Normal balance	Debit	Credit	Credit	Credit	Debit	Debit
Increase to account balance	Debit	Credit	Credit	Credit	Debit	Debit
	Left Column of Acc	**Right Column** of Acc	**Right Column** of Acc	**Right Column** of Acc	**Left Column** of Acc	**Left Column** of Acc
Decrease to account balance	Credit	Debit	Debit	Debit	Credit	Credit
	Right column of Acc	**Left Column** of Acc	**Left Column** of Acc	**Left Column** of Acc	**Right Column** of Acc	**Right Column** of Acc
Account example	**NON-CURRENT ASSETS** Land and buildings Equipment Furniture Vehicles Computer equipment Investments Law library **CURRENT ASSETS** Inventory Accounts receivable (Debtors/Clients) Bank account (Positive) Cash on hand	**NON-CURRENT LIABILITIES** Long-term loan Mortgage bond **CURRENT LIABILITIES** Short-term loan Bank overdraft (Negative) Accounts payable (Creditors) Trust creditors	**OWNER'S EQUITY** Capital	**INCOME** Commission received Fees Interest received Office rent received Sales Services rendered	**EXPENSES** Advertising Audit fees Credit losses Insurance Interest paid Fuel Office rent paid Rental paid Repairs and maintenance Salaries and wages Stationery Telephone Water and electricity	**DRAWINGS** Drawings

Acc = Account

2.3 Descriptions of individual accounts

Accounts form the basis of the accounting system. The following are descriptions of generally used accounts in the books of legal practitioners:

(a) ASSETS – Non-current assets

Property	The account for the recording of the transactions relating to land and buildings (property) purchased for the business.
Equipment or computer equipment	The account for the recording of the transactions relating to equipment or computer equipment purchased for the business.
Furniture	The account for the recording of the transactions relating to furniture purchased for the business.
Motor vehicles	The account for the recording of the transactions relating to motor vehicles purchased for the business.
Law library	An account for the recording of the transactions relating to the accumulation of legal books.
Investment (longer than 12 months)	Long-term investments are assets that a business intends to hold for more than a year. It is not the intention of the business to realise the investment within the next 12 months from the financial year-end.

(b) ASSETS – Current assets

Accounts receivable	Accounts receivable are amounts due to the business from customers/clients that have received goods or services on credit. The amounts arise from providing services or products to clients and they have not yet paid the business.
Accrued income	Accrued income is income that has not been received in the accounting period when the underlying obligation was fulfilled. Since the obligation was fulfilled, the business is entitled to the corresponding income and therefore the income is recognised and a liability is created for the amount owing. (See Learning unit 5)
Bank account	A bank account is a financial account held between a bank i.e. ABSA and the customer i.e. SA Attorneys. This account records the cash transactions (cash inflows and outflows) between the bank and the customer. If the bank owes money to the business, it is referred to as a favourable balance. If the business owes the bank money, it is referred to as an unfavourable balance.
Deposit	This account is used to record deposits e.g. a deposit paid to the municipality for the connection of water and electricity.

Inventory	The account for the recording of the transactions relating to inventory purchased by the business for resale or for the manufacturing of a product.
Investments (short-term)	Short-term investments are assets that a business does not intend to hold for more than a year. The intention is to realise the investment within a period of less than 12 months from the financial year-end.
Petty cash	The petty cash account is the account used for the recording of small cash payments that are impractical to pay by EFTs.
Prepaid expenses	A prepaid expense is an expenditure paid for in one accounting period, but for which the underlying asset will not be consumed until a future period. When the asset is eventually consumed, it is charged to expense. (See Learning unit 4)
Trust clients account	The trust clients account are the accounts for recording the money owed by the clients to an attorney's practice (i.e. debtors of the attorney's practice). The trust clients accounts arise from credit transactions.
VAT control account	The account for the recording of the transactions relating to VAT. VAT is payable to SARS. Both output VAT (Credit side) and input VAT (Debit side) are recorded in the VAT control account. This account may be an asset from time to time as the business can be entitled to a refund from SARS.

(c) LIABILITIES – Non-current liabilities

Long-term loans	A loan is an amount of money that has been loaned from a bank or financing institution and has to be repaid to the lender. The term long-term refers to loans that are repaid in specific instalments over a longer period of time (i.e. a term of 5 – 10 years). Long-term loans may have a fixed interest rate, or a floating interest rate (based upon the reserve bank prime rate).
Mortgage loan	A mortgage loan is a long-term loan for the financing of the purchase of a property or building. The property or building serves as security for the mortgage loan.

(d) LIABILITIES – Current liabilities

Accounts payable (business)	Accounts payable is money owed by a business to its suppliers. The amounts arise from people who have supplied the business with goods and services, but the supplier has yet to be paid.

Accrued expenses	An accrued expense is an expenditure for which the underlying asset was consumed but was not yet paid. The business therefore incurred the expense and should recognise the expense together with the liability to pay the expense. The liability is called an accrued expense. (See Learning unit 4)
Bank overdraft (Negative)	A bank account where the business owes the bank money. It is referred to as an unfavourable balance.
Income received in advance	Income received in advance is income received in one accounting period, but for which the underlying obligation will only be fulfilled in the next accounting period. When the obligation is eventually fulfilled, it is recognised as income. (See Learning unit 4)
Short-term loan	A loan is an amount of money that has been loaned from a bank or financing institution and has to be repaid to the lender. Loans are repaid in instalments and interest is charged on the outstanding amount. Short-term loans refers to loans that are generally repaid within a few months or a year.
Trust creditors	The money that is in a trust account at any point in time belongs to the clients of the legal practice and the clients are referred to as trust creditors of the legal practice.
VAT control account	The account for the recording of the transactions relating to VAT. VAT is payable to SARS. Both output VAT (Credit side) and input VAT (Debit side) are recorded in the VAT control account.

2.4 The basic accounting equation

The financial position of an entity is indicated by this equation. By using the equation, any unknown elements of the statement of financial position can be calculated. In the accounting records, all the figures must "balance". This is what makes the recording process so effective. All transactions must balance in the form of an equation. This equation is termed the *basic accounting equation (BAE).*

2.4.1 Right-hand side and left-hand-side of BAE

When preparing an equation, the right-hand side will always equal the left-hand side. The assets are on the left-hand side and the equity and liabilities are on the right-hand side. The transactions can affect the BAE in four different ways.

- An increase on the left-hand side and an equal increase on the right-hand side –

Left-hand side	=	Right-hand side
Assets		Equity + Liabilities
+100 000		+100 000

- A decrease on the left-hand side and an equal decrease on the right-hand side –

Left-hand side	=	Right-hand side
Assets		Equity + Liabilities
−100 000		−100 000

- An increase and an equal decrease on the left-hand side –

Left-hand side	=	Right-hand side
Assets		Equity + Liabilities
+100 000 −100 000		

- An increase and an equal decrease on the right-hand side

Left-hand side	=	Right-hand side
Assets		Equity + Liabilities
		+100 000 −100 000

2.4.2 How to apply the basic accounting equation

The equation is as follows:

OWNERS' EQUITY = ASSETS – LIABILITIES;

OR

ASSETS = OWNERS' EQUITY + LIABILITIES

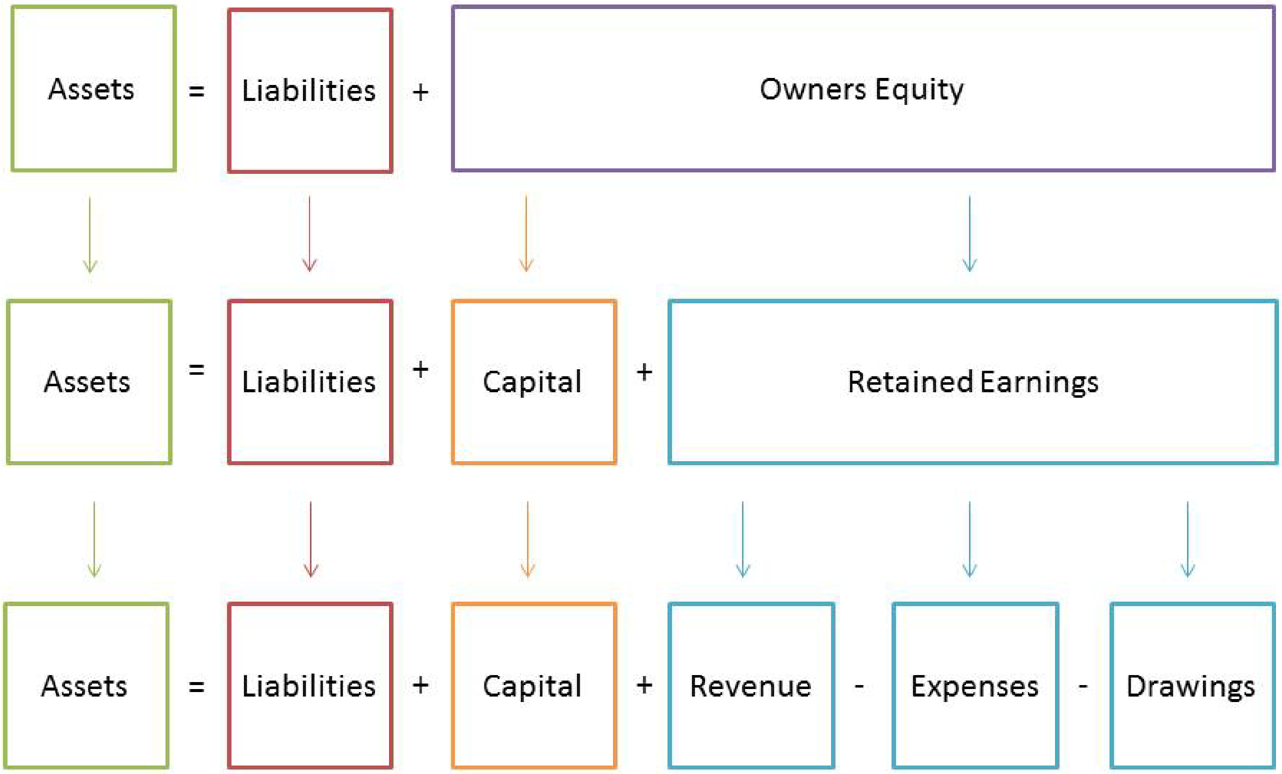
RECAP

Memorising the simple accounting equation will help you learn the debit and credit rules for entering amounts into the accounting records.

As you can see, assets equal the sum of liabilities and owner's equity. This makes sense when you think about it because liabilities and equity are essentially just sources of funding for companies to purchase assets. The expanded accounting equation is as follows:

ASSETS = LIABILITIES + CAPITAL + REVENUE – EXPENSES – DRAWINGS

The following is the expanded accounting equation in the format of a diagram:



LBL PAUSE	*The owner's drawings represent cash taken out of the business by way of a salary or goods taken for own use.*	See Lessons Drawings

2.4.3 4-STEPS to determine the result of a transaction

All transactions measurable in monetary value will have an effect on the financial results of the entity. With the recording of every transaction, there will be a change in the financial position of the entity and since the basic accounting equation (BAE) reflects the financial position of the entity, each recorded transaction will affect the BAE.

Notes

The following table represents a logical method of recognising a transaction.

STEPS		
	Step 1	*Identify the accounts affected by the transaction.* *What is the account? (i.e. Equipment)*
		⬇
	Step 2	*Will the transaction cause an increase or decrease in the account?* *(i.e. Account is increasing as equipment was purchased)*
		⬇
	Step 3	*Classify the account.* *What is the type of account? (i.e. Asset, Expense etc.)*
		⬇
	Step 4	*Step 2 PLUS Step 3 equals effect on Step 1*

EXAMPLE 2.1

S Africa deposited R100 000, as capital into the business bank account of SA Attorneys. Recognise the transaction in the accounting records of the business using the 4-step method.

EXPLANATION 2.1

Transaction	**Deposit of R100 000**	**Deposit of R100 000**
Step 1	Bank	Capital
Step 2	The transaction will increase the "bank account"	The transaction will increase the "capital account"
Step 3	Asset	Equity
Step 4	Debit the asset, Bank, to increase it.	Credit the equity, Capital, to increase it.

Prepare the BAE incorporating the information from the above table:

Assets	**=**	**Equity**	**+**	**Liabilities**	**LBLL**
+100 000		+100 000		—	
bank account dr		capital account cr		—	

Notes

The BAE is an accounting equation that must balance after each transaction. S Africa deposited R100 000, as capital into the business bank account of SA Attorneys. To increase the bank account (an asset) debit the account. The opposite entry is a credit to the Capital account. The equity account is credited to increase the owner's equity in the business.

See Lessons Explanation 2.1

EXAMPLE 2.2

SA Attorneys purchased computer equipment and paid R85 000 for the equipment. Recognise the transaction in the accounting records of SA Attorneys using the 4-step method.

EXPLANATION 2.2

Transaction	Payment of R85 000	Payment of R85 000
Step 1	Computer equipment	Bank
Step 2	The transaction will <u>increase</u> the “computer equipment account”	The transaction will <u>decrease</u> the “bank account”
Step 3	Asset	Asset
Step 4	Debit the asset, computer equipment, to increase it.	Credit the asset, Bank to increase it.

Prepare the BAE incorporating the information from the above table:

Assets	=	Equity	+	Liabilities	LBLL
+85 000 Computer equipment dr		—		—	
-85 000 Bank account cr		—		—	See Lessons Explanation 2.2

Notes

The BAE is an equation that must balance after each transaction. SA Attorneys purchased computer equipment and paid R85 000 for the equipment. To increase the computer equipment account (an asset), debit the account. The opposite entry is a credit to the Bank account. The Bank account is an asset and an asset account is decreased by crediting the account.

Notes

2.4.4 Examples illustrating the application of the double-entry system

The following examples illustrate the double-entry system:

EXAMPLE 2.3

Assume a business buys equipment for R2 000 by EFT. How would the bookkeeper record this transaction?

EXPLANATION 2.3

In this case the business has paid money to purchase equipment. The double entry will be made as follows:

Dr	**Bank account**	**Cr**
		- R2 000

Dr	**Equipment**	**Cr**
+ R2 000		

STEPS

- *The bookkeeper must show that cash of R2 000 has left the business.*
- *Since cash is an asset, the principles pertaining to assets will be used.*
- *The cash balances have decreased, and assets decrease on the* ***credit*** *side.*
  ∴ the bank account is ***credited****.*
- *In return for the cash payment, the business has received equipment.*
- *Equipment is an asset and therefore assets have increased.*
- *Assets increase on the debit side of the account ∴ the equipment account is* ***debited****.*

The rules of double-entry state that all debits should equal all credits. In this case, we have debited the equipment account and credited the bank account. The double-entry rule has been applied successfully.

EXAMPLE 2.4

Assume a business receives a loan of R10 000 from the bank. How would the bookkeeper record this transaction?

EXPLANATION 2.4

In this case, the business has received a loan from the bank. The double entry will be made as follows:

Dr	Bank account	Cr
+ R10 000		

Dr	Bank loan	Cr
		+ R10 000

STEPS	
	– *The bookkeeper must show that cash of R10 000 has flowed into the business.* – *Since cash is an asset, the principles pertaining to assets will be used.* – *The cash balances have increased and assets increase on the **debit** side. ∴ the bank account is **debited**.* – *At the same time, the business has incurred a debt (a liability).* – *The bank loan is a liability, and the rule that applies to liabilities states that liabilities increase on the **credit side**.* – *Loan debts increase on the credit side of the account ∴ the bank loan account is **credited**.*

The rules of double entry state that all debits should equal all credits. In this case, we have debited the bank account and credited the loan account. The double entry rule has been applied successfully.

EXAMPLE 2.5

Assume a business pays the telephone account of R550. How would the bookkeeper record this transaction?

EXPLANATION 2.5

In this case, the business has paid money. The double-entry will be made as follows:

Dr	Bank account	Cr
		- R550

Dr	Telephone expenses	Cr
+ R550		

STEPS

- *The bookkeeper must show that cash of R550 has flowed out of the business. The business has spent money on an item that cannot be changed back into cash.*
- *Since cash is an asset, the principles pertaining to assets will be used.*
- *Cash has decreased (credit bank) and an expense has been incurred (telephone expense).*
- *Expenses have increased and the telephone account should be debited. Remember: expenses increase on the **debit** side.*

Once again, an account has been debited and another account credited. The rules of double entry state that all debits should equal all credits. In this case, the expense account (telephone) has been debited and the bank account credited. The double entry rule has been applied successfully.

EXAMPLE 2.6

Assume a business receives R3 500 cash for services rendered. How would the bookkeeper record this transaction?

EXPLANATION 2.6

In this case, the business has received money. The double-entry will be made as follows:

Dr	**Bank account**	**Cr**
+ R3 500		

Dr	**Services rendered**	**Cr**
		+ R3 500

STEPS

- *The bookkeeper must show that cash of R3 500 has flowed into the business.*
- *Since cash is an asset, the principles pertaining to assets will be used.*
- *The balance of the bank account will therefore increase and assets increase on the **debit** side.*
  *∴ the bank account is **debited**.*
- *The money was received for services rendered.*
- *This means that the **services rendered account** will be credited.*
- *This is an income account, and all income accounts increase on the credit side.*

Once again, we have debited one account and credited another. The rules of double-entry state that all debits should equal all credits. In this case, the expense account (telephone) has been debited and the bank account credited. The double entry rule has been applied successfully.

EXAMPLE 2.7

SA Products opened its doors on 1 April 2020. The entity uses the periodic inventory system and is not registered as a VAT vendor (inventory systems will be discussed in more detail in learning unit 3). The following transactions took place during the first month of business:

Date	Transactions
2	The owner, Mr South made a capital contribution to the business, being R5 000 cash and equipment with a fair market value of R2 000.
5	Purchased trading inventory per cheque, R1 000.
9	Sold inventory for cash, R2 500.
12	Purchase trading inventory on credit, R600.
19	Paid monthly insurance of R1 000.
23	Sold inventory on credit, R7 000.
27	Purchased equipment per electronic funds transfer (EFT), R3 000.
29	Paid wages per cash, R800.
30	Paid the water and electricity account, R1 100.

REQUIRED:

Indicate the effect of the transactions under the accounting equation.

EXPLANATION 2.7

DAY	ASSETS R		=	OWNERS' EQUITY R		+	LIABILITIES R	
2	+ 2 000 + 5 000	Equipment Bank		+ 2 000 + 5 000	Capital Capital		0	
5	- 1 000	Bank		- 1 000	Purchases #		0	
9	+ 2 500	Bank		+ 2 500	Sales *		0	
12	0			- 600	Purchases #		+ 600	Accounts payable
19	- 1 000	Bank		- 1 000	Insurance #		0	
23	+ 7 000	Accounts receivable		+ 7 000	Sales *		0	
27	- 3 000 + 3 000	Bank Equipment		0			0	
29	- 800	Bank		- 800	Wages #		0	
30	- 1 100	Bank		- 1 100	Water and electricity #		0	

Expenses * Income ^ Periodic inventory system see Learning unit 3.2.2

EXAMPLE 2.8

SA Traders entered into the following transactions during July 2020. The entity uses the periodic inventory system and is **not** registered as a VAT vendor.

Date	Transactions
1	Sold inventory on credit to A South – R1 300.
3	Bought stationery for cash – R1 000.
4	Purchased office furniture and paid by business credit card from Africa Bank – R20 000.
6	B Africa owed SA Traders R1 780 and paid R1 700 in full settlement of his account.
8	Credit card sales of R15 000.
11	A delivery vehicle was purchased on credit from Natal Motors for R75 000. A deposit of R35 000 was paid immediately and the outstanding balance is still due to Natal Motors.
13	Paid printing costs by electronic funds transfer (EFT) – R1 200.
15	Paid the insurance account by EFT – R1 345.
22	Received an invoice from SA Traders for the purchase of packing material – R1 450.
25	Paid R6 350 by EFT for a computer purchased for the owner's son.
26	Paid the business telephone account – R1 005.

REQUIRED:

Indicate the effect of the transactions under the accounting equation.

EXPLANATION 2.8

DAY	ASSETS R		=	OWNERS' EQUITY R		+	LIABILITIES R	
1	+ 1 300	Accounts receivable		+ 1 300	Sales *		0	
3	- 1 000	Bank		- 1 000	Stationery #		0	
4	+ 20 000	Office furniture					+ 20 000	Accounts payable
6	+ 1 700 - 1 780	Bank Accounts receivable		- 80	Discount allowed #			
8	+ 15 000	Accounts receivable		+ 15 000	Sales *			
11	- 35 000 + 75 000	Bank Motor vehicle					+ 40 000	Loan liability
13	- 1 200	Bank		- 1 200	Printing #		0	
15	- 1 345	Bank		- 1 345	Insurance #		0	

DAY	ASSETS R		=	OWNERS' EQUITY R		+	LIABILITIES R	
22				- 1 450	Packing materials #		+ 1 450	Accounts payable
25	- 6 350	Bank		- 6 350	Drawings		0	
26	- 1 005	Bank		- 1 005	Telephone #		0	

Expenses

* Income

EXAMPLE 2.9

List each of the following ledger accounts under one of the categories in the table below. "Furniture" is inserted as an example.

ASSETS		EQUITY			LIABILITIES	
Non-current assets	**Current assets**	**Capital**	**Income**	**Expenditure**	**Non-current liabilities**	**Current liabilities**
Furniture						

Ledger accounts to be classified:

(a) land and buildings
(b) mortgage
(c) petty cash
(d) postage
(e) interest income
(f) vehicles
(g) salaries
(h) debtors (Accounts receivable)
(i) creditors (Accounts payable)
(j) bank overdraft
(k) fees earned
(l) electricity deposit
(m) subscriptions

EXPLANATION 2.9

ASSETS		EQUITY			LIABILITIES	
Non-current assets	**Current assets**	**Capital**	**Income**	**Expenditure**	**Non-current liabilities**	**Current liabilities**
(a) land and buildings (f) vehicles	(c) petty cash (h) debtors (l) electricity deposit *		(e) interest income (k) fees earned	(d) postage (g) salaries (m) subscriptions	(b) mortgage	(i) creditors (j) bank overdraft

* Electricity deposit is an amount paid by the entity to serve as security for the payment of the electricity account. The amount will be paid back to the entity if they sell the land and buildings and will no longer make use of the electricity; therefore, it is not an expense but a current asset.

EXAMPLE 2.10

A South Poll is a partner in SA Attorneys. SA Attorneys commenced operations on 1 May 2020. The following transactions took place during the first month:

May 1	Cash deposited in the bank as opening capital, R25 000.
2	A South made his private computer equipment available to the business, R9 000.
3	Additional equipment purchased and paid for by EFT, R12 000.
4	Fees were charged for work done on account for North Suppliers, R4 200.
6	Vehicle purchased on credit from Zulu Limited, R22 400.
10	SA Attorneys received R2 000 in cash for fees earned from West Finance.
17	North Suppliers paid R2 200 on their account.
28	Wages paid, R4 000.
30	Paid R9 000 to Zulu Limited in part settlement of the business's account.

REQUIRED:

Use the accounting equation in the format below to analyse the above-mentioned transactions.

Date	Assets =	Equity +	Liabilities	Effect on accounts

NB: (1) Show the effect of each transaction on the accounting equation with a plus sign (+) for an increase and a minus sign (–) for a decrease.

EXPLANATION 2.10

Date	Assets =	Equity +	Liabilities	Effect on accounts
01/05	+ 25 000	+ 25 000		Cash received will increase the bank, therefore assets increased. The cash was received
02/05	+ 9 000	+ 9 000		Equipment received from partner. Assets, equipment increases and capital, equity increases.
03/05	+ 12 000 - 12 000			Cash used to purchase equipment. Assets, equipment increased and an asset, bank decreased.
04/05	+ 4 200	+ 4 200		Services rendered on account. Assets, debtors increased and income (fees) therefore equity increased.
06/05	+ 22 400		+ 22 400	Vehicle purchased on credit. Assets, vehicles increased and liabilities, long-term loan increased.
10/05	+ 2 000	+ 2 000		Cash received will increase the bank, therefore assets increased. The cash was for installation fees, an income, therefore equity increased.
17/05	+ 2 200 - 2 200			Payment received from debtor. Assets, bank increased and an asset, debtors decreased
28/05	- 4 000	- 4 000		Paid wages. Cash paid will decrease bank, therefore assets decrease. Wages (expenses) increases, therefore equity decreases.
30/05	- 9 000		- 9 000	Cash used to pay creditor. Assets, bank decreased and liability, creditor decreased.
	49 600	36 200	13 400	

Assets (R49 600) = Equity (R36 200) + Liabilities (R13 400)

2.5 Recordkeeping

Rule 54.6 of the Legal Practice Council Rules (LPC Rules) requires that all legal practitioners that conduct a trust account practice MUST comply with PART XII of the Rules and keep accounting records. The accounting records will contain the day to day transactions of all monies received, held or paid by a legal practitioner on his own account (his business) or for, or on behalf of any person (the trust).

An accountant, employed by a legal practice, should be aware that there are different stages in the process of recordkeeping. There needs to be a set of detailed records in which all the necessary information pertaining to every **transaction** should be recorded. These detailed records are known as the subsidiary journals. There is also a need for a set of accounts with **summarised** balances which is known as ledgers. At the end of a financial period, statements of performance and position need to be compiled.

LBL PAUSE	*The financial statements are a set of accounts (summarised) showing the financial results of the legal practice.*	See Lessons Financial statements

2.5.1 What is the accounting cycle?

The accounting cycle *(See summary on p23)* is a set of steps that are repeated in the same order every period. The starting point of the cycle is the recording of the business transactions and leading up to the preparation of financial statements. The key steps in the accounting cycle include recording journal entries, posting to the general ledger, preparing the trial balances, making adjusting entries, and creating financial statements. An accountant should be aware at all times, at which stage of the accounting cycle the recording process is. The sole purpose of recording transactions and keeping track of expenses and revenues is to convert the data into meaning financial information by presenting it in the form of financial statements. Financial statements are composed of the following components:

- statement of financial position (balance sheet)
- statement of profit or loss and other comprehensive income (income statement)
- statement of owner’s equity, and
- statement of cash flows.

Notes

The accounting cycle is summarised as follows:

The accounting cycle

CASH	*Step 1: Transaction*	CREDIT

OR

Step 2: Source document (duplicate or original)

Receipts	**Payments**	
Deposit slip Receipt Till slip	EFT (Electronic funds transfer - internet banking) Petty cash voucher	Invoice Credit note
Bank statement		

Step 3: Subsidiary journals (books of first entry)

CRJ **CPJ** **PCJ**		**SJ** **SRJ** **PJ** **PRJ**

Post all journals to the general ledger and subsidiary ledgers

Step 4: General ledger **and** **Subsidiary ledgers**

Apply accounting equation rules	
Dr	**Cr**
Post to trial balance	Use to create financial statements

Apply accounting equation rules			
Details	**Debit**	**Credit**	**Balance**
Do not post to trial balance. Use balances to create debtors and creditor statements			

Step 5: Trial balance

Debits = Credits

Step 6: Financial statements

Statement of profit or loss and other comprehensive income	**Statement of changes in equity**	**Statement of financial position**
Income – expenses	Capital – drawings + profit – loss	Assets = equity + liabilities

2.5.2 Completion of source documents

Source documents are the forms prepared by a business that document all the financial transactions of the business i.e. buying goods or providing a service. The business forms include purchase orders, receipts, invoices etc. For every transaction, a source document needs to be completed e.g. when the firm receives cash, a receipt is issued and when services are rendered on credit (customer pays later), an invoice or debit note is issued. There are two types of source documents, namely:

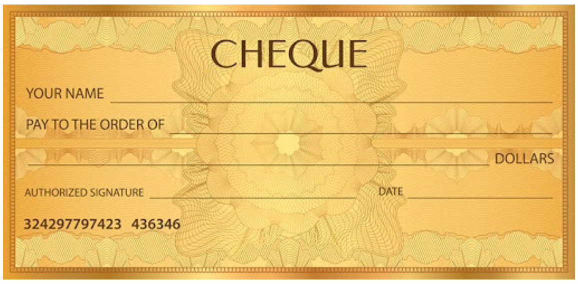
(a) Internal source documents

Internal source documents are those documents prepared by the entity itself to record transactions with external clients. Source documents are usually drawn up in duplicate. The original will be given to the other party to the transaction and the **duplicate will remain with the entity** to enable the entity to record the transaction in their accounting records.

Examples of internal source documents are:
- cash register rolls
- duplicate cash sales invoices
- duplicate receipts
- petty cash vouchers
- duplicate bank deposit slips

An internal source document, cheques, has been excluded from the list above. Cheque counterfoils (cheque stubs in the cheque book) used to be an internal source document but this format of payment will no longer be available as cheques are being phased out by the banks from 31 December 2020. A cheque is a signed, written instruction given by the payer to their bank to pay money from their account to the payee.

The following is an example of a cheque:



The current formats of payments that will be discussed for this module are:

Electronic payments	► internet banking
	► credit card payments,
	► cash send transactions, and
	► Snapscan or Zapper payments (Uses QR codes)
Other payments	► cash payments and
	► debit cards

QUICK NOTE	*A QR code is a machine-readable code consisting of an array of black and white squares, typically used for storing URLs or other information for reading by the camera on a smartphone.*

The source document for an internet payment is an electronic funds transfer (EFT) notice of payment and for a credit card payment a signed credit card slip. A credit card is a payment card issued to a user (cardholder) to enable the user to pay a supplier for goods and services. The card is issued to the user based on the agreement to pay back to the card issuer (i.e. the bank) the amount paid plus other agreed charges (service fee and interest).

A debit card is a payment card (issued by a bank for the making payments from the bank account of the cardholder), which allows the cardholder to transfer money electronically from their bank account to the bank account of the supplier when making a purchase. A debit card eliminates the need to carry cash to make purchases. The source document for a debit card payment is a signed debit card slip.

The cash send transactions are a popular method of drawing money for the petty cash imprest system. The source document for a cash send transaction is the document printed by the ATM (Automatic Teller Machine).

Snapscan is a smartphone application, and it is a contactless mobile payment solution, which makes it easy and safe to pay and receive payments in a store, online, and at home. There is no need for a card, cash, or an EFT. Snapscan makes use of QR codes for processing the payments. Zapper works on the same basis as Snapscan.

(b) External source documents (also referred to as supporting documents)

External source documents are the documents prepared by the other party to the transaction and received by the business as proof that the transaction did take place. The business will receive the original source document and the entry into the accounting records is recorded from this original source document received. Examples of external source documents are:

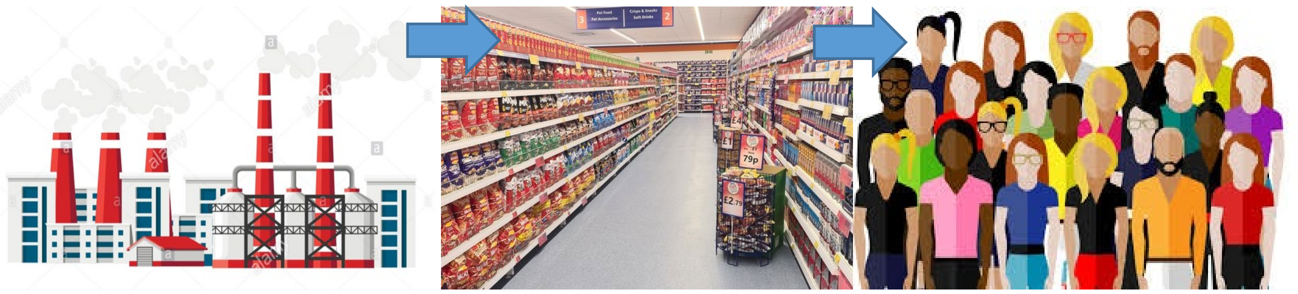
- original cash purchases invoices
- original receipts
- credit card slips
- debit card slips
- cash slips

If a customer or debtor of the business makes a payment by credit card, the credit card receipt will only be settled overnight and therefore will not reflect in the bank statement until the following day.

2.5.3 Recording of source documents

Example 2.11 illustrates the situation when SA Business is the seller (i.e. retailer). Example 2.12 illustrates the situation when SA Business is the buyer (i.e. customer) of goods.

The diagram below shows the flow of goods between manufacturers, retailers and customers:



Manufacturer **Retailer** **Customer**

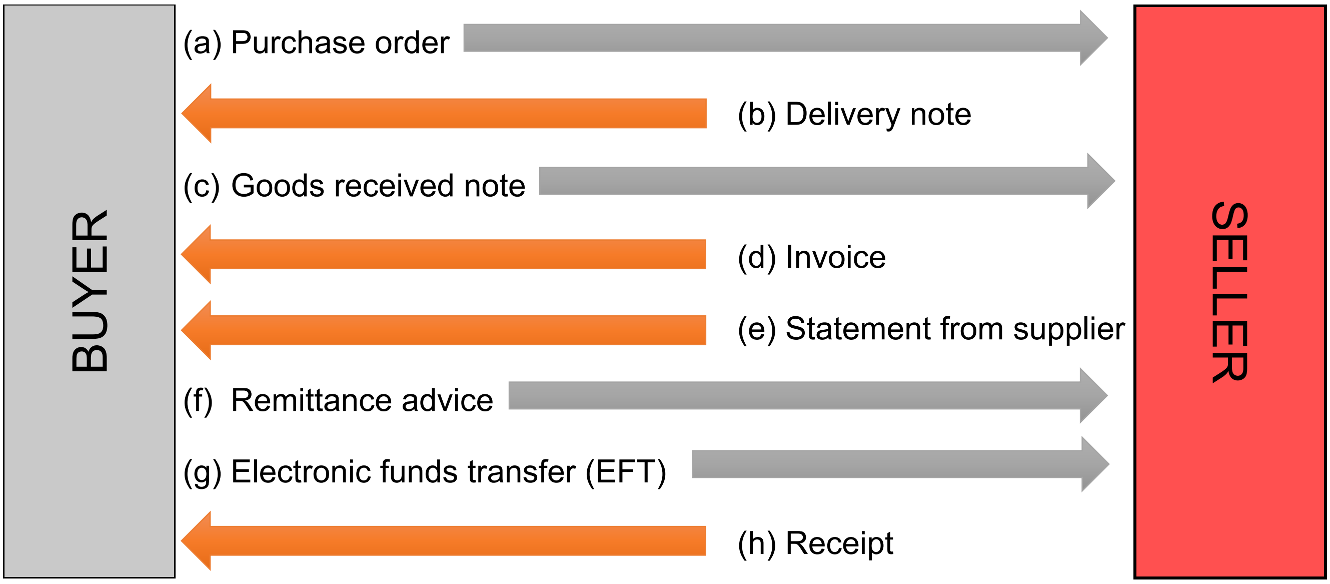
Consider the following transactions entered into by a business called SA Business. The transactions are discussed as follows:

- Example of the source document that generates the transaction;
- The effect of the transaction on the accounting equation;
- The general ledger accounts affected by the transaction; and
- An explanation of the aforementioned.

		SA Business (Seller) to Customer	**SA Business (Buyer) from Supplier**
		EXPLANATION 2.11	**EXPLANATION 2.12**
(a)	Purchase order	✓Received from customer	✓Sent to supplier
(b)	Delivery note	✓Sent to customer with delivery of goods	✓Received from supplier with delivery of goods
(c)	Goods received note	✓Made out by customer	✓Made out by SA Business
(d)	Invoice	✓Sent to customer	✓Received from supplier
(e)	Statement of account	✓Sent to customer	✓Received from supplier
(f)	Remittance advice	✓Received from customer	✓Sent to supplier
(g)	Electronic funds transfer	✓EFT payment made to customer	✓EFT payment made to supplier
(h)	Receipt	✓Sent to customer	✓Receipt received from supplier

EXAMPLE 2.11

The discussion is based on the following diagram, which illustrates the movement of the accounting source documents (these source documents form part of the syllabus):



The following information was included in the purchase order and will be used as part of the illustration:

Item code	***Description***	**Quantity**	**Price per unit R**	**Total price R**
IBM1334	*Toolbox*	2	2 600	5 200
IBM2043	*Electrician tool kit*	1	4 000	4 000
IBM6033	*Screwdriver sets*	4	200	800
				10 000
	Ignore VAT	VAT @ 15%		0
		Total price		10 000

EXPLANATION 2.11

(a) Purchase order

SA Business (seller/retailer) received a purchase order (a) from their customer, S Africa (buyer) and the requested goods were pulled from inventory. SA Business is the seller of the goods.

(i) What is a purchase order?

QUICK NOTE	*Purchase order (a) — A buyer-generated source document used to place an order with a vendor or supplier. When accepted by the seller, it becomes a legally binding contract between the buyer and the seller. Purchase orders are used when a buyer wants to purchase supplies or inventory on account.*

(ii) Example of a purchase order (source document):


Company Name

Company Phone: 555-555-555555
Website: www.aftemplates.com
Email: abc@example.com
Company Address Goes Here
City State Zip Code

Purchase Order

Dated As: ____________

Purchase Order #: ____________

About Vendor:

Vendor Name: ____________
Company Name: ____________
Address: ____________
City, State, Zip Code Phone: ____________

Ship To:

Name: ____________
Company Name: ____________
Address: ____________
City, State, Zip Code Phone: ____________

Details	Quantity	Unit Price	Total
		SUBTOTAL	
		TAX	
		TOTAL	000000.00

Additional Notes:

[Signatures of Authorized Person]
[Write Designation Here]

(iii) The effect of the transaction reflected in the source document:

Assets	=	Equity	+	Liabilities
—		—		—
—		—		—

Notes
A transaction has yet to take place. Once the delivery note has been signed by the customer the invoice can be generated.

(b) Delivery note

A delivery note was processed, and the goods left the premises for delivery to S Africa.

(i) What is a delivery note?

QUICK NOTE	*Delivery note (b) — A document that accompanies a shipment of goods that lists the description and quantity of the goods delivered. A copy of the delivery note, signed by the buyer is returned to the seller as a proof of delivery.*

(ii) Example of a delivery note (source document):

Delivery Note

Delivery To

Mr. Chan
Evinco Solutions Limited
Unit 2202, Causeway Bay Plaza 1
489 Hennessy Road, Causeway Bay, HK

Date	**2009-10-07**	Invoice No.	**INV10000XA**
Delivery Date	**2009-10-13**	Delivery Term	**COURIER**
Notes	--		

ID	Description	Unit	Qty
00003	**RoboMail Mass Mail Software**	**PCS**	**1**
00004	**ChequeSystem Cheque Printing Software**	**PCS**	**1**

Received in good condition

For And On Behalf Of

Authorized Signature(s)

(iii) The effect of the transaction reflected in the source document:

Assets	=	Equity	+	Liabilities
—		—		—
—		—		—

Notes
A transaction has yet to take place. Once the delivery note has been signed by the customer the invoice can be generated.

(c) Goods received note

In this instance, it is the accounting system *of the customer*, which will generate the goods received note. This source document does not affect the accounting records of SA Business.

(i) What is a goods received note?

QUICK NOTE	*Goods received note – A document prepared by the buyer at the point of receipt, recording the receipt of goods. The goods received note (GRN) and the purchase order are compared before the buyer makes payment.*

(ii) Example of a goods received note (source document):

Goods Received Note

GRN No:
PO No:

Supplier Name Delivered by:

Date Signature

No	Goods	Order Qty	Deleverd Qty	Note

Received By Checked By

(iii) The effect of the transaction reflected in the source document:

Assets	=	Equity	+	Liabilities
—		—		—
—		—		—

Notes
A transaction has yet to take place. The goods received note is issued by the customer but does not affect the accounting records of SA Business.

(d) Invoice

The goods are delivered and SA Business issues an invoice to S Africa. The invoice specifies what the customer/buyer (S Africa) must pay the seller (SA Business).

(i) What is an invoice?

QUICK NOTE	*Invoice – A document issued by a seller to the buyer that indicates the quantities and costs of the products or services provider by the seller*

(ii) Example of an invoice (source document):

Acoustics 25 Trade Centre Centurion, Gauteng, 0157 012 667 6465 Acoust@gmail.com VAT Reg. No. 12345678		**Tax Invoice**	
Bill To: Client Name Client Address City, State Postal code] VAT Reg. No.		**Invoice Number** **Date** **Terms** Due Date	2001321
Description	**Quantity**	**Unit price**	**Amount R**
IBM1334 Toolbox	2	2 600	5 200
IBM2043 Electrician tool kit	1	4 000	4 000
IBM6033 Screwdriver sets	4	200	800
			10 000
		VAT @ 15%	0
		Total price	10 000

(iii) The effect of the transaction reflected in the source document:

Assets	**=**	**Equity**	**+**	**Liabilities**	**LBLL**
+10 000		+10 000		—	PAUSE
Accounts receivable (dr)		Sales (cr)		—	
Notes Once the customer has received the goods, the sale has been concluded and an invoice is issued to the customer. The accounts receivable account increases and is therefore debited. The opposite entry is the increase in the sales account and this account must be credited (double-entry system).					See Lessons Source document invoice

(e) Statement from a supplier

(i) What is a statement?

QUICK NOTE	*Statement – An accounting statement is summary of accounting activities/ transactions incurred over a period of time (i.e. a month).*

(ii) Example of a statement (source document):

Liberty Law Corporation
Attorneys at Law EIN 38-2123191
145 E. 35th St.
Seattle, Washington 98450
Phone: (212) 291-9211 Fax: (212) 291-9221

Invoice Number: **20100003**
Invoice Date: **March 31, 2010**
File Number: **NORTHM**

To: **Mary North**
Apartment 114 - 125 West 10th Avenue
Seattle WA 98108

Matter: Estate of John North

Attorney: Frank R. Galvin

Reference: **Estate of John North**

OUR FEES - In connection with the above matter			*Hours*	*Rate*	*Fees*
Mar 14, 2010	ASC	Draft letter to opposing council	.20	375.00	75.00
Mar 15, 2010	ASC	Draft letters to opposing council; telephone to client	1.10	375.00	412.50
Mar 17, 2010	ASC	Meet with client	.50	375.00	187.50
Mar 24, 2010	ASC	Draft release letter	.50	375.00	187.50
Mar 26, 2010	ASC	Correspondence with client; telephone to opposing lawyer	.20	375.00	75.00
Mar 27, 2010	ASC	Revise release letter	.30	375.00	112.50
	Total Fees				*1,050.00*
DISBURSEMENTS - Incurred on your behalf			*Qty*	*Each*	*Costs*
Mar 12, 2010	File administration fee				35.00
Mar 16, 2010	Photocopies		145	0.25	36.25
Mar 16, 2010	Faxes to counsel		4	10.00	40.00
	Total Disbursements				*111.25*
				Invoice Total:	$1,161.25

Please make Check(s) payable to: "Liberty Law Corporation"

Invoices are payable when rendered.
Interest on outstanding accounts at
1.5% per month, 18% per annum.

(iii) The effect of the transaction reflected in the source document:

Assets	=	Equity	+	Liabilities
—		—		—
—		—		—

Notes
There is no entry in the accounting records. The statement is sent to the customer and is a summary of all the transactions for the month. The transaction has already been recorded when the invoice was issued (see section (d) above).

(f) Remittance advice

(i) What is a remittance advice and an electronic funds transfer?

QUICK NOTE	
	Remittance advice – Is a statement detailing a payment made by the customer and the customer sends remittance advice to the supplier. This informs the supplier of the payment of an invoice (or group of invoices). *Electronic funds transfer (EFT) — An EFT is a payment transaction that takes place over an online network, either among accounts at the same bank or to different accounts at separate financial institutions.*

(ii) Example of a remittance advice (source document):

Remittance Advice

To:
My Supplier Name
123 Fake Street
Fake Avenue
Fake Town
Fake City

Payment Date
04/10/2017

From:
Big Red Book Limited
Rathdown Hall
Upper Glenageary Road
Glenageary
Co. Dublin

Issue Date
04/10/2017

Date	Reference	Total	Discount	Amount Paid
12/11/2012	Invoice 049	1000.00	0.00	1000.00
30/11/2012	Invoice 000058	50.00	0.00	50.00
04/03/2013	Invoice 000068	100.00	0.00	100.00
09/11/2012	Invoice 000005	500.00	0.00	500.00
01/11/2012	Invoice 000004	100.00	0.00	100.00
			Total	1750.00

Notes

(iii) Example of an EFT proof of payment (source document):

ABSA

Absa Online: Notice of Payment XXXXXXXXX

Dear Hollywood Bets

Subject: Notice Of Payment: Hollywood Bets

Please be advised that MISS XXXX XXXXX made a payment to your account as indicated below.

Transaction number:	XXXXXXXXX
Payment date:	XXXXXXXXX
Payment made by:	XXXXXXXXX
Payment made to:	Hollywood Bets
Beneficiary bank name:	ABSA BANK
Beneficiary account number:	XXXXXXXXX
Bank branch code:	XXXXXXXXX
For the amount of:	XXXXXXXXX
Immediate interbank payment :	XXXXXXXXX
Reference on beneficiary statement:	XXXXXXXXX
Additional comments by payer:	-

View your account to confirm that you have received this payment as the following apply to Absa Online payments into non-ABSA bank accounts.

- Payments made on weekdays before 15:30 will be credited to the receiving bank account by midnight of the same day.
- Payments made on weekdays after 15:30 will be credited by midnight of the following day.
- Payments made on a Saturday, Sunday or Public holiday will be credited to the account by midnight of the 1st following weekday.

If you need more information or assistance, please call us on 08600 08600 or +27 11 501 5110 (International calls).

If you have made an incorrect internet banking payment, please send an email to digital@absa.co.za

Yours sincerely

General Manager: Digital Channels

This document is intended for use by the addressee and is privileged and confidential. If the transmission has been misdirected to you, please contact us immediately. Thank you.

(iii) The effect of the transaction reflected in the source document:

<table>
<tr><th>Assets</th><th>=</th><th>Equity</th><th>+</th><th>Liabilities</th></tr>
<tr><td>—</td><td></td><td>—</td><td></td><td>—</td></tr>
<tr><td>—</td><td></td><td>—</td><td></td><td>—</td></tr>
<tr><td colspan="5">Notes
The customer has sent through a remittance advice of an EFT payment that has been made to SA Business. SA Business will issue a receipt (Refer (g) below)</td></tr>
</table>

(g) Receipt

(i) What is a receipt?

QUICK NOTE	*Receipt — A source document which is written acknowledgement that the seller has received payment (goods or money) from the buyer.*

(ii) Example of a cash receipt (source document):

Cash Receipt

Date: ____________________ **Receipt Num:** xxxxxxxxxxxxxx

Amount Received From: ____________________

Address: ____________________

Amount: ____________________

Purpose of Payment: ____________________

Account	
Total Amount Due	
Amount Paid	
Balance Due	

Payment Made BY	
Cash	
Cheque	
Others	

Amount Received By: ____________________

Authorized Signatures

Authorized Signatures

Business Name Here

Business Address

City, State and Zip Code

Phone, Fax

Website: www.websiteaddress.com

(iii) The effect of the transaction reflected in the source document:

Assets	=	Equity	+	Liabilities	LBLL
+10 000 -10 000		—		—	See Lessons Source document remittance advice
Bank (dr) Accounts receivable (cr)		—		—	

Notes

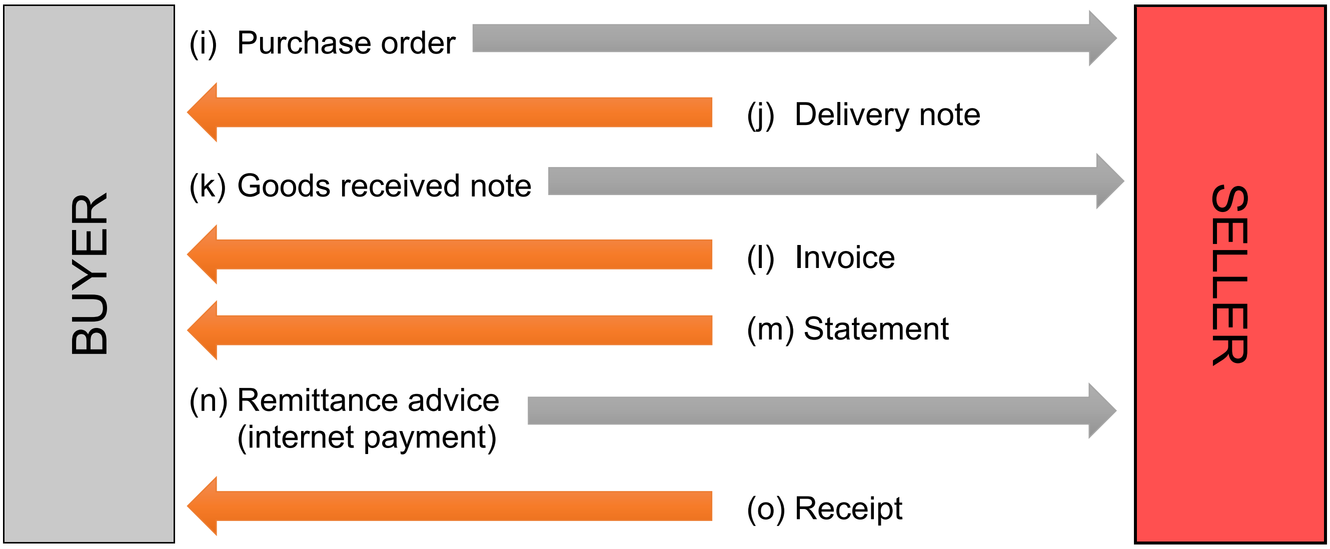
The remittance advice is sent to the seller as proof that the payment of the account has been made. The seller issues a receipt. The original receipt is sent to the buyer and the duplicate receipt is used to enter the payment into the CRJ. The accounts receivable account decreases and is therefore credited and the bank account increases and is therefore debited.

This transaction has been completed.

EXAMPLE 2.12

Consider the following transactions entered into by a business called SA Business.

SA Business is now the buyer of the goods. The discussion of the transactions will consider the source documents that generate the transaction, the effect of the transaction on the accounting equation and the explanation will be based on the following diagram, which illustrates the movement of accounting source documents (these source documents form part of the syllabus):



EXPLANATION 2.12

SA Business sends a purchase order through to South Suppliers for the purchase of the following goods:

Item code	***Description***	**Quantity**	**Price per unit R**	**Total price R**
IBM1334	*Toolbox*	2	2 600	5 200
IBM2043	*Electrician tool kit*	1	4 000	4 000
IBM6033	*Screwdriver*	4	200	800
				10 000
	Ignore VAT	VAT @ 15%		0
		Total price including VAT		10 000

(i) Purchase order

The effect of the transaction reflected in the source document:

Assets	=	Equity	+	Liabilities
—		—		—
—		—		—

Notes
A transaction has yet to take place. Once the delivery note has been signed by the customer the invoice can be generated.

(j) Delivery note

The goods arrive at the premises of SA Business with a delivery note from South Suppliers. The goods are checked to the delivery note of South Suppliers and signed as proof that the goods have been received. SA Business issues a goods received note.

The effect of the transaction reflected in the source document:

Assets	=	Equity	+	Liabilities
—		—		—
—		—		—

Notes
A transaction has yet to take place. Once the delivery note has been signed by the customer the invoice can be generated.

(k) Goods received note

SA Business has received the goods and issues a goods received note (GRN).

The effect of the transaction reflected in the source document:

Assets	=	Equity	+	Liabilities
—		—		—
—		—		—

Notes
A transaction has yet to take place. Once the delivery note has been signed by the customer the invoice can be generated.

(l) Invoice

Once the invoice is received, the amount owed of R10 000 is recorded.

The effect of the transaction reflected in the source document:

Assets	=	Equity	+	Liabilities
+R10 000		—		+R10 000
Inventory		—		Accounts payable

Notes
SA Business has received the goods and an invoice from the supplier. The inventory account increases and is therefore debited. The opposite entry is the increase in the accounts payable account (South Suppliers) and this account must be credited (double-entry system).

(m) Statement

SA Business has received the goods and the invoice. The amount owing of R10 000 has been recorded and SA Business receives a statement from South Suppliers for the invoices due for payment up until the end of the month.

The effect of the transaction reflected in the source document:

Assets	=	Equity	+	Liabilities
—		—		—
—		—		—

Notes
The transaction has been recorded. The statement from the supplier does not generate another transaction.

(n) Remittance advice (Proof of payment)

SA Business has received the goods and the invoice. The amount owing of R10 000 has been recorded. SA Business makes an internet payment of R10 000 to South Suppliers.

The effect of the transaction reflected in the source document:

Assets	=	Equity	+	Liabilities
- R10 000		—		- R10 000
Bank		—		Accounts payable

Notes
SA Business makes an internet payment and sends through proof of payment to South Suppliers (Either EFT notification, SMS or a fax). The bank account, an asset is decreased and therefore credited. The opposite entry is a debit to accounts payable as the liability has decreased.

(o) Receipt

SA Business has received the goods and the invoice. The amount owing of R10 000 has been recorded. SA Business makes an internet payment of R10 000 to South Suppliers. South Suppliers acknowledges receipt of the payment by issuing a receipt.

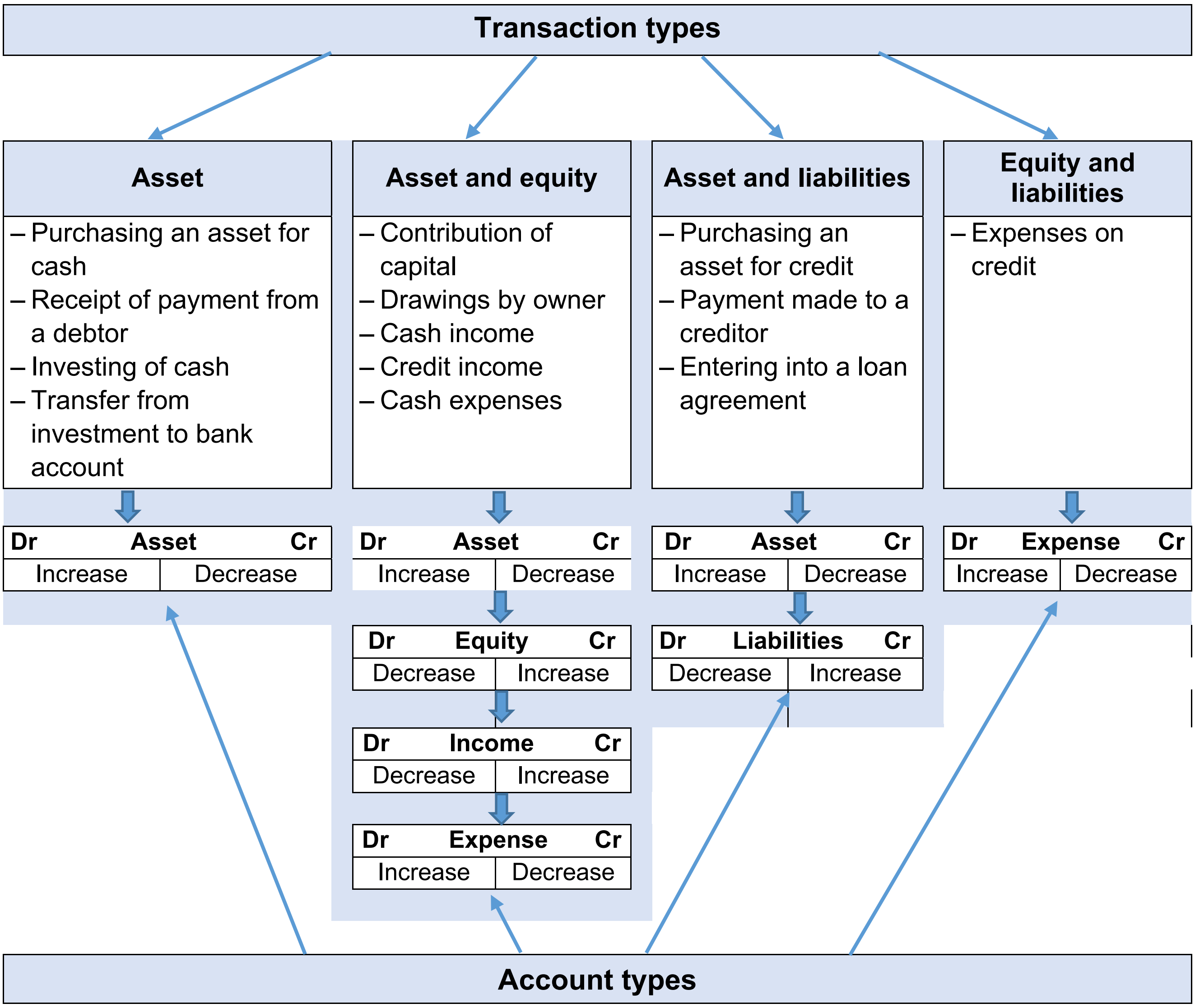
The effect of the transaction reflected in the source document:

Assets	=	Equity	+	Liabilities
—		—		—
—		—		—
Notes The receipt from the supplier (South Suppliers) does not generate another transaction.				

This transaction has been completed.

Notes

2.6 Overview of the recording of transactions



2.7 Completion of books of first entry

(See Learning unit 4)

The accountant employed by a law practice will be aware that there are different stages in the process of recordkeeping. The different stages form part of the accounting cycle.

As part of the accounting cycle there will be:

- a set of detailed records in which all the necessary information pertaining to every business **transaction** is recorded.
- These detailed records are known as the subsidiary journals.
- There is also a need for a set of accounts with summarised balances, which is known as ledgers.
- At the end of a financial period, statements of performance and position need to be compiled. The statements that are known as financial statements are the most summarised records of the firm.

A journal entry is like a set of instructions compiled after the transaction is analysed. The carrying out of these instructions is known as *posting*.

A posting is recording the information contained in the journal in the ledger accounts. The journal entries do not change when the posting is done; the journal entry is the instruction for debiting or crediting a general ledger account. The account that is debited or credited in the journal entry will be debited or credited in the general ledger.

LBL		
PAUSE	*An accountant should, at all times be aware of which stage of the accounting cycle the recording process is. (Grey shading in attached document)*	See Lessons Accounting cycle

2.8 Self-assessment exercises

Question	Answer
What is a transaction?	
How do you know a business transaction has taken place?	
What does bookkeeping entail?	
What is the double–entry system?	
List the steps in the financial accounting cycle.	

What is an account?	
How do you decide which accounts to set up?	
What is accounts receivable?	
What is accounts payable?	
What is an expense?	
What is income?	
What is the accounting requirement?	
What is the double-entry procedure?	
What is the commonly used abbreviation for a debit?	
What is the commonly used abbreviation for a credit?	

What is a journal entry?	
Explain the nature of (i) assets (ii) equity (iii) liabilities	
What category of account is accounts payable?	
What element is accounts payable?	
What is a current asset?	
What is a current liability?	
What do you call the collection of all accounts and transactions for a business?	
What is posting?	

2.9 Terminology and definitions – cheat sheet

What is an asset?	What is a liability?	What is an expense?
Assets are resources owned by the business, which have economic value and a business uses to generate income.	Liabilities are creditors' interest or interests of parties other than the owner(s). Liabilities are therefore the debts of the business.	An expense is a cost related to the day-to-day running of a business. An expense is a debit.
What is income?	What is equity?	Property (Non-current asset) Debit balance
Income is the revenue a business receives from selling services and goods to clients or customers and returns on investments.	Equity is the interest which the owner has in the business and which the entity therefore owes to him.	The account for the recording of the transactions relating to land and buildings (property) purchased for the business.
Equipment or computer equipment (Non-current asset) Debit balance	Furniture (Non-current asset) Debit balance	Motor vehicles (Non-current asset) Debit balance
The account for the recording of the transactions relating to equipment or computer equipment purchased for the business.	The account for the recording of the transactions relating to furniture purchased for the business.	The account for the recording of the transactions relating to motor vehicles purchased for the business.
Law library (Non-current asset) Debit balance	Bank account (Current asset) Debit balance	Accounts receivable (Current asset) Debit balance
An account for the recording of the transactions relating to the accumulation of legal books.	A bank account is a financial account maintained by a bank i.e. ABSA, wherein financial transactions (cash inflows and outflows) between the bank and the business are recorded. If the bank owes the business money, it is referred to a favourable balance. If the business owes the bank money, it is referred to as an unfavourable balance.	Accounts receivable are amounts due to the business from customers/ clients that have received goods or services on credit. The amounts arise from providing services or products to clients and they have not yet paid the business.

Inventory (Current asset) Debit balance	Trust clients account (Current asset) Debit balance	Petty cash (Current asset) Debit balance
The account for the recording of the transactions relating to inventory purchased by the business for resale or for the manufacturing of a product.	The trust clients account are the accounts for recording the money owed by the clients to an attorney's practice (i.e. debtors of the attorney's practice). The trust clients accounts arise from credit transactions.	The petty cash account is the account used for the recording of small cash payments that are impractical to pay by EFTs.
Long-term loans (Non-current liability) Credit balance	Short-term loan (Current liability) Credit balance	Accounts payable (business) (Current liability) Credit balance
A loan is an amount of money that has been loaned from a bank or financing institution and has to be repaid to the lender. The term long-term refers to loans that are repaid in specific instalments over a longer period of time (i.e. a term of 5 – 10 years). Long-term loans may have a fixed interest rate, or a floating interest rate (based upon the reserve bank prime rate).	A loan is an amount of money that has been loaned from a bank or financing institution and has to be repaid to the lender. Loans are repaid in instalments and interest is charged on the outstanding amount. Short-term loans refers to loans that are generally repaid within a few months or a year.	Accounts payable is money owed by a business to its suppliers. The amounts arise from people who have supplied the business with goods and services but the supplier has yet to be paid.
Trust creditors (Current liability) Credit balance	Bank overdraft (Negative) (Current liability) Credit balance	VAT control account (Current liability) Credit balance
The money that is in a trust account at any point in time belongs to the clients of the legal practice and the clients are referred to as trust creditors of the legal practice.	A bank account where the business owes the bank money. It is referred to as an unfavourable balance.	The account for the recording of the transactions relating to VAT. VAT is payable to SARS. Both output VAT (Credit side) and input VAT (Debit side) are recorded in the VAT control account.

FINANCIAL ACCOUNTING PRINCIPLES FOR LAW PRACTITIONERS

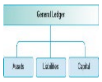
LEARNING UNIT

3	**SUNDRY ITEMS**

Contents

Concept cards

The following concept cards are available for this learning unit:

CONCEPT CARDS 	○ *Inventory cycle* ○ *Perpetual inventory method* ○ *Periodic inventory method* ○ *Depreciation* ○ *Straight-line depreciation method* ○ *Reducing balance depreciation method* ○ *VAT* ○ *Bank reconciliation*

3.1 Learning unit outline

This learning unit will deal with sundry items that affect the statement of profit and loss and the statement of financial position. The items to be discussed are:

– Inventory;
– Depreciation;
– VAT (Value Added Tax); and
– Bank reconciliations

3.2 Inventory

Learning outcomes

After studying this learning unit, you should be able to:

- define a perpetual inventory control system
- define a periodic inventory control system
- explain the difference between a periodic and a perpetual inventory control system
- define the first-in, first-out method
- Calculate the value of cost of sales and gross profit
- record inventory transactions in the accounting records

Key concepts

- Perpetual inventory control system
- Periodic inventory control system
- First-in, first-out method
- Mark-up
- Cost of sales
- Gross profit

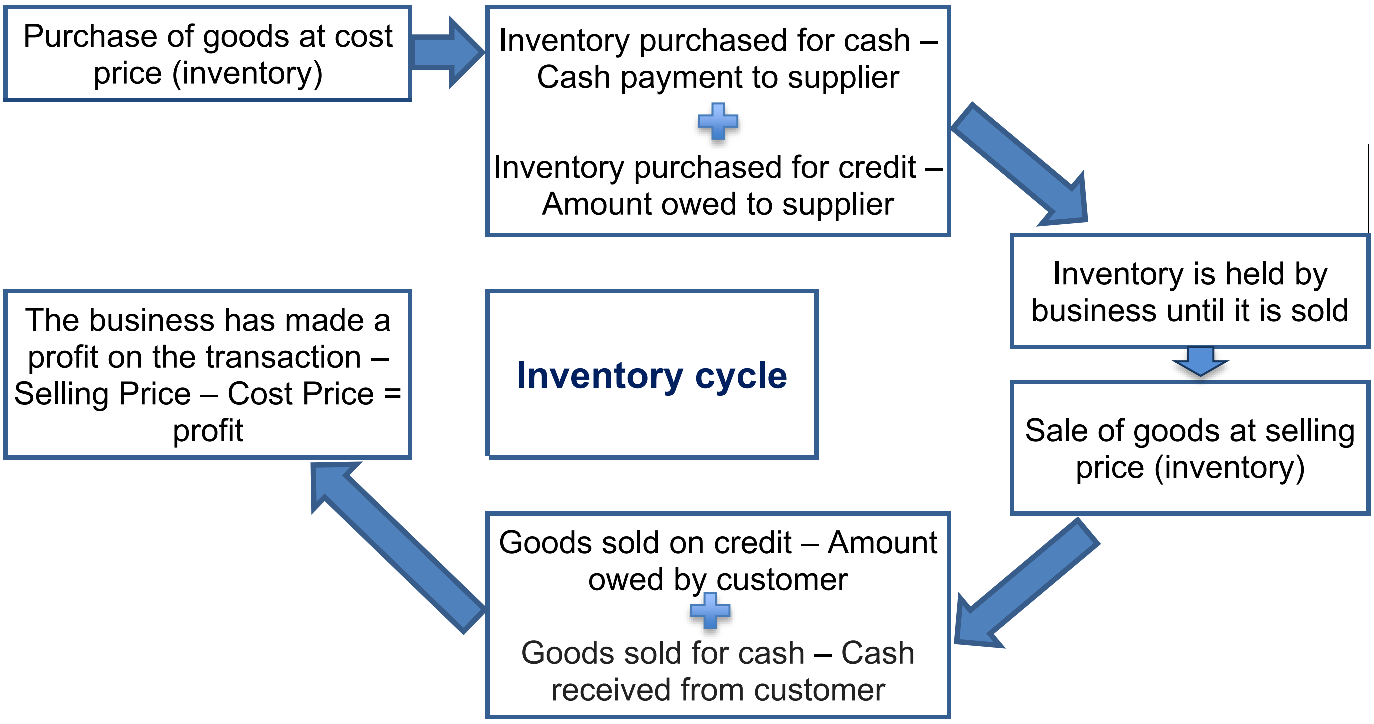
3.2.1 Introduction

In most cases inventory is the largest current asset of a trading entity. It is important that a trading entity at all times is able to supply the demand for its different types of merchandise.Trading entities (entities that buy and sell goods) keep inventory on hand (unsold goods) in order to supply their customers with different types of goods. Additional purchases are made to replace the sold inventory. A business makes a profit by selling the inventory for more than what it paid to buy the inventory. In determining the profit of a trading entity, it is important to determine the cost of the goods sold (cost of sales).

The discussion of inventory has been included in the learning material as law practitioners may deal with inventory in their interaction with clients in the following situations:

- Drawing up contracts,
- Remedies for breach of contracts,
- Legalities regarding insurance claims etc.

The inventory cycle is summarised as follows:



3.2.2 *Recording of inventory during the year for the periodic inventory system*

Under the periodic inventory system, the purchase of inventory is **not recorded** in the inventory account. A separate account known as the **purchases account** is used to record these purchases.

Under the periodic inventory system, the cost of sales is not determined at the time of the recording of the sale. The cost of sales can **only** be determined at the end of the financial period after a physical inventory count has been done.

The cost price of inventory sold during an accounting period will be determined as follows:

	R
Cost price of inventory at the beginning of the financial year *	XXX
Add: Cost price of inventory purchased during the financial year (the total amount on Purchases Account)	XXX
	XXX
Less: Cost price of inventory at the end of the financial year, determined by a physical inventory count (the unsold inventory)	(XXX)
	XXX

* closing inventory of previous year

The keeping of inventory records, the calculating of cost of sales and the valuing of inventory is determined by using either the perpetual inventory system or the periodic inventory system as follows:

Recording of inventory

Periodic inventory system	**Perpetual inventory system**
The periodic inventory system does not keep continuous, up to date records of inventory on hand. Many small businesses use a periodic system of inventory.	Perpetual means ***continuous***. This is a system where a business keeps continuous, moment-to-moment records of the number, value and type of inventories that it has at the business.
The entity will only have accurate records *periodically* (i.e. at certain points in time).	A computerised accounting system – where each item of inventory is linked to the electronic accounting records – creates a *perpetual system*.
The records will be accurate once the journal entries are processed to account for the values of the inventory stock take.	Products that have barcodes are automatically recorded as having been sold at tills in a supermarket when they are 'swiped.' Inventory levels are automatically decreased as soon as the invoice has been entered and completed at the till.

Mark-up on cost - Cost of sales is the cost of goods sold over the period, the mark-up percentage is the gross profit percentage of the cost price

Notes

3.2.3 *Schematic representation of a periodic inventory system*

(The term refers to the *periodic inventory counts* that are performed by the entity)

Periodic inventory system

NB: The inventory account is updated at regular intervals after completing a stock take

Advantages:
1. **Easy to maintain**
2. **Cost efficient**

Disadvantages:
1. **Lack of accurate, real time inventory information could lead to inefficient management of inventory**
2. **Little control**
3. **Delayed results**

Step 1 – Inventory at beginning of year

Closing balance previous period = Opening inventory this period

Dr	Inventory account	Cr	Cr
	R		R
Opening balance (Step 1)	xxx	Adjustment (Step 4)	xxx
Adjustment (Step 4)	xxx	Closing balance	xxx
	xxx		xxx

Step 2 – Purchases

Record inventory purchases in the purchases account

Cash transaction:
Debit: Purchases
Credit: Bank

Credit transaction:
Debit: Purchases
Credit: Creditors control

Step 3 – Revenue

Recognise revenue (sales) as the sales take place.

Cash transaction:
Debit: Bank
Credit: Sales

Credit transaction:
Debit: Debtors control
Credit: Sales

INVENTORY: No recognition

Step 4

Close off the purchases account with a journal entry

Debit: Cost of sales
Credit: Purchases

Stock take

Step 4

Update closing inventory and calculate cost of sales

Opening inventory
+ Purchases
+ Sales returns
– Purchases returns
– Closing inventory (= stock take value)
= Cost of sales

The accounting entries (VAT is ignored) associated with a periodic inventory system can be summarised as follows:

STEPS

Purchase of inventory for cash:

- *Dr Purchases (under the periodic inventory system, purchases are regarded as an expense that reduces equity)*
- *Cr Bank (the asset **bank** decreases when money is paid out)*
- *The transaction is recorded in the cash payments journal at cost price.*

Purchase of inventory on credit:

- *Dr Purchases (see above)*
- *Cr Creditor (creditors is a liability account which is created or increased) and Cr Creditors control*
- *The transaction is recorded in the purchases journal at cost price.*

Sale of merchandise for cash:

- *Dr Bank (the asset increases with the money received)*
- *Cr Sales (an income account which increases equity)*
- *The transaction is recorded in the cash receipts journal at selling price.*

Sale of merchandise on credit:

- *Dr Debtor (an asset which is created or increased) and*
- *Dr Debtors control*
- *Cr Sales (see above)*

EXAMPLE 3.1

The information for a business with a 31 December year end for recording inventory using the periodic inventory system is as follows:

1. A business started the financial year with R20 000 inventory on hand.
2. Inventory of R10 000 was purchased by the business on 30/04 for cash.
3. Inventory of R15 000 was purchased by the business on 31/05 for credit.
4. Inventory of R22 000 was sold by the business on 30/04 for cash.
5. Inventory of R26 000 was sold by the business on 31/10 for credit.

Notes

EXPLANATION 3.1

The *journal entries*[1] to record the inventory purchased during the financial year are as follows:

GJ1

Date		**Dr R**	**Cr R**
30/04	Purchases (expense) Bank *Purchase inventory for cash*	10 000	 10 000
31/05	Purchases (expense) Creditors control *Purchase inventory for credit*	15 000	 15 000

Dr **Purchases** **Cr**

Date			**R**	**Date**		**R**
30/04	Cash purchase	GJ1	10 000			
31/05	Credit purchase	GJ1	15 000			

The journal entries to record the inventory sold during the financial year are as follows:

GJ2

Date		**Dr R**	**Cr R**
30/06	Bank Sales (Revenue) *Sell inventory for cash*	22 000	 22 000
31/10	Debtors control Sales (Revenue) *Sell inventory for credit*	26 000	 26 000

Dr **Sales** **Cr**

Date		**R**	**Date**			**R**
			30/06	Cash sales	GJ2	22 000
			31/10	Credit sales	GJ2	26 000

[1] A journal entry is a chronological record of accounting transactions, and each journal entry has a **debit** and a **credit**.

3.2.4 Recording of end of year adjustments for the periodic inventory system

In a periodic inventory system, there are no entries entered into the accounting records during the financial year for cost of goods sold. At the end of the financial year (when a physical inventory count is performed) the accounts "inventory" and "cost of goods sold" are adjusted.

In this step-by-step example of the recording of periodic inventory of an entity, the entity started the financial year with R20 000 inventory on hand (opening inventory at the beginning of the year). The following is the inventory **T-account**[2] that looks as follows:

Dr **Inventories** **Cr**

Date			R	Date			R
01/01	Balance (opening)	b/d	20 000				

At the end of the financial year an inventory count was performed and inventory to the value of R40 000 was counted. Therefore, at the end of the financial year the following adjustments are processed:

General journal

GJ3

Date		Dr R	Cr R
31/12	Cost of sales	25 000	
	Purchases		25 000
	Transfer total purchases to the cost of sales account		

Dr **Purchases** **Cr**

Date			R	Date			R
30/04	Cash purchase	GJ1	10 000	31/12	Cost of sales	GJ3	25 000
31/05	Credit purchase	GJ1	15 000				
			25 000				25 000

The above closing entries (entries at the end of the financial year) are in line with the formula to calculate cost of sales at the end of the year:

Cost of sales	=	Opening inventory	+	Purchases	−	Closing inventory

2 An account is a summary record of all transactions relating to a particular item in an entity. In conventional accounting in books, the account has the format of the letter T and is therefore called a T-account.

The inventory account reflects an amount of R20 000 and needs to be adjusted to the inventory count amount of R40 000 (physical count) at the end of the year. This is done in two steps:

Step 1: The amount of R20 000 is cancelled, and
Step 2: The inventory amount of R40 000 is then added to account.

The contra account is “cost of sales."

The accounting entries will look as follows at the end of the year:

GJ4

Date		**Dr R**	**Cr R**
31/12	Cost of sales	20 000	
	Inventory (opening balance)		20 000
	Transfer opening inventory to the cost of sales account		
31/12	Inventory (closing balance)	40 000	
	Cost of sales		40 000
	Record closing inventory and adjust cost of sales		

Asset

Dr **Inventory** **Cr**

Date			**R**	**Date**			**R**
01/01	Balance (opening)	b/d	20 000	31/12	Cost of sales	GJ4	20 000
31/12	Cost of sales	GJ4	40 000		Balance (closing)	c/d	40 000
			60 000				60 000
	Balance (opening)	b/d	40 000				

Expense

Dr **Cost of sales** **Cr**

Date		**R**	**Date**		**R**
31/12	Purchases	25 000	31/12	Inventory (closing)	40 000
31/12	Inventory	20 000	31/12	Cost of sales	5 000
		45 000			45 000

At the end of the financial period the purchases account is credited (closing off of account) and the cost of sales account is debited.

Dr **Purchases** **Cr**

Date		**R**	**Date**		**R**
31/12	Purchases	45 000	31/12	Cost of sales	45 000

3.2.5 Schematic representation of a perpetual inventory system

Perpetual inventory system

Continuous updating of inventory accounts – real time tracking of inventory levels

Advantages:
1. **Greater control over inventory**
2. **Provides real time information that could aid management decision-making regarding purchases, discounts and returns**
3. **Reduces the need for physical inventory counts**

Disadvantages:
1. **Expensive to implement**
2. **Time consuming to keep the detailed level records**

1. Closing balance previous period = Opening inventory this period

2. Record inventory purchases in the inventory account

Inventory

3. Recognise revenue (sales) and cost of goods sold as the sales take place

Inventory

4. Inventory account balance updated in real time

Inventory account

Opening balance	**xxx**	**Cost of sales**	**xxx**
Bank/Creditors control (Purchases)	**xxx**	**Closing balance**	**xxx**
	xxx		**xxx**

Cash transaction:
Dr: Inventory
Cr: Bank

Credit transaction:
Dr: Inventory
Cr: Creditors' control

Cash transaction:
Debit: Bank
Credit: Sales

Recognition of cost of sales:
Debit: Cost of sales
Credit: Inventory

Credit transaction:
Debit: Debtors' control
Credit: Sales

Notes

3.2.6 Inventory valuation methods

When a trading entity purchases an inventory item, the price paid at beginning of the financial year may not be the same price that is paid for the inventory item at a later stage in the financial year. Not all inventory (goods) is sold by the end of the financial year, and the trading entity will need to place a value on the inventory still on hand at the end of the financial year.

LBL PAUSE	*The valuation method used by the trading entity to determine the cost of the inventory (and therefore the cost of sales) should be the one that brings the most realistic determination of profit in the particular entity.*	See Lessons Inventory valuation method

The three most used valuation methods in practice are the following:

- **First in, First out (FIFO) method:** *According to this method, the items that were purchased first are sold first. Inventory on hand is therefore valued at the latest prices.*
- **Last in, First out (LIFO) method:** According to this method, the items that were purchased last are sold first. The inventory at the end of the financial year is therefore valued at the earlier prices. This method falls outside the scope of this module and therefore will not be discussed in any examples.
- **Weighted average method:** According to this method the total cost of the goods on hand is divided by the number of units available for sale in order to determine an average cost per unit. This method falls outside the scope of this module and therefore will not be discussed in any examples.

NB	*You will only be tested on the FIFO method of inventory valuation.*

Notes

3.2.7 Illustration of movement of inventory units for the perpetual inventory system

If an entity keeps very detailed accounting records of the inventory on hand then each receipt of goods is recorded (purchase) and each sale of goods is recorded (cost of goods sold).

EXAMPLE 3.2

The following table illustrates the movement in inventory for a month for one type of inventory:

Water pumps	Goods received	Goods sold
02/02/2020	10 @ R1 000	
03/02/2020		5
06/02/2020	8 @ R1 100	
16/02/2020		4
22/02/2020		7
26/02/2020	4 @R1 200	

EXPLANATION 3.2

The following table shows how to cost the inventory using the perpetual inventory system:

Water pumps	Goods received	Goods sold	Units on hand	Cost		Balance	
02/02/2020	10 @ R1 000		10	10 000	(10 x 1 000)	10 000	
03/02/2020		5	5 (10 – 5)	(5 000)	(5 x 1 000)	5 000	
06/02/2020	8 @ R1 100		13 (5 + 8)	8 800	(8 x 1 100)	13 800	(5 x 1 000) + (8 x 1 100)
16/02/2020		4	9 (13 – 4)	(4 000)	(4 x 1 000)	9 800	(1 x 1 000) + (8 x 1 100)
22/02/2020		7	2 (9 – 7)	(7 600)	(1 x 1 000) + (6 x 1 100)	2 200	(2 x 1 100)
26/02/2020	4 @ R1 200		4	4 800	(4 x 1 200)	7 000	(2 x 1 100) + (4 x 1 200)
Total inventory on hand – 6 units costing R7 000			6			7 000	

3.2.8 Journal entries during the year for the perpetual inventory system

When a business keeps a perpetual record of inventory and additional inventories are acquired, the inventories account is continuously updated. This happens after each sale of inventory. When the periodic inventory system is in place and inventory is purchased the “purchases" account is used to record the receipt of inventory. At the end of the year, the cost of sales and inventories accounts do not have to be adjusted as it has been done throughout the year.

STEPS

- *The bookkeeper must show that goods have been received by the business. The business has spent money on an item that will form part of the goods on hand (inventory) of the business.*
- *Since inventory is an asset, the principles pertaining to assets will apply.*
- *Cash has decreased (credit bank) and an asset has been purchased (debit inventory of water pumps).*
- *Inventory (asset) has increased and will be debited. Remember: assets increase on the **debit** side. The opposite entry is the bank account, and it will be credited (Assets decrease on the **credit** side).*

3.2.9 Mark-up on cost

Cost of sales is the cost price (CP = R10 000) of the goods that were sold during a period.
The selling price (SP = R15 000) is what the inventory was sold for.
The mark-up percentage on cost is the gross profit percentage of the cost price.

	R	**%**
Cost price	10 000	100
Profit (mark-up)	5 000	50
Selling price	15 000	150

To calculate the cost price when the mark-up percentage (20%) and selling price (R12 000) is given, you will use the following formula:

Formula

Cost price = Selling price x 100 ÷ (100 + mark-up percentage on cost)

CP = 12 000 x 100/120 = R10 000

	R	**%**
Cost price	10 000	100
Profit (mark-up)	2 000	20
Selling price	12 000	120

To calculate the selling price when the mark-up percentage (20%) and cost price (R12 000) is given, you will use the following formula:

Formula	*Sales price = cost price + (cost price x mark-up percentage on cost)*

SP = 12 000 + (12 000 x 20%) = R14 400

	R	%
Cost price	12 000	100
Profit (mark-up)	2 400	20
Selling price	14 400	120

EXAMPLE 3.3

The information for recording inventory using the perpetual inventory system is as follows:

1. A business started the financial year with R20 000 (01/04) inventory on hand.
2. Inventory of R10 000 was purchased by the business on 30/04 for cash.
3. Inventory of R15 000 was purchased by the business on 30/05 for credit.
4. Inventory of R22 000 (selling price) was sold by the business on 31/05 for cash.
5. Inventory of R26 000 (selling price) was sold by the business on 31/10 for credit.
6. The mark-up on inventory cost is 25%.

EXPLANATION 3.3

When a *perpetual inventory system* is used and inventories are purchased the journal entries to record the inventory purchased during the financial year are as follows:

GJ1

Date		**Dr** **R**	**Cr** **R**
30/04	Inventory (asset) Bank *Purchase inventory for cash*	10 000	 10 000
30/05	Inventory (asset) Creditors control *Purchase inventory on credit*	15 000	 15 000

When the inventory is sold, the following entries are made:

GJ2

Date	Details	Dr R	Cr R
31/05	Bank (asset) Sales (Revenue) *Sell inventories for cash*	22 000	 22 000
31/05	Cost of sales (22 000 x 100/125) Inventories (asset) *Cancel out inventories and record cost of sales*	17 600	 17 600[1]
31/10	Debtors control Sales (Revenue) *Sell inventory for credit*	26 000	 26 000
31/10	Cost of sales (26 000 x 100/125) Inventories (asset) *Cancel out inventories and record cost of sales*	20 800	 20 800[2]

Inventory to start business amount given in Example 3.3

Asset

Dr **Inventory** **Cr**

Date			R	Date			R
01/04	Opening balance		20 000	31/05	Cost of sales	GJ2	17 600[1]
30/04	Cash purchase	GJ1	10 000	31/10	Cost of sales	GJ2	20 800[2]
31/05	Credit purchase	GJ1	15 000				

Liability

Dr **Creditors control** (Purchase inventory on credit) **Cr**

Date			R	Date			R
				30/05	Inventory	GJ1	15 000

Asset

Dr (Selling of inventory for cash) **Bank** (Purchase inventory for cash) **Cr**

Date			R	Date			R
31/05	Sales	GJ2	22 000	30/04	Inventory	GJ1	10 000

Income/Revenue

Dr **Sales** (Selling price of inventory sold) **Cr**

Date			R	Date			R
				31/05	Bank	GJ2	22 000
				31/10	Debtors control	GJ2	26 000

Expense

Dr (Cost price of inventory sold) **Cost of sales** Cr

Date		R	Date		R
31/05	Sale of inventory GJ2	17 600			
31/10	Sale of inventory GJ2	20 800			

Asset

Dr (Selling of inventory for credit) **Debtors control** Cr

Date		R	Date		R
31/10	Sales GJ2	26 000			

The effect of the journal entries above is that there are cash sales of R22 000 that can be matched against an expense ► cost of goods sold of R17 600, which gives us a gross profit of R4 400.

There are also credit sales of R26 000 that can be matched against an expense ► cost of goods sold of R20 800, which gives us a gross profit of R5 200.

LBL		
PAUSE	*The big difference between the perpetual and periodic inventory systems is the <u>continuous adjustment</u> of inventory (perpetual inventory) or an <u>adjustment only at certain times</u> (periodic inventory).*	See Lessons Perpetual periodic

3.2.10 Comparison of entries for perpetual inventory system and periodic inventory system

The following explanation reflects the differences between the recording of inventory on the perpetual inventory system and the periodic inventory system.

EXPLANATION 3.4

On 1 May 2020 a business purchased 1 000 units of merchandise at R120 per unit on credit. This purchase will be recorded as follows for each inventory system:

Perpetual inventory system

Date	Details	Dr R	Cr R
01/05	Inventory (1 000 x 120) Accounts payable *Purchase inventories for cash*	120 000	 120 000

Periodic inventory system

Under periodic inventory system, all purchases during the accounting period are recorded in the "Purchases" account.

Date	Details	Dr R	Cr R
01/05	Purchases (1 000 x 120) Accounts payable *Purchase inventories for cash*	120 000	 120 000

On 6 May 2020 the business sold 350 units of inventory for R200 per unit on credit.

Perpetual inventory system

Date	Details	Dr R	Cr R
06/05	Accounts receivable (350 x 200) Sales *Sale of inventory for cash*	70 000	 70 000
06/05	Cost of goods sold (350 x 120) Inventory *Cancel out inventories and record cost of sales*	42 000	 42 000

Under the perpetual inventory system the changes in the inventory account are recorded after each transaction

Periodic inventory system

Date	Details	Dr R	Cr R
06/05	Accounts receivable (350 x 200) Sales *Sale of inventory for cash*	70 000	 70 000

Under the periodic inventory system, the following journal entry is recorded at the end of the accounting period:

Date	Details	Dr R	Cr R
31/05	Inventory Purchases *Sale of inventory for cash*	78 000	 78 000

Quantity of inventory on hand at end of financial period:
= 1 000 units purchased – 350 units sold = 650 units left

Cost of inventory on hand at end of financial period:
= 650 units x R120 cost per unit = R78 000

Date	Details	Dr R	Cr R
31/05	Cost of goods sold Purchases *Cost of inventory sold*	42 000	 42 000

Cost of goods sold
= Total purchases – closing balance of inventory
= (1 000 units x R120 cost per unit) – (650 units x R120 cost per unit)
= 120 000 – 78 000
= R42 000

3.2.11 Recording of end of year closing entries for the perpetual inventory system

The closing off entries required at the end of the financial year under the perpetual inventory or periodic inventory system is the same, with one exception. For the periodic inventory system, an entry is made in the "Inventory account" to adjust the balance to the amount of inventory that was counted and valued at year-end. Otherwise, the steps are the same:

EXAMPLE 3.5

The following transactions for Africa Suppliers took place during May 2020:

1. On 1 May 2020 Africa Suppliers purchased 1 000 units of goods at R30 per unit on credit.
2. On 15 May 2020 Africa Suppliers sold 200 units of goods at R50 per unit on credit.
3. Determine the value of inventory at the end of May 2020.

REQUIRED:

For each of the inventory systems prepare the journals for the purchase and sale of goods.

Prepare the general ledger accounts for purchases or cost of sales and inventory and for the month ended 31 May 2020.

EXPLANATION 3.5

(a) Perpetual inventory system

Journal entries **GJ**

Date	Detail	Debit R	Credit R
01/05	Inventory – Goods (1 000 x 30)	30 000	
	Accounts payable		30 000
	Purchase of goods		
15/05	Accounts receivable (200 x 50)	10 000	
	Sales		10 000
	Sale of goods		
31/05	Cost of goods sold (200 x 30)	6 000	
	Inventory – Goods		6 000
	Cost of goods sold		

General ledger

Dr			Inventory			Cr
Date			**R**	**Date**			**R**

Date			**R**	**Date**			**R**
01/05	Credit purchase	GJ	30 000	15/05	Cost of sales	GJ	6 000
				31/05	Balance	c/d	24 000
			30 000				30 000

Dr — Cost of sales — Cr

Date			**R**	**Date**			**R**
15/05	Sale of inventory	GJ	6 000				

(b) Periodic inventory system

Journal entries

GJ

Date	**Detail**	**Debit R**	**Credit R**
01/05	Purchases (1 000 x 30)	30 000	
	Accounts payable		30 000
	Purchase of goods		
15/05	Accounts receivable (200 x 50)	10 000	
	Sales		10 000
	Sale of goods		

Under periodic inventory system, the following journal entry is recorded at the end of accounting period.

Date	**Detail**	**Debit R**	**Credit R**
15/05	Inventory – Goods (800* x 30)	24 000	
	Purchases		24 000
	Cost of goods sold		

* 1 000 (units purchased) – 200 (units sold) = 800 units left
Closing balance = 800 (remaining) x R30 (Cost per unit) = R24 000.

Notes

General ledger

Dr **Inventory** **Cr**

Date			R	Date			R
15/05	Purchases	GJ	24 000	31/05	Balance	c/d	24 000
			24 000				24 000

Dr **Purchases** **Cr**

Date			R	Date			R
01/05	Credit purchase	GJ	30 000	31/05	Inventory sold		24 000
				31/05	Balance c/d		6 000
			30 000				30 000

3.2.12 Recording of drawings and donations of inventory

LBLL PAUSE	*Inventory taken by owner for personal use.*	See Lessons Inventory taken by owner for personal use

(a) Use the following accounting equation to record the effect of inventory (R10 000 at cost price) taken by the owner for personal use:

Assets	Equity	Liabilities	Notes[3]

(b) Use the following accounting equation to record the effect of inventory (R10 000 at cost price) donated by the business:

Assets =	Equity +	Liabilities	Notes

[3] What is the effect of the transaction?

The following table represents the journal entries required for recording the above inventory:

Transaction	Perpetual inventory account	Periodic inventory account
(a) Inventory taken by owner for personal use	Dr Drawings* Cr Inventory	Dr Drawings Cr Purchases
(b) Donation of inventory	Dr Donations Cr Inventory	Dr Donations Cr Purchases

* If a business owner has withdrawn goods for personal use, (Cost R10 000), then the amount must be recorded as drawings of the owner and not as an expense for the business.

Notes

3.2.13 Self-assessment exercise

Complete the following table by applying your knowledge acquired from working through the learning unit (Solutions to the *self-assessment exercise* are included in "Lessons" for learning unit 3):

Question	Answer
What is inventory?	
What category of account is inventory?	
What is a current asset?	
What is the FIFO method of valuing inventory?	
What is the perpetual inventory system?	
What is the periodic inventory system?	
What is cost of sales (COS)?	

Question	Answer
How is cost of sales calculated?	
An inventory items mark-up percentage is 40% and the selling price is R280. Calculate the cost price.	
An inventory items mark-up percentage is 60% and the cost price is R280. Calculate the selling price.	
An inventory items selling price is R300 and the cost price is R120. Calculate the mark-up% (Gross profit % – GP%).	
How is a “donation” of inventory recorded?	
How is “inventory taken for personal use recorded”?	

3.3 Depreciation

Learning outcomes

After studying this learning unit, you should be able to:

- differentiate between non-current asset and a current asset
- understand why there is a provision for depreciation
- apply the different depreciation methods;
- comprehend methods of calculating depreciation charges;
- identify the factors to be considered when choosing a depreciation method; and
- determine the impact on profits by using different depreciation methods.
- record depreciation transactions in the accounting records

Key concepts

- Non-current asset
- Property, plant and equipment
- Depreciation
- Accumulated depreciation
- Carrying amount
- Useful life
- Residual value
- Straight-line deprecation method
- Reducing balance deprecation method

3.3.1 What is property, plant and equipment

A business that buys and sells products normally has some sort of property, plant and equipment as part of the non-current assets of the business. Property, plant and equipment is a category of assets that are tangible items owned by a business which are used to produce or supply goods or services, for rental to others, or for administrative purposes. The most important aspect of property, plant and equipment is that the assets are expected to be used for more than one financial period and therefore it is necessary to make a provision for depreciation. Examples of property, plant and equipment are:

– Buildings (Expected period of use 20 years)
– Vehicles (Expected period of use 5 years)
– Trucks (Expected period of use 5 years); and
– Furniture (Expected period of use 7 years)

The opposite of a non-current asset is a current asset, which refers to an asset that will be used up within a period of one financial year. Examples of current assets are:

– Inventory (Refer to section 3.1)
– Trade debtors
– Trust debtors; and
– Cash and cash equivalents (Bank accounts)

Current assets are not depreciated.

3.3.2 What is depreciation

When an entity buys an asset which is intended to be used in the entity for more than one financial year, that asset is described as a non-current asset. Through their continuous use, these non-current assets lose value through wear and tear. This loss of value is known as depreciation.

Depreciation for accounting purposes refers to the allocation of the cost of the asset to the financial periods in which the asset is used. Depreciation is provided in terms of the matching principle (an accounting principle) that requires that the expenses incurred during the financial period be recorded in the same financial period as the related revenue (also known as the matching of revenues to expenses principle). Depreciation is calculated for each accounting period using an agreed method of depreciation.

The following are methods of calculating depreciation:

- **Straight-line method**

  According to this method, depreciation is calculated on the cost of the asset using a pre-determined depreciation rate. The depreciation rate could be given as a percentage (i.e. 15% per year) or number of years (i.e. written off over the useful life of 5 years). Where the economic (useful) life of the asset can be estimated with certainty, this can be used to determine the depreciation rate.

  If a non-current asset was bought for R5 000 and its depreciation rate was given as 10% per annum, the annual depreciation will be:

  Cost of asset x depreciation rate = depreciation
  R5 000 x 10% = R500.

  This method can be used when the useful life of an asset can be estimated with certainty. The expected useful life is then used to determine the depreciation rate. If an asset was bought for R10 000 and it is expected to have a useful life of 5 years the annual depreciation will be calculated as follows:

  R10 000/5 years = R2 000.

  The useful life of an asset is an estimation of the length of time the asset can reasonably be used to generate income (revenue) and therefore be a benefit to the business. The original cost of the asset is adjusted based on the depreciation calculated. The adjusted value of the asset is shown in the books as the carrying amount.

If the asset is expected to have some value after its economic life, this value is known as residual value. To calculate the depreciation, the residual value must first be deducted from the cost of the asset before the depreciation rate is applied.

- **Reducing balance method**

Based on this method, the annual depreciation is calculated on the carrying amount of the asset. The carrying amount is obtained by deducting the accumulated depreciation (total depreciation to date) on the asset from the original cost of the asset. The depreciation rate is then applied to the carrying amount to calculate the depreciation.

(Cost of assets – accumulated depreciation) x depreciation rate = depreciation.

If a non-current asset was bought for R5 000 and its depreciation rate was given as 10% per annum, the annual depreciation will be:

Year 1:
(Cost of assets – accumulated depreciation) x depreciation rate = depreciation.
(R5 000 – R0) x 10% = R500.

Year 2:
(Cost of assets – accumulated depreciation) x depreciation rate = depreciation.
(R5 000 – R500) x 10% = R450.

QUICK NOTE	*If the asset was bought during the financial year, the depreciation needs to be apportioned for the months the asset was in use. For example, a business with a 28 February financial year-end bought an asset on 1 October. The depreciation charge will be apportioned for 5 months. (1 October to 28 February)*

Notes

3.3.3 Schematic representation of depreciation

Depreciation (Expense – Debit)
Depreciation is the amount by which the cost of a physical asset reduces in value each year. The cost of the asset is allocated systematically over its useful life or life expectancy.

↓

Statement of profit or loss and other comprehensive income

Accumulated depreciation (Credit)
The amount of a long-term asset's cost that has been allocated to the depreciation expense since the time that the asset was acquired.

↓

Statement of financial position

Methods of calculating depreciation

Straight-line method	
Advantages	**Disadvantages**
• Easy to calculate • Uniform expense charge from month-to-month • Calculated on original cost	• Depreciation not related to usage • Ignores possible decline in efficiency of asset over time

Reducing-balance method	
Advantages	**Disadvantages**
• Easy to calculate • Matches cost with revenue by providing higher depreciation on new assets and the cost is reduced as the efficiency of the asset declines	• Cannot reduce book value of asset to zero • Requires a high rate of depreciation otherwise it takes a long time to write down to its residual value

Example of calculation

On 1 January 2016, Moot Traders purchased a delivery vehicle for R100 000. The financial year-end of Moot Traders is 31 December.

Straight-line method at 10% pa		Reducing-balance method at 10% pa
Cost price x depreciation rate		(Cost price – accumulated depreciation) x depreciation rate
R100 000 x 10% = R10 000	Dec 2016	R100 000 x 10% = R10 000
Dr Depreciation R10 000 Cr Accumulated depreciation R10 000		Dr Depreciation R10 000 Cr Accumulated depreciation R10 000
R100 000 x 10% = R10 000	Dec 2017	(R100 000 – R10 000) x 10% = R9 000
Dr Depreciation R10 000 Cr Accumulated depreciation R10 000		Dr Depreciation R9 000 Cr Accumulated depreciation R9 000
R100 000 x 10% = R10 000	Dec 2018	(R100 000 – R19 000) x 10% = R8 100
Dr Depreciation R10 000 Cr Accumulated depreciation R10 000		Dr depreciation R8 100 Cr Accumulated depreciation R8 100
R100 000 x 10% = R10 000	Dec 2019	(R100 000 – R27 100) x 10% = R7 290
Dr Depreciation R10 000 Cr Accumulated depreciation R10 000		Dr depreciation R7 290 Cr Accumulated depreciation R7 290

3.3.4 Schematic representation: Depreciation — straight-line method

Advantages	Disadvantages
• Easy to calculate • Uniform expense charge from month-to-month • Calculated on original cost	• Depreciation is not related to usage • Ignores possible decline in efficiency of asset over time

Example of calculation	
On 1 January 2016 MOOZ Traders purchased a delivery vehicle for R100 000. The financial year-end of MOOZ Traders is 31 December	
Asset	Straight-line method at 10% per annum Cost price x depreciation rate
Dec 2016	100 000 x 10% = R10 000
Dec 2017	100 000 x 10% = R10 000
Dec 2018	100 000 x 10% = R10 000
Dec 2019	100 000 x 10% = R10 000

Time-line (The depreciation is being written off at 10% per year, which equates to the cost of the delivery vehicle being charged as an expense of the business over a period of 10 years.)

Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10
R10 000	R10 000	R10 000	R10 000	R10 000	R10 000	R10 000	R10 000	R10 000	R10 000

Annual journal entry

(The amount of depreciation (a debit) being charged as an expense every year.)

	Debit	Credit
Depreciation	**R10 000**	
Accumulated depreciation		**R10 000**

Posted to general ledger

Accumulated depreciation is a credit and is deducted from the cost of the asset in the statement of financial position

Dr	Depreciation		Cr
Accumulated depreciation	R10 000		

Dr	Accumulated depreciation		Cr
		Depreciation	R10 000

Statement of profit and loss and other comprehensive income: disclosed as expense

Statement of financial position (SFP): disclosed in the notes for property plant and equipment (PPE)

Property, plant and equipment includes the delivery vehicle.
PPE is shown at carrying amount (CA) in the SFP, which is Cost less Accumulated depreciation.
In this case for Y1, CA = R100 000 – R10 000 = R90 000.

3.3.5 Schematic representation: depreciation — reducing-balance method

Advantages	Disadvantages
• Easy to calculate	• Carrying amount of asset will not be reduced to zero
• Match cost with revenue by providing higher depreciation on new assets, and matching cost of asset with efficiency of asset as value of asset decrease	• Requires a high depreciation rate otherwise the asset will take a long time before it is written down to its residual value

Example of calculation	
On 1 January 2016 MOOZ Traders purchased a delivery vehicle for R100 000. The financial year–end of MOOZ Traders is 31 December	
Asset	Reducing balance method at 10% per annum (Cost price – accumulated depreciation) x depreciation rate
Dec 2016 Dec 2017 Dec 2018 Dec 2019	100 000 x 10% = R10 000 (100 000 – 10 000) x 10% = 9 000 (100 000 – 19 000*) x 10% = R8 100 (100 000 – 27 100*) x 10% = R7 290

* 10 000(Y1) + 9 000 (Y2) = 19 000
* 10 000(Y1) + 9 000 (Y2) + 8 100 (Y3) = 27 100

Time-line

Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10
R10 000	R9 000	R8 100	R7 290	R6 561	R5 905	R5 314	R4 783	R4 305	R3 874

General journal: Year 1

(The amount of depreciation (a debit) being charged as an expense every year.)

	Debit	Credit
Depreciation	R10 000	
Accumulated depreciation		R10 000

General journal: Year 2

	Debit	Credit
Depreciation	R9 000	
Accumulated depreciation		R9 000

YEAR 1: Posted to general ledger

Expense

Dr	Depreciation		Cr
Accumulated depreciation	R10 000		

Dr	Accumulated depreciation		Cr
		Depreciation	R10 000

YEAR 2: Posted to general ledger

Dr	Depreciation		Cr
Accumulated depreciation	R9 000		

Dr	Accumulated depreciation		Cr
		Balance b/d Depreciation	R10 000 R9 000

Statement of profit and loss and other comprehensive income: disclosed as an expense

Statement of financial position: disclosed in the notes for property plant and equipment (PPE)

Property, plant and equipment includes the delivery vehicle. PPE is shown at carrying amount (CA) in the SFP, which is Cost less Accumulated depreciation. In this case for Y1, CA = R100 000 – R10 000 = R90 000.

3.3.6 Self-assessment exercise

Complete the following table by applying your knowledge acquired from working through the learning unit (Answers to the s*elf-assessment exercise* are included in “Lessons” for learning unit 3):

Question	**Answer**
What is a non-current asset?	
What is a current asset?	
What is depreciation?	
What are the methods of depreciation?	
What is accumulated depreciation?	
What is the useful life of the asset?	
What is the carrying amount of an asset?	

3.4 VAT (Value Added Tax)

Learning outcomes

After studying this learning unit, you should be able to:

- demonstrate an understanding of the principles and application of VAT
- list and explain relevant VAT terminology
- calculate the amount of VAT applicable
- record VAT transactions in the accounting records

Key concepts

- Value Added Tax (VAT)
- Vat vendor
- Entity
- Output VAT
- Input VAT
- Standard rated supply
- Zero-rated supply
- Exempt supply

3.4.1 Introduction

This learning unit aims to provide a brief and basic outline of some of the more founding principles of VAT as well as the calculation of the VAT owed by the vendor to the South African Revenue Service (SARS) or the VAT owed by SARS to the vendor and the accounting treatment thereof. VAT is levied in terms of the Value-Added Tax Act 89 of 1991.

3.4.2 What is VAT?

VAT is a tax added to the cost of a product or service and is levied for purposes of generating revenue for government. VAT is often referred to as a tax on consumption of goods or services, and is levied at 15% on the supply by a vendor of goods or services in the course or furtherance of any entity carried on by a vendor.

3.4.3 What is a VAT vendor and who must register as a VAT vendor?

QUICK NOTE	• *A "person" in this learning unit refers to sole proprietors, partnerships, close corporations, public companies, state-owned companies, personal liability companies and private companies.* • *A VAT vendor is defined in the Value Added Tax Act (referred to as the Act) as any person who is or is required to be registered under the Act.*

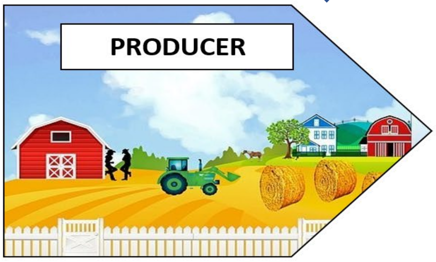
3.4.4 Schematic representation of the concept of VAT

VALUE ADDED TAX (VAT) = 15%

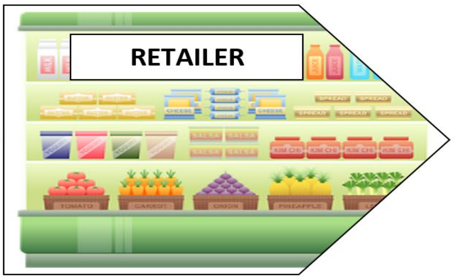
Added to the cost of a product or service and is levied for purposes of generating revenue for government.

Categories of supplies

- **Zero rated**
- **Standard rated**
- **Exempt**



Cost price: R1 600
+ 15% VAT: R240
= Selling price: R1 840



Cost price: R1 840 (value added)
+ 15% VAT: R276
= Selling price: R2 116

Cost price: R2 116 (value added)
+ 15% VAT: R317.40
= Selling price: R2 433.40

How do you calculate VAT?

If the amount given is <u>excluding</u> VAT:
Cost price x 15% = VAT
E.g. R1 000 x 15% = R150

If the amount given is <u>including</u> VAT:
Selling price / 115 x 15 = VAT
E.g. R1 150 / 115 x 15 = R150

Recording in financial records

VAT input = VAT that can be claimed back from SARS — **Asset**; **Inflow of cash**

VAT vendor pays R1 840 (inclusive) cash for stationery: **Debit:** **Stationery R1 600**
Debit: VAT input R240
Credit: **Bank R1 840**

VAT output = VAT that the business owes SARS — **Liability**; **Outflow of cash**

VAT vendor receives R2 116 (inclusive) cash for fees: **Debit:** **Bank R2 116**
Credit: **Fees earned R1 840**
Credit: VAT output R276

Dr VAT output Cr

Date	Details	R	Date	Details	R
2020	VAT control	276	2020	Cash receipts	276

Dr VAT input Cr

Date	Details	R	Date	Details	R
2020	Cash payments	240	2020	VAT control	240

Dr VAT control Cr

Date	Details	Fol	R	Date	Details	Fol	R
2020	VAT input		240	2020	VAT output		276
2020	Bank		36				

Amount paid over to SARS at month end

Recorded in the business cash payments journal (BCPJ)

The Act requires any person to register as a vendor for VAT purposes in South Africa if the person carries on an "entity" in South Africa, and:

- the total value of taxable supplies made by that person exceeds or is likely to exceed the registration threshold of R1 million for a twelve month period. Such persons are liable for compulsory registration as a vendor, or

- the value of taxable supplies by that person does not exceed the registration threshold of R1 million but exceeded R50 000 in the past twelve months or will exceed R50 000 within 12 months of registration. Such a person may register voluntarily.

Persons who do not meet the R1 million registration threshold but comply with certain requirements relating to ownership, can register for turnover tax. The rate of turnover tax applies on a sliding scale from 0% to 3% based on actual turnover (receipts).

3.4.5 Tax periods

The vendor is required to file vat returns to SARS in a specific tax period allocated by SARS to the vendor. The periods are:

- Category A: two month periods ending on uneven months (January, March etc)
- Category B: two month periods ending on even months (February, April etc)
- Category C: monthly periods
- Category D: six month periods ending February and August (for farmers)
- Category E: twelve month periods ending on the same date as the year-end of the vendor for income tax purposes.

3.4.6 Output VAT and Input VAT

Output VAT in relation to a vendor, is defined as the tax charged in respect of the supply of goods and services **by** the vendor. The tax charged is collected from the recipient of such goods and services by the vendor and is required to be paid over to SARS, even though the customer may not yet have paid for the goods or services.

Input VAT is defined as the VAT incurred on the supply of goods or service **to** the vendor. Also included in the definition of input VAT is the deemed input VAT deduction on the acquisition of second-hand goods. Input VAT is only deductible to the extent that it is uncured for the purpose of consumption, use or supply, in the course of making taxable supplies (e.g. Fees). An input VAT deduction may be claimed for a period of 5 years from the date of receipt of the tax invoice.

Net: VAT payable or refundable The difference between the amount of output VAT attributable to a tax period, and the deductible input VAT not previously claimed by a vendor, represents the VAT payable to or refundable by SARS. To the extent that the output VAT exceeds the allowable input VAT deductions, a VAT payment will be due to SARS. Where a vendor's permissible input VAT deductions exceed the amount of output VAT for a tax period, a VAT refund may be claimed from SARS.

A vendor is required to retain a valid tax invoice as proof of any input tax deductions which are made. These tax invoices as well as other records of transactions must be retained for a period of at least 5 years.

3.4.7 Different categories of supplies

For VAT purposes all supplies are treated as either being a **standard rated** supply, a **zero-rated** supply or an **exempt** supply. Supplies (good or services) that are standard rated or zero-rated are considered to be 'taxable supplies' as defined.

Standard rated supplies are supplies that are subject to VAT at the prescribed rate of 15%. The supply of goods and services are generally subject to VAT at the standard rate, unless such supply is specifically zero-rated or exempt in terms of the Act. Vendors making standard rated supplies are required to levy output VAT at the prescribed rate of 15% on the value of the supply which must then be paid over to SARS. Such vendor may claim its input VAT deductions on goods or services acquired in the course of making such taxable supplies.

A zero-rated supply is a taxable supply on which VAT is levied at the rate of 0%. Therefore no output tax will be payable to SARS in respect of zero-rated supplies. Section 11 of the VAT Act sets out specific instances of supplies of goods and services that may be zero-rated. Vendors making zero-rated supplies are entitled to claim their input VAT deductions on goods or services acquired in the course of making such zero-rated supplies.

An exempt supply is **not** a taxable supply. An exempt supply is the supply of goods or services upon which neither VAT at the standard rate or zero-rate is chargeable. Supplies which constitute exempt supplies are specifically provided for in section 12 of the VAT Act. Vendors may not claim an input tax deduction in respect of goods or services acquired in the course or furtherance of making exempt supplies. A person that makes only exempt supplies cannot register as a vendor as such person will not be seen to be carrying on an 'entity' as defined.

No VAT can be claimed or charged on exempt supplies.

The main differences between zero-rated and exempt supplies are:

- Suppliers of zero-rated goods/services may be registered for VAT, but vendors of exempt supplies may not.
- The supplier of a zero-rated item may claim input VAT on the inputs made to render the particular zero-rated supply. No input VAT may, however, be claimed on the inputs to exempt supplies.

The following supplies are **zero-rated** supplies in a legal practice:

- Services to welfare organisations
- The sale of an entity (or part thereof) as a going concern
- Fuel

The following supplies are **exempt** from VAT:

- Sheriff (messenger of the court-) tariffs
- Interest received on clients' overdue balances
- Interest paid
- Residential accommodation
- Educational services

Although the following items may include VAT at 15%, no input VAT may be claimed as they are specifically excluded in the VAT Act:

- Entertainment expenses
- Membership fees in respect of membership of any club of a sport participating, social or recreational nature
- Goods and services not utilised for taxable supplies
- Salaries and wages
- Goods and services purchased from a non-vendor (i.e. a person or entity who is not registered for VAT with the exception of a notional input VAT such as second-hand goods
- Passenger vehicles

Expenses paid out of the trust money of clients, and expenses paid on behalf of clients by a legal practice, are **not** services rendered to the legal practice but to the client. The practise can therefore not claim input VAT on the payments. The individual clients can claim the input VAT. Examples of such payments are:

- Advocate fees
- Rates and taxes on conveyancing transactions
- Occupational rent, etc.

3.4.8 Responsibilities as a VAT vendor

Persons registering as vendors should bear in mind the duties associated with being a vendor. These include, *inter alia,* the collection or levying of VAT on taxable transactions, the issuing of tax invoices within 21 days from the time the supply was made, record retention for a period of 5 years and the submission of VAT returns and payments of the VAT liability. VAT is due and payable on the 25th day of the month following a one, two, six or twelve month period assigned to the vendor by SARS.

Notes

3.4.9 Tax invoices

The VAT Act prescribes that a tax invoice must contain certain details about the taxable supply. As from 8 January 2016, the following information must be reflected on a tax invoice where the consideration (price) exceeds R5 000 for it to be considered valid:

(1) It must contain the words "Tax Invoice", "VAT Invoice" or "Invoice"
(2) Name address and VAT registration number of the supplier
(3) Name, address and where the recipient is a vendor, the recipient's VAT registration number
(4) Serial number of invoice and the date of issue
(5) Accurate description of goods and and/or services, indicating where applicable that the goods are second hand goods
(6) Quantity or volume of goods or services supplied
(7) Value of the supply, the amount of tax charged and the consideration of the supply

For tax invoices where the consideration is R5 000 or less, the information in (1), (2), (4), (5) and (7) above is required.

3.4.10 The accounting treatment of VAT

Every registered VAT vendor that renders a service or sells products to other entities, is obliged to charge VAT on these supplies, except in cases where the supply is deemed to be zero-rated or exempt of VAT.

The process will be explained by means of the following example:

EXAMPLE 3.6

S Africa attorneys charged Mrs Nkosi fees to the amount of R10 250 (**ex**cluding VAT) for her divorce and a R250 collection fee (**ex**cluding VAT) for collecting R2 500 from her husband.

The following expenses have been paid from the business bank account:
- R460 for office supplies,
- R2 000 for salaries,
- R500 for fuel, and
- R1 725 for office rent

All these payments were accompanied by valid tax invoices and include VAT at 15% where applicable.

REQUIRED:

Calculate the amount of VAT payable to SARS.

EXPLANATION 3.6

S Africa Attorneys

		VAT calculation R	VAT amount R
Output VAT: Services rendered	(R10 250 + R250) = R10 500 (Excluding VAT)	10 500 x 15%	1 575
			(285)
Input VAT: Office supplies	R460 (Including VAT)	460 x $^{15}/_{115}$	60
Salaries	R2 000 (Including VAT)	Exempt	–
Fuel	R500 (Including VAT)	Zero-rated	–
Office rent	R1 725 (Including VAT)	1 725 x $^{15}/_{115}$	225
Net VAT payable			1 290

Explanation for office supplies and office rent

Both the figures already include VAT. The inclusive amounts are therefore equal to 100% + 15%.The amounts need to be divided by 115% and multiplied with 100% to get the amounts before VAT. VAT can then be calculated by multiplying the "before" VAT amounts with 15%. A simplified method as applied in the above calculation is to combine the two calculation by dividing the "after" VAT amounts by 115% and multiplying the answer with 15%.

EXAMPLE 3.7

Complete the following table, on the basis that all supplies were done via a valid tax invoice (where applicable).

EXPENSES / PAYMENTS	INCOME / RECEIPTS	Can input VAT be claimed back?	Should output VAT be charged and paid over?	COMMENTS
Example: Vehicle purchased for business use		YES		As long as the vehicle is not a passenger vehicle
	Example: Cash received for services rendered		YES	Standard supply @ 15%
Drawings of cash by one of the partners				
Drawings of stationery by one of the partners				
	Services rendered on credit			
Purchase fuel for the delivery vehicle				

EXPLANATION 3.7

EXPENSES / PAYMENTS	INCOME / RECEIPTS	Can input VAT be claimed back?	Should output VAT be charged and paid over?	COMMENTS
Stationery purchased on credit		YES		Standard supply
Drawings of cash by one of the partners			NO	Cash withdrawn has already been taxed
Drawings of stationery by one of the partners			YES	Input VAT was claimed on the stationery
	Services rendered on credit		YES	Standard supply on invoice basis
Purchase fuel for the delivery vehicle		YES		Zero – rated supply

EXAMPLE 3.8

The following transactions of SA Attorneys took place during June 2020:

SA Attorneys charged a client, A South, fees to the amount of R12 650 (VAT inclusive) for her divorce and a R667 collection fee (VAT inclusive) for collecting R2 500 from her husband.

The following expenses have been paid from the business bank account:

- R4 600 for rental of office space,
- R20 000 for salaries,
- R1 955 for stationery

All of the payments were accompanied by valid tax invoices and include VAT at 15% where applicable.

REQUIRED:

Account for the above transactions in the accounting records of SA Attorneys.

Notes

EXPLANATION 3.8

QUICK NOTE	*Summary of the impact of the transactions —* *Fees levied* ▶ *SA Attorneys has levied fees to a client. VAT is included in the amounts levied.* ▶ *The transactions will increase the income of SA Attorneys.* ▶ *The increase of income is a credit.* ▶ *The VAT included in the income to be received is a VAT output (credit - current liability).* ▶ *The fees levied are debited to the clients accounts (an asset).* *Expenses* ▶ *SA Attorneys have incurred expenses. VAT is included in the amounts paid.* ▶ *The transactions will increase the expenses of SA Attorneys.* ▶ *The increase of expenses is a debit.* ▶ *The VAT included in the expenses paid is a VAT input (debit - current asset).* ▶ *The payment from the bank account reduces the bank account (an asset) which means the bank account is credited.*

Accounting records of SA Attorneys for June 2020

In the general ledger, there is an account for clients (debtors) control (**B1**). This account represents the Clients ledger (a sub-ledger). In the clients ledger, there will be a separate account for each client i.e. **A South.** The balance of A South's account in the clients ledger will reflect as R13 327. At the end of each financial period a "List of client accounts" is prepared and the total of the list must equal the balance on the client's control account in the general ledger.

1. Fees journal

FJ

Date	Details	Fol.	Clients control R	VAT output R	Fees R
30/06	**A South** (Divorce)	TCL1	12 650	1 650	11 000
30/06	A South (Collection fees)	TCL1	667	87	580
			13 317	1 737	11 580
			B1	B3	N1

2. Business cash payments journal

BCPJ

Date	Details	Fol.	Sundry accounts R	VAT input R	Bank R
30/06	Rental of office space	N2	4 000	600	4 600
30/06	Salaries	N4	20 000	–	20 000
30/06	Stationery	N3	1 700	255	1 955
			24 700	855	26 555
				B3	B2

3. General ledger accounts

Dr **Fees earned** **N1** **Cr**

2020			R	2020			R
				30/06	Fees earned	FJ	11 580

Dr **Clients control account** **B1** **Cr**

2020			R	2020			R
30/06	Fees earned	FJ	13 317				

Dr **Bank account** **B2** **Cr**

2020			R	2020			R
				30/06	Cash payments		26 555

Dr **VAT control account** **B3** **Cr**

2020			R	2020			R
30/06	Cash payments	BCPJ	855	30/06	Fees earned	FJ	1 737

The balance on the VAT control account is **R882** (1 737 – 855). Therefore, there is an amount of R882 owing (credit balance) to SARS for output tax.

Dr		Office rental				N2	Cr
2020			R	2020			R
30/06	Business bank	BCPJ	4 000				

Dr		Stationery				N3	Cr
2020			R	2020			R
30/06	Business bank	BCPJ	1 700				

Dr		Salaries				N4	Cr
2020			R	2020			R
30/06	Business bank	BCPJ	20 000				

4. Clients ledger account

Dr		A South				TCL1	Cr
2020			R	2020			R
30/06	Fees levied	FJ	12 650				
30/06	Fees levied	FJ	667				
			13 317				

5. List of client accounts

	R
A South	13 317
	13 317 *

* The balance of the ledger account “Clients control account (B1)” is R13 317.

3.4.11 Self-assessment exercise

Question	Answer
What is VAT an acronym for?	
What is VAT?	
What is the VAT Act?	
What is an indirect tax?	
What is the current VAT rate?	
What is the government's revenue service	
What is a VAT vendor?	
When do you register as a VAT vendor?	

Question	Answer
What is a zero rated product?	
What does it mean to say "VAT inclusive or including VAT"	
What does it mean to say "VAT exclusive or excluding VAT"	
What is the VAT percentage (15%) based on?	
What is output VAT?	
What is input VAT?	
Can you advertise prices excluding VAT?	
Calculate the amount of output VAT for the transaction. Client A is invoiced for fees. The fees levied are R10 000 (VAT inclusive).	

<table>
<tr><th>Question</th><th colspan="4">Answer</th></tr>
<tr><td rowspan="3">Record the above transaction re fees levied, in the applicable journal.</td><td colspan="4">FJ</td></tr>
<tr><td>Detail</td><td>Clients
R</td><td>VAT output
R</td><td>Fees
R</td></tr>
<tr><td></td><td></td><td></td><td></td></tr>
<tr><td rowspan="6">Record the above transaction re fees levied, in the applicable general ledger account.</td><td colspan="4">Dr VAT control account Cr</td></tr>
<tr><td colspan="2"></td><td colspan="2"></td></tr>
<tr><td colspan="4">Dr Clients control Cr</td></tr>
<tr><td colspan="2"></td><td colspan="2"></td></tr>
<tr><td colspan="4">Dr Fees Cr</td></tr>
<tr><td colspan="2"></td><td colspan="2"></td></tr>
<tr><td>Calculate the amount of input VAT for the transaction.
Paid an invoice for a laptop – R9 200 (VAT inclusive).</td><td colspan="4"></td></tr>
<tr><td rowspan="3">Record the above transaction re purchase of laptop, in the applicable journal.</td><td colspan="4">BCPJ</td></tr>
<tr><td>Detail</td><td>Computer equipment
R</td><td>VAT input
R</td><td>Bank
R</td></tr>
<tr><td></td><td></td><td></td><td></td></tr>
<tr><td rowspan="6">Record the above transaction re purchase of laptop, in the applicable general ledger account.</td><td colspan="4">Dr VAT control account Cr</td></tr>
<tr><td colspan="2"></td><td colspan="2"></td></tr>
<tr><td colspan="4">Dr Computer equipment Cr</td></tr>
<tr><td colspan="2"></td><td colspan="2"></td></tr>
<tr><td colspan="4">Dr Bank Cr</td></tr>
<tr><td colspan="2"></td><td colspan="2"></td></tr>
</table>

3.5 Bank reconciliations

This section of the learning unit will explain the purpose of a bank reconciliation and describe the various reconciling items. This will enable you to prepare a bank reconciliation statement.

Learning outcomes

After studying this learning unit, you should be able to:

- explain the purpose of a bank reconciliation
- list the various reconciling items
- prepare a bank reconciliation statement.

Key concepts

- Electronic fund transfer (EFT)
- Deposit
- Debit order
- Bank costs (e.g. Service fees)
- Interest
- Bank statement

3.5.1 Introduction

The rules for the Attorneys' Profession require that the accounting records of a legal practice (including the bank reconciliation statement) be updated and balanced on a monthly basis. A business can arrange with the bank to issue a bank statement at regular intervals, usually monthly.

The bank statement shows, among other things, the opening balance for the period, bank transactions made during the period and the closing balance for the period. Since bank transactions made by the business are also recorded in its cash journals, the balance shown in the bank statement *SHOULD agree* with the balance in the bank account as per the general ledger of the business. This is rarely the case.

Some of the reasons why the two balances do not agree are as follows:

- **Outstanding electronic fund transfers (EFT's):** there are electronic fund transfers (EFT) made by the business to creditors and third parties during the period, which have not yet been debited in the bank statement.

- **Outstanding deposits:** these are deposits banked in the bank account by the business during the statement period but which have not yet been credited in the bank statement.

- **Direct deposits:** these are deposits made by clients and third parties directly into the bank account of the business, which have not yet been included in the cash receipts journal. The deposits include both cheque deposits and electronic fund transfers.

- **Direct electronic fund transfers and debit orders:** these are payments/transfers to service providers (e.g. insurance companies) directly by the bank; which have not yet been included in the cash payments journal.

- **Bank charges:** these comprise of service fees, commissions, ledger fees etc. Because of the nature of these charges, they can only be recorded in the cash payments journal when the bank statement is received.

- **Interest charged on overdraft:** this is the cost of overdrawing the bank account. The bank statement will reflect a debit balance. Again, the bank interest can only be recorded in the cash payments journal when the bank statement is received.

- **Errors made by the business or the bank:** these can be errors made when entering the incorrect amounts in the cash journals or bank statement e.g. R255 instead of R225 or R546 instead of R456.

The reasons listed above can be classified under the following categories:

a) Entries in the cash journals, but not in the bank statement

The following items must be entered in the bank reconciliation statement:

- Outstanding deposits
- Outstanding electronic fund transfers

b) Items in the bank statement, but not in the cash journals

These following items must be entered in the cash journals:

- Direct deposits
- Bank charges
- Direct electronic fund transfers and debit orders
- Interest on overdraft

c) Items which can affect either the bank statement or the cash journals

Errors made by the bank must be corrected in the bank reconciliation statement and errors made by the business must be corrected in the cash journals.

LBL PAUSE	*Deposits are shown as debit entries in the bank account in the general ledger but as credit entries in the bank statement.* *Payments are shown as credit entries in the bank account in the general ledger but as debit entries in the bank statement.*	See Lessons Deposits and payments

A *favourable* balance is shown as a *debit in the bank account in the general ledger* and a *credit in the bank statement* and an unfavourable balance as a credit in the bank account in the general ledger and a debit in the bank statement.

QUICK NOTE

A favourable bank account is an asset to the business. To increase the bank balance the general ledger account is debited and the payments made from the bank account are credited to the bank account in the general ledger.

The accounting equation is as follows

Assets	=	Equity	+	Liabilities
+ receipts		—		—
- payments		—		—

If the business has a favourable balance with the Bank, the account of the business in the accounting records of the Bank with be unfavourable for the Bank. The Bank owes the business the deposited funds. The balance in the Bank's accounting records will be a credit as it is a liability for the Bank.

3.5.2 Steps in the bank reconciliation process

The bank reconciliation statement can be prepared by following the steps listed below:

STEPS

1. *Compare the debit column of the bank statement with the cash payments journal in the accounting records. Tick off items, which appear in both the bank statement and the cash journal.*
2. *Compare the credit column of the bank statement with the cash receipts journal in the accounting records. Tick off items, which appear in both the bank statement and the cash receipts journal.*
3. *Update the cash receipts journal and the cash payments journal with the items in the bank statement, which are not in the cash journals i.e. bank charges. Correct any errors made in the cash journals.*
4. *Use the totals obtained from the updated cash journals to prepare an adjusted bank account in the general ledger. (i.e. balance the ledger account.)*
5. *Prepare the bank reconciliation statement. Always start with the closing balance as per the bank statement. Taking the outstanding deposits and outstanding electronic fund transfers listed under a) in section 3.5.1 above, into account. Correct any errors made by the bank, in the bank reconciliation statement. The final balance on the bank reconciliation statement should agree with the closing balance as per the **adjusted** bank account.*

3.5.3 Schematic representation: Bank reconciliation

Step 1: Obtain bank statement, cash receipts journal and cash payments journal

Bank

Aim of bank reconciliation is to insure that all cash transactions are correctly recorded in the records of the business

Cash journals

Prepared by bank	Prepared by business
External source document	Internally generated journals from source documents
Bank records all deposits and with-drawals from bank account	All cash receipts are recorded in the cash receipts journal All cash payments are recorded in the cash payments journal

Step 2: Compare the bank statement and the journal

BANK STATEMENT OF AM DEALERS FOR SEPTEMBER 20.1

Address: 46 Kaskastreet

Tshwane

0003

Date	Details	Debits R	Credits R	Balance R
01.09.20.1	Balance			2 400
05.09.20.1	Deposit		500v	2 900
06.09.20.1	Cheque no: B110	420v		2 480

Cash receipts journal

Day	Details	Analysis R	Bank R	
5	Cash sales	500	500	v
9	A Bean	1 240	1 240	

Cash payments journal

Cheque no	Day	Details	Bank R	
B110	6	T Yoti PNA	420	v
B111	12	Municipality	64	

Tick all transactions that appear on the bank statement and in one of the cash journals

Step 3: Record all transactions that appear only on the bank statement in the correct cash journal

Examples: Cash receipts journal	Examples: Cash payments journal
• Direct deposit from client • Interest received from bank • Correction of errors	• Correction of error • Debit order • Bank charges • Interest paid to bank • Correction of errors

Step 4: Prepare the bank account in the general ledger

Dr		Bank			Cr
		R			R
Opening	Balance (favourable)	xxx	Opening	Balance unfavourable)	xxx
	Cash receipts	xxx		Cash payments	xxx
		xxx			xxx
New closing	Balance (favourable)	xxx	New closing	Balance (unfavourable)	xxx

Step 5: Prepare the bank reconciliation statement (All transactions in cash journals not appearing on bank statements)

Bank reconciliation statement as at …..		
	Debit	**Credit**
Balance as per bank statement	Unfavourable	Favourable
Credit outstanding deposits		xxx
Debit outstanding payments	xxx	
Balance as per bank account	Favourable	Unfavourable
	xxx	**xxx**

Amounts should balance

3.5.4 First bank reconciliation of the business

EXAMPLE 3.9

The following are the accounting records of Mann Attorneys for the month ended 30 September 2020:

Bank statement of Mann Attorneys for September 2020

2020 Date	Details	Debits R	Credits R	Balance R
01/09	Deposit (Owner's capital)		2 400	2 400
01/09	Deposit (EFT from client)		500	2 900
07/09	EFT paid 001	420		2 480
09/09	Deposit (EFT from client)		1 240	3 720
13/09	EFT paid 002	64		3 656
19/09	EFT paid 003 - Municipality	104		3 552
20/09	Deposit (EFT from client)		160	3 712
21/09	EFT paid 004	1 288		2 424
22/09	Service fee	1		2 423
26/09	Deposit (EFT from client)		1 680	4 103
27/09	EFT paid 005 – Monate Ltd	600		3 503
28/09	EFT paid 006	48		3 455
30/09	Bank charges	10		3 445
	Service fee	5		3 440
	Debit order- insurance	300		3 140
	Deposit (EFT from client)		200	3 340

Cash receipts journal (bank column only) for September 2020

2020 Date	Particulars	Amount R
01/09	A Mann (Owner's contribution)	2 400
05/09	A South (client)	500
09/09	B Gauteng (client)	1 240
20/09	S Africa (client)	160
26/09	C Kwazulu (client)	1 680
28/09	D Western (client)	480
	Total	6 460

Cash payments journal (bank column only) for September 2020

2020 Date	Details	Amount R
06/09	EFT paid 001 – T Yoti	420
12/09	EFT paid 002 – Stationery	64
18/09	EFT 300 – Municipality	104
20/09	EFT paid 004 – Town Furnishers	1 288
26/09	EFT paid 005 – Monate Ltd.	600
28/09	EFT paid 006 – Green stores	48
29/09	EFT paid 008 - Rolke Engineers	612
	Total	3 136

REQUIRED:

a) Complete the cash receipts journal and the cash payments journal of Mann Attorneys for September 2020 from the information given above.

b) Compile the bank reconciliation statement of Mann Attorneys at 30 September 2020.

EXPLANATION 3.9

When a business entity starts its operations for the first time, the bank reconciliation is relatively simple. The only accounting records needed to do the reconciliation are the cash receipts journal, the cash payments journal and the bank statement. Both the bank account in the general ledger and the bank statement will not have opening balances.

STEPS

1. *Compare the debit column of the bank statement with the cash payments journal. Tick off items, which appear in both the bank statement (debit column) and cash payments journal. Outstanding items will be the service fee (R6), cash fees (R10), debit order (R300), and a credit card (CC) payment to Roll Engineers (R612). When the CC payment was made the bank system was offline.*
2. *Compare the credit column of the bank statement with the cash receipts journal. Tick off items, which appear in both the bank statement (credit column) and the cash receipts journal. Outstanding items will be the direct deposit (R200) and the cash sales (R480) deposited on 28 September 2020.*
3. *Update the cash receipts journal and the cash payments journal with items in the bank statement, which are not in the cash journals.*
4. *Use the totals obtained from the updated cash receipts journal and cash payments journal to prepare an adjusted bank account.*
5. *Prepare the bank reconciliation statement.*

1. Cash receipts journal (abridged)

Details	Amount R
Original total	6 460
Direct deposit – A Thlape	200
Total	6 660

2. Cash payments journal (abridged)

Details	Amount R
Original total	3 136
Service fee	16
Debit order	300
Total	3 452

3. Adjusted bank account

Dr **Adjusted bank account** **Cr**

	R		R
Total receipts	6 660	Total payments	3 452
		Balance c/d	3 208
	6 660		6 660
Balance b/d	3 208		

4. Bank reconciliation statement of Mann Attorneys at 30 September 2020

Details	Dr R	Cr R
Credit balance as per bank statement		3 340
Credit outstanding deposit: 28 September 2020		480
Debit outstanding CC payment	612	
Debit balance as per bank account	3 208	
	3 820	3 820

QUICK NOTE

*A credit balance (favourable) on the **bank statement** is shown in the credit column of the bank reconciliation statement.*

*If the **bank statement** had a debit (unfavourable/overdrawn) balance, it would be shown in the debit column of the bank reconciliation statement.*

EXAMPLE 3.10

In this example Steps 1 and 2 have already been done.

The bank account in the accounting records of Western Stores showed an unfavourable balance of R1 040 on 31 October 2020. On the same date, the business bank statement showed a favourable balance of R1 400. A comparison of the bank statement with the cash journals revealed the following differences:

a) A deposit of R760 on 31 October 2020 was not credited in the bank statement.

b) An electronic funds transfer 007 for R4 200 has not been included in the bank statement by 31 October 2020.

c) The bank made the following charges:

- interest on overdrawn account of R390, and
- service fees of R110.

e) Original totals:

- cash receipts journal, R9 100
- cash payments journal, R9 600.

REQUIRED:

a) Complete the cash journals of Western Stores for October 2020 from the information given above.

b) Compile the bank reconciliation statement of Western Stores at 31 October 2020.

EXPLANATION 3.10

Cash payments journal for October 2020

Details	**Amount R**
Original total	9 600
Interest on overdraft	390
Service fees	110
Total	10 100

Dr — Adjusted bank account — Cr

	R		R
Total receipts	9 100	Opening balance	1 040
Closing balance c/d	2 040	Total payments	10 100
	11 140		11 140
		Opening balance b/d	2 040

Bank reconciliation statement as at 31 October 2020

Details	Dr R	Cr R
Credit balance as per bank statement		1 400
Credit outstanding deposit		760
Debit outstanding EFT payment: no 007	4 200	
Debit balance as per adjusted bank account		2 040
	4 200	4 200

3.5.4 Subsequent bank reconciliations

Bank reconciliation where a bank reconciliation statement was prepared in the previous financial period

Where a bank reconciliation statement was prepared in the previous period, the first step will be to ascertain if the cheques, electronic fund transfers and deposits outstanding as per the previous bank reconciliation statement appear in this period's bank statement. The items that appear in this period's bank statement must be ticked off first and those still outstanding from the previous period must be noted and shown in the current period's bank reconciliation statement as outstanding. The 'normal' procedures for bank reconciliation statements will then be followed to prepare the bank reconciliation statement for the current period.

Notes

EXAMPLE 3.11

Natal Traders is a general dealer in food and other household items in the rural areas of Mpumalanga. Natal Traders prepared the following bank reconciliation statement for July 2020.

Bank reconciliation statement for July 2020

Details	Dr R	Cr R
Credit balance as per bank statement at 31 July 2020		974
Credit outstanding cash deposit		360
Debit balance as per adjusted bank account	1 334	
	1 334	1 334

The business received the following bank statement for August 2020:

Date	Details	Debit R	Credit R	Balance R
Aug 1	Balance			974
	Bank deposit		360	1 334
6	Bank deposit		1 000	2 334
7	EFT payment 48	900		1 434
	ATM fees	8		1 426
	Service fees	12		1 414
	EFT payment 49	400		1 014
12	Deposit		384	1 398
13	EFT payment 50	168		1 230
15	EFT payment 51	77		1 153
15	EFT payment 52	71		1 082
16	EFT payment 53	136		946
19	Bank deposit		800	1 746
20	Direct deposit		80	1 826
27	EFT payment 54	70		1 756
30	EFT payment 55	750		1 006
	Debit order payment	550		456

Cash receipts journal for August 2020 (Abridged) (CRJ)

Details	Amount R
S African	1 000
Cash sales	384
A South	800
Cash sales	583
Total	2 767

Cash payments journal for August 2020 (Abridged) (CPJ)

Details	Amount R
EFT048	900
EFT049	400
EFT050	168
EFT051	77
EFT052	71
EFT053	136
EFT054	70
EFT055	750
Total	2 572

REQUIRED:

a) Complete the cash journals of Natal Traders for August 2020 from the information given above.

b) Post the cash journals to the bank account in the general ledger.

c) Prepare a bank reconciliation statement for August 2020.

EXPLANATION 3.11

QUICK NOTE

As part of the explanation for clearing the items between the bank statement and the cash payments journal and cash receipts journal the relevant parts of the question have been replicated below. When answering the question you would not need that, as you would use the information in the question as your workings.

Bank reconciliation statement for July 2020

The first step is to clear the items that were shown as outstanding in the bank reconciliation of the previous month.

	Dr R	Cr R
Credit balance as per *bank statement* at 31 July 2020 ƶ		974
Credit outstanding cash deposit		360
Debit balance as per adjusted bank account	1 334	
	1 334	1 334

The business received the following bank statement for August 2020:

Date	Details	Debit R	Credit R	Balance R
Aug 1	Balance ƶ opening balance of bank statement is the closing balance per the July bank reconciliation			974
	Bank deposit		360	1 334
6	Bank deposit		1 000	2 334
7	EFT payment 48	900		1 434
	ATM fees	8		1 426
	Service fees	12		1 414
	EFT payment 49	400		1 014
12	Deposit		384	1 398
13	EFT payment 50	168		1 230
	EFT payment 51	77		1 153
	EFT payment 52	71		1 082
16	EFT payment 53	136		946
19	Bank deposit		800	1 746
20	Direct deposit [o/s]		80	1 826
27	EFT payment 54	70		1 756
30	EFT payment 55	750		1 006
	Debit order payment	550		456

Notes

Cash receipts journal for August 2020 (Abridged) (CRJ)

Details	Amount R
S African	1 000
Cash sales	384
A South	800
Cash sales [o/s]	583
Total	2 767

Cash payments journal for August 2020 (Abridged) (CPJ)

Details	Amount R
EFT048	900
EFT049	400
EFT050	168
EFT051	77
EFT052	71
EFT053	136
EFT054	70
EFT055	750
Total	2 572

The following are the steps for answering the required section of the question:

STEPS

1. *Update the cash receipts journal and the cash payments journal with items in the bank statement, which are not in the cash journals.*
2. *Use the totals obtained from the updated cash receipts journal and cash payments journal to prepare an adjusted bank account.*
3. *Prepare the bank reconciliation statement.*

Updated cash receipts journal for August 2020 (Abridged)

Details	Amount R
Original total	2 767
Direct deposit	80
Total	2 847

Updated cash payments journal for August 2020 (Abridged)

Details	Amount R
Original total	2 572
Bank costs	8
Service fee	12
Debit order	550
Total	3 142

Dr **Adjusted bank account** **Cr**

	R		R
Opening balance b/d	1 334	Payments	3 142
Receipts	2 847	Closing balance c/d	1 039
	4 181		4 181
Opening balance b/d	1 039		

Bank reconciliation statement for August 2020

	Dr R	Cr R
Credit balance as per bank statement		456
Credit outstanding deposit		583
Debit balance as per bank account	1 039	
	1 039	1 039

The bank reconciliation balances!!

3.5.5 Self-assessment exercises

Question	Answer
What is a bank reconciliation?	
What is the aim of a bank reconciliation?	
Why is it necessary (important) to perform a bank reconciliation?	
What type of items are reconciling items in a bank reconciliation?	
Describe the difference between the bank account in the general ledger and the bank statement.	
What is the starting point of a bank reconciliation?	
What is the procedure for performing a bank reconciliation?	

FINANCIAL ACCOUNTING PRINCIPLES FOR LAW PRACTITIONERS

LEARNING UNIT

4 RECORDING OF TRANSACTIONS IN THE BOOKS OF FIRST ENTRY

Contents

Learning outcomes

After studying this learning unit, you should be able to:

- demonstrate an understanding of the accounting process
- distinguish between books of first entry and ledgers
- distinguish between cash and non-cash transactions
- identify trust and business transactions
- demonstrate an understanding of the differences between trust and business money
- determine which journal should be used for each transaction
- explain the principle of trust and business cash journals
- distinguish between the cash receipts journal and cash payments journal
- distinguish between the trust and business cash journals (bank accounts)
- explain the principle of a petty cash book
- record petty cash transactions and balance the petty cash book
- list the various journals and describe their separate functions
  - fees journal
  - advocates journal
  - sheriffs journal
  - general journal
- explain when a journal is used
- prepare the different journal entries
- demonstrate an understanding of the entries that are made when receiving and paying accounts on behalf of clients in respect of:
  - counsel fees
  - tracing agent fees
  - witness fees
  - advocate fees, and
  - sheriff fees

Key concepts

- Transaction
- Books of first entry
- Cash journals
- Petty cash book/journal
- Fees journal
- Advocates journal
- Sheriffs journal
- General journal
- Ledgers
- Trust transactions
- Business transactions
- Payments on behalf of clients
- Trust money

Acronyms

BCRJ	Business cash receipts journal
BCPJ	Business cash payments journal
CL	Clients ledger
FJ	Fees journal
GJ	General journal
LPA	Legal Practice Act, 28 of 2014
LPC Rules	Legal Practice Council Rules
TJ	Transfer journal
TCL	Trust creditors ledger
TCRJ	Trust cash receipts journal
TCPJ	Trust cash payments journal

4. Introduction

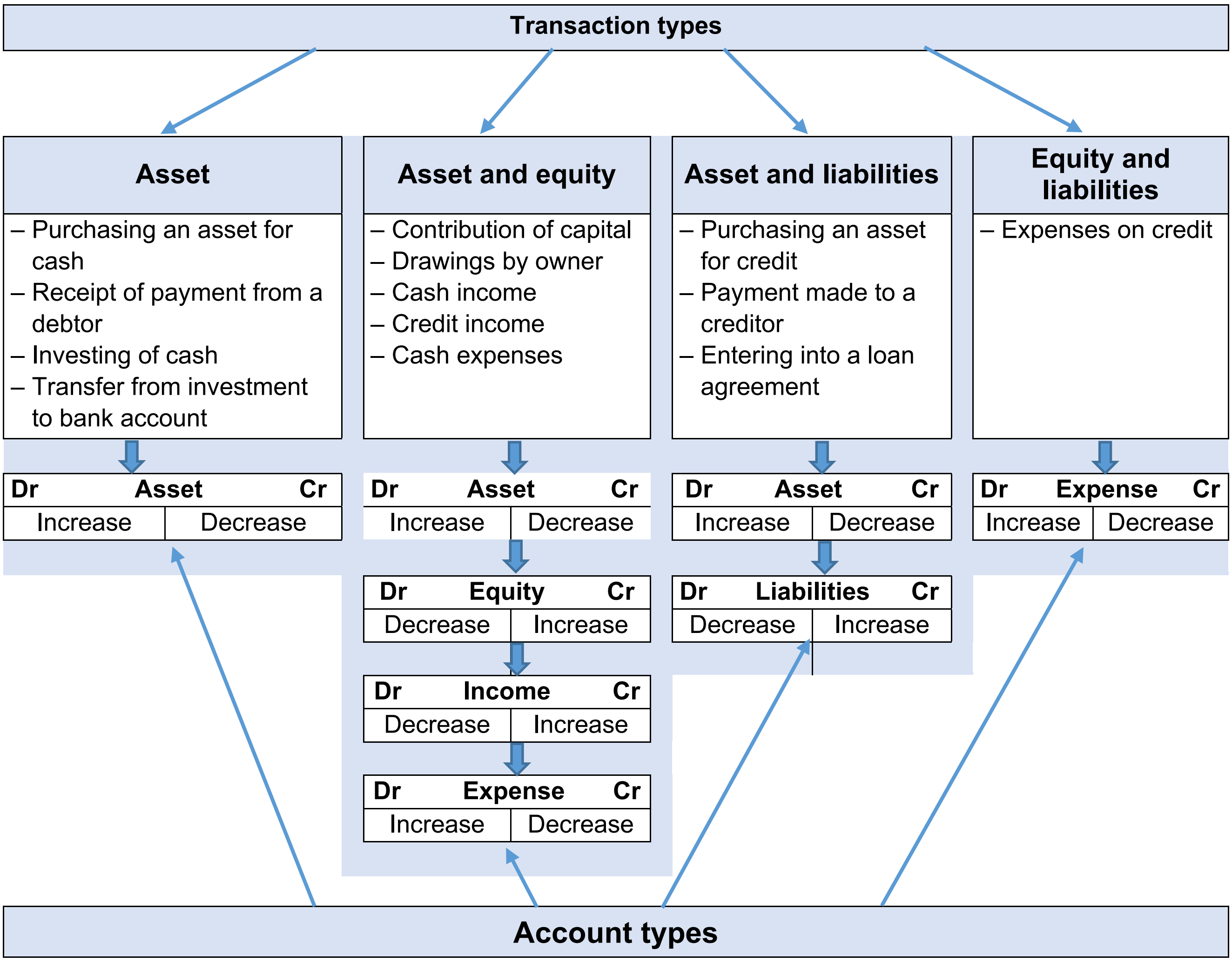
In practice, there are transactions that occur repeatedly during the accounting process and instead of entering them all into the ledgers, which is impracticable use is made of books of first entries. The transactions are summarised in the books of first entry and contain the information such as names of parties to the transaction, description of transactions, source document numbers etc.

4.1 Accounting cycle

The accounting cycle details the formal accounting process. The steps discussed in this learning unit are as follows (indicated by yellow shading):

Transactions	The accounting process starts once a transaction has taken place.
Source documents	Source documents provide the evidence for a transaction having taken place
Books of prime entry	The source document is prepared and the information is entered into the books of prime entry
Ledger accounts	The entries from the books of prime entry are posted to the general ledger, creditors' ledger, and debtors' ledger.
Trial balance	The trial balance is drawn up from the accounts in the general ledger
Financial statements	The financial statements are drawn up from the trial balance

4.2 Overview of the recording of transactions



4.3 Purpose of books of first entry

Rule 54.6 of the Law Society requires that accounting records containing the day to day transactions of all monies received, held or paid by a law practitioner on his own account (his business) or for, or on behalf of any person (the trust), be kept.

Books of first entry are books where the transactions are listed when they first occur, with their entries being made on a daily basis before they are posted to their respective ledger accounts. The information in the source documents is used to record the entries in the books of first entry. The purpose of the journals is to make a detailed, chronological analysis of transactions as depicted by the source documents.

Although all transactions can be reflected by means of a double-entry in a T-format, it would be beneficial for any attorney's firm to first analyse each transaction in a journal or book of first entry.

For every transaction, a source document needs to be completed. When the firm receives cash, a receipt is issued and when services are rendered on credit (customer pays later), an invoice or debit note is issued, etc.

The purpose of the journals is to make a detailed, chronological analysis of transactions as depicted by the source documents. Different journals are used for different types of transactions and the following are examples of the books of first entry that will be encountered in an attorney's practice:

Journal name	Journal description	LBL
Business cash receipts journal	The business cash receipts journal and the business cash payments journal are used to record flows of cash into and out of the business bank account.	See Lessons BCRJ
Business cash payments journal		See Lessons BCPJ
Trust cash receipts journal	The trust cash receipts journal and trust cash payments journal are used to record flows of cash into and out of the trust bank account.	See Lessons TCRJ
Trust cash payments journal		See Lessons TCRJ
Sheriffs' journal	The sheriffs' journal is used to record claims for services rendered on credit by sheriffs.	See Lessons SJ
Advocate's journal	The advocate's journal is used to record claims for services rendered on credit by advocates.	See Lessons AJ
General journal	The general journal is used to record those transactions that cannot be recorded in any of the aforementioned journals.	See Lessons GJ
Petty cash journal	The petty cash journal is used to record flows of cash into and out of the business petty cash.	See Lessons PCJ
Transfer journal	The transfer journal is used for transfers from a client's trust creditor's account to his/her business account.	See Lessons TJ

Notes

4.4 Cash records

In terms of section 86(2) of the Legal Practice Act, 28 of 2014 (LPA) and rule 35.7 of the Rules of the Legal Practice Council (LPC Rules), every practising attorney must open and keep two separate bank accounts with a banking institution in the Republic, namely

- a business bank account; and

> The business bank account is used for receipts and payments relating to ordinary business transactions. In some instances, payments can be made from the business bank account on behalf of clients. These payments are not recommended and must be limited. An attorney should not make payments on behalf of a client from the business bank account, based on a promise from the client that the amount will be returned.

- a trust bank account.

> The trust bank account is used for receipts of trust money entrusted by clients to the attorney and payment of trust money to third parties as mandated by the client. The bank statement must contain a reference to the fact that it is an account opened and maintained in terms of section 86(2) of the LPA.

The trust bank account and trust creditors will be discussed in section 4.6.

One of the following methods may be used to keep cash records:

(1) Business money and trust money is recorded separately by keeping:
- a cash receipts and cash payments journal for **business transactions;** and
- a cash receipts and cash payments journal for **trust transactions**.

(2) A combined cash book with a bank column for business transactions and another bank column for trust transactions.

The first method is applied in this guide.

4.4.1 Cash receipts

Please note: “Cash” receipts include both physical cash and electronic fund transfers (EFT) received. The following steps are taken to record cash receipts.

STEPS	***Step 1**: Initial procedures* *For internal control purposes, two employees have to open the mail and record it in a postal register. After sorting the mail according to the attorney’s preference, it is handed over to the secretary of the attorney who has to acknowledge receipt thereof in the postal register. The secretary then files all relevant correspondence in the specific clients’*

	files. After taking into account the instructions of the attorney, the cash received is handed over to the cashier who acknowledges receipt thereof. The receipt numbers and amounts are recorded in the postal register opposite the clients' names. ***Step 2:*** *Initial procedures for the receipt of electronic fund transfers (EFT)* *The staff member responsible for the bank reconciliation must draw bank statements on a daily or weekly basis to see if there are any EFT deposits in the bank account. A copy of the bank statement must be filed in the client's file and handed over to the attorney for his instructions.* ***Step 3****: Identifying cash receipts* *All cash and EFT receipts must be clearly identified by the attorney, and he/she must indicate, according to the clients' files, whether it is* ***business*** *or* ***trust*** *money.* *Upon receipt of the cash, a receipt, pre-numbered and in triplicate, must be issued. This receipt must clearly indicate:* ► *the date;* ► *from whom the money was received;* ► *the amount in words and in figures;* ► *the purpose for which the money was received;* ► *the accounts affected; and* ► *the name of the issuer of the receipt.* *The trust receipt books and the business receipt books should be separate.*
	Step 4: *Recording of the cash receipts in the book of first entry* *Cash receipts are listed individually and in number sequence in the business cash receipts journal and the trust cash receipts journal respectively.* ***Step 5:*** *Deposit the cash in the bank accounts* *An attorney's practice must have two separate bank accounts. The bank columns in the business cash receipts journal and the trust cash receipts journal are added separately and the totals must agree with the relevant deposit slips.*

4.4.2 Cash payments

Business entities make payments by electronic fund transfer (EFT), except in the case where small amounts such as postage stamps or cleaning materials are purchased via the petty cash.

An attorney's practice has a separate series of source documents, namely one for business payments and one for payments from the trust bank account. An attorney must therefore, determine beforehand whether the payment are to be made from the business bank account or trust bank account. The following section identifies the different categories of cash payments in an attorney's practice:

(a) General business expenses

General business expenses are all money paid out by the attorney for his own account and include for example office rent, insurance, telephone expenses, membership fees, salaries and wages and other expenses incurred as a result of the day-to-day business activities of the attorney's practice.

(b) Expenses incurred in respect of the clients of the attorney's practice

Expenses incurred in respect of the clients of the attorney's practice can be paid from either the business bank account or the trust bank account depending on whether the client has money available in his/her trust account. If money was deposited in the trust bank account, which was not specifically earmarked for another purpose, the expenses must be paid from the trust bank account. If money was not deposited, the payment must be made from the business bank account. An account statement must be prepared and sent to the client/debtor.

If the payment was made from the trust bank account, the relevant trust creditor account must be debited. The payment of the expenses from the business bank account on behalf of the client is debited to the relevant client/debtor account.

Examples of such payments are:

– Travelling expenses incurred in the investigation of a case,
– Advocate fees,
– Sheriff fees, and
– Tracing fees.

QUICK NOTE

The clients of an attorney's practice are debtors and thus included in the current assets in the accounting records.

If a service provider (e.g. advocate, sheriff, etc.) is used on a regular basis, the law firm can record the services rendered in an advocate's journal and the sheriff's journal. (Refer to section 4.8.4.)

The treatment of trust creditors who previously deposited amounts for expenses to be paid out of the trust bank account is discussed in Learning Unit 7.

As in the case of cash receipts, the attorney determines (by means of the client's file) from which bank account (business or trust) the payment must be made.

4.5 The recording of business money in an attorney's practice

An attorney's practice has two main categories of income and expenses within in the practice. An attorney's practice incurs expenses necessary to operate the practice as a business (i.e. cost of renting a premises, water and electricity costs, telephone costs etc.). The practice also receives clients' money in order to make payments on behalf of those clients (i.e. transfer duties).

4.5.1 Introduction

The cash journals are specialised journals used to record the receipt or payment of cash by a business. The journals are a chronological listing of all receipts and payments including both cash and EFT's. There is more information about the transactions recorded in the cash receipts journal and cash payments journal, which prevents the entering of too much detail in the general ledger. The information recorded in the cash receipts journal and cash payments journal is used to make postings to the subsidiary ledgers (debtors' ledger and creditors' ledger) and to relevant accounts in the general ledger.

4.5.2 Books of first entry – business account

The business cash receipts journal records the receipts of cash deposited in the business bank account and the business cash payments journal records the payments made from the business bank account.

(a) Business cash receipts journal

All cash flows into the business bank account are recorded in the **business** cash receipts journal. In an attorney's practice, the business cash receipts journal should contain only a few entries. Normally, the business cash receipts journal should be compiled from the business receipt books. Because deposits can be made in the business bank account for a number of reasons, the business cash receipts journal may contain various analysis columns.

Example of the details of each column of the cash receipts journal:

Business cash receipts journal

Date	Doc no.	Details	Fol.	Sundries R	Clients control R	Bank R
Date of tran-saction	Receipt number	Name of client from whom cash is received <u>or</u> on whose behalf cash is received, or sundry account to be credited	Client ledger account number	Amount to be credited if cash is received other than from a client	Amount to be credited when cash is received from clients	Amount banked

(b) Business cash payments journal

All cash payments made from the business bank account are recorded in the **business** cash payments journal. In an attorney's practice there are various day-to-day expenses pertaining to general office administration, for example, office rent, stationery expenses, salaries, etc. that need to be paid.

The business cash payments journal must be written up numerically from the business EFT documents and from the entries obtained from the business bank statement such as bank charges. In addition to these business expenses, an attorney can pay expenses on behalf of a client that must be recovered from such client. For this reason, the attorney must ensure that the payment documentation is properly completed. Due to payments being made for various purposes, the business cash payments journal may have several analysis columns. From these journals, the bank reconciliation (learning unit 3) is prepared and posting is done to the different ledger accounts as discussed in learning unit 5.

Example of the details of each column of the cash payments journal

Business cash payments journal

Date	Doc no.	Details	Fol.	Sundries R	Clients control R	Bank R
Date of tran-saction	EFT no	Name of client to whom payment is made or on whose behalf payment is made <u>or</u> of sundry account to be debited	Client ledger number	Used when there is no column for the specific account to be debited	Amount to be debited when money is paid to clients	Amount withdrawn from bank

LBL		
PAUSE	*A very important rule is that no trust receipts nor payments are recorded in the business cash receipts/payments journal.*	See Lessons Trust transactions

EXAMPLE 4.1

The following information relates to the attorney's practice, SA Attorneys. The practice is registered as a VAT vendor. VAT at 15% is included where applicable.

Business bank transactions during March 2020:

Date	Details
1	SA Attorneys deposits R10 000 into the business bank account as capital. Receipt no. 21 is issued.
4	Pay office rent for March 2020 to S Africa by EFT no. 31, R2 300. Receive payment from A South of R18 240 in cash for services rendered on 28 February 2020. Receipt no. 22 is issued.
7	Cash is drawn for petty cash, R1 600.
9	Pay R920 for advertisements per EFT no. 32.
12	Pay R1 150 per EFT no. 33 for membership fees to the Law Society.
14	Issue receipt no 23 to C Natal in settlement of his account, R969.
19	Pay short-term insurance for the period 1 April 2020 to 30 June 2020 per EFT no. 34, R6 900.
24	Pay the following expenses: EFT no. 35 Water and electricity, R1 035. EFT no. 36 Telephone, R690. EFT no. 37 Salaries, R4 788.

REQUIRED:

Prepare the business cash receipts journal and the business cash payments journal of SA Attorneys for March 2020.

EXPLANATION 4.1

(a) Use the following layout to draw up the business cash receipts journal:

Business cash receipts journal

Date	Doc no.	Details	Fol.	Sundries R	Clients control R	Bank R
Date of tran-saction	Receipt number	Name of client from whom cash is received <u>or</u> on whose behalf cash is received, or sundry account to be credited	Client ledger account number	Amount to be credited if cash is received other than from a client	Amount to be credited when cash is received from clients	Amount banked

The business cash receipts journal is prepared as follows:

Business cash receipts journal of SA Attorneys for March 2020

Date	Doc.	Details	Fol.	Sundries R	Output VAT R	Clients control R	Bank R
1	21	Capital		10 000			10 000
4	22	A South			[1]	18 240	18 240
14	23	C Natal			[1]	969	969
				10 000		19 209	29 209

2. Use the following layout to draw up the business cash payments journal:

Business cash payments journal

Date	Doc no.	Details	Fol.	Sundries R	Clients control R	Bank R
Date of tran-saction	Cheque number	Name of client to whom payment is made or on whose behalf payment is made <u>or</u> of sundry account to be debited	Client ledger number	Used when there is no column for the specific account to be debited	Amount to be debited when money is paid to clients	Amount withdrawn from bank

The business cash payments journal is prepared as follows:

Business cash payments journal of SA Attorneys for March 2020

Date	Doc.	Details	Fol.	Sundries R	Input VAT R	Bank R
4	31	Office rent		2 000	300	2 300
7	CW[2]	Petty cash		1 600		1 600
9	32	Advertisements		800	120	920
12	33	Law Society Membership		1 000	150	1 150
19	34	Insurance		6 000	900	6 900
24	35	Water & electricity		900	135	1 035
	36	Telephone		600	90	690
	37	Salaries		4 788		4 788
				17 688	1 695	19 383

[1] Fees are first recorded in the fees journal where the Output VAT is recorded separately.

[2] Cash withdrawal

EXAMPLE 4.2

The following information relates to the attorney's practice, SA Attorneys. The practice is registered as a VAT vendor. VAT at 15% is included where applicable. The following business bank transactions took place during May 2020:

Date	Details
1	S Africa contributes R20 000 in cash as a capital contribution. Receipt no. 41 is issued.
5	Receive an EFT from A South in settlement of her account, R798. Receipt no. 42 is issued.
8	Pay office rent for May 2020 to E North by EFT no. 110, R1 610
10	Receive R2 394 from G Langa for services rendered during April 2020. Receipt no. 43 is issued.
16	Pay the annual membership fee to the Law Society per EFT no. 111, R1 495.
20	Cash withdrawal for petty cash, R1 100.
23	Pay the telephone account per EFT no. 112, R529.
25	Pay salaries per EFT no. 113, R3 762.
27	Receive an EFT from H Mpuma as payment on his account, R1 000. Receipt no. 44 is issued.

REQUIRED:

Prepare the business cash receipts journal and the business cash payments journal of SA Attorneys for May 2020.

EXPLANATION 4.2

Refer to Example 4.1 for the required layout of a business cash receipts journal and a business cash payments journal

Business cash receipts journal of SA Attorneys for May 2020

Date	Doc no.	Details	Fol.	Sundries R	VAT R	Clients control R	Bank R
1	41	Capital		20 000			20 000
5	42	A South				798	798
10	43	G Langa				2 394	2 394
29	44	H Mpuma				1 000	1 000
				20 000		4 192	24 192

Business cash payments journal of SA Attorneys for May 2020

Date	Doc no.	Details	Fol.	Sundries R	VAT R	Bank R
8	110	Office rent		1 400	210	1 610
16	111	Law Society Membership		1 300	195	1 495
20		Petty cash		1 100		1 100
23	112	Telephone		460	69	529
25	113	Salaries		3 762		3 762
				8 022	474	8 496

4.6 The recording of trust money in an attorney's practice

The trust cash receipts journal records the receipts of cash deposited in the trust bank account and the trust cash payments journal records the payments made from the trust bank account.

4.6.1 Introduction

Trust money, as the name indicates, is money entrusted to an attorney, to be held in trust by the attorney and to be dealt with according to the client's instructions. Money received by an attorney in respect of a matter for which the final fee cannot be accurately calculated until the date of receipt of the deposit, for example, a property transaction, forms part of trust moneys according to Section 86(2) of the LPA. The attorney must ensure that this position of trust is not abused; hence the reason for all the rules and regulations relating to the handling of trust money.

Trust money remains the property of the client or another party until the instruction is executed or the fees in that regard debited to the client. As long as it is in the attorney's possession, the attorney must safeguard such money to the best of his or her ability. Trust monies do not form part of the assets of the practitioner and may therefore, not be claimed by a creditor of the practitioner.

Trust money may comprise, inter alia:
- money paid in by clients with regard to services still to be rendered, as well as related expenses
- money paid in by a third party (the buyer) in respect of purchase transactions
- money to be refunded to a nominated person
- transfer of money from the business bank account to the trust bank account

Trust payments (EFT's) may be:
- expenses are paid for a specific purpose (e.g. advocates)
- money is paid to third parties according to the client's instructions (e.g. the seller of property)
- payment to the instructed attorney in respect of correspondent transactions

- transfer of money from the trust bank account to the business bank account in respect of the amount owing to the attorney. The amount owing to the attorney must be a legitimate debit entry made in the client's account in the clients ledger after services have been rendered.

4.6.2 Books of first entry – trust account

In terms of section 86 of the LPA and the LPC Rules, a legal practitioner must keep a separate trust bank account at a banking institution in the Republic, and in this account must deposit the money held or received by the attorney on behalf of any person. The LPA and LPC Rules stipulate that the name of the trust bank account must specifically indicate that it is an account in terms of the Act. (Refer to learning unit 7 for examples)

(a) Trust cash receipts journal

On receipt of trust money, an attorney must issue a proper receipt to the client. Such receipts must be bound in numerical sequence and must indicate:

(a) the date
(b) from whom the money was received
(c) the amount in words and in figures
(d) the purpose for which the money was received
(e) the account(s) affected
(f) the name of the issuer of the receipt

The trust cash receipts journal must be completed from the duplicate receipts in the trust receipt book, in numerical order.

Receipts are the main source documents in respect of all money received. A receipt must contain full particulars, especially, as regards the trust creditor account to be credited. It is not always the person who pays the amount (e.g. in the case of a property transaction) whose account must be credited. Where a property transaction is involved and the seller is your client, a third party will deposit the purchase price.

The bank statement is also a source document from which receipts (e.g. interest on the trust bank account) can be entered in the business cash receipts journal. (As discussed under 4.4.1 Step 2 – EFT receipts.)

Sometimes an attorney's practice receives money for purposes other than trust, for example from a client (with no funds in trust) who settles his or her account. This money may be deposited directly in the business bank account.

The following is an *example* of the columns usually encountered in the trust cash receipts journal (TCRJ):

Trust cash receipts journal of SA Attorneys – February 2020

TCRJ

Date	Receipt no	Details	Fol.	Sundries R	Trust creditors R	Bank R
04/02	308	S Africa			150	150
	309	A South			50	50

The trust creditors ledger is completed from the *individual* entries in the trust cash receipts journal and the trust creditors control account (pertaining to receipts) is completed in the general ledger from the **total** of the trust cash receipts journal.

(b) Trust cash payments journal

When a trust Electronic Cash Payment (EFT) is made, the supporting document must be completed in full and must indicate the following:

- the date
- to whom the EFT was made
- the account affected
- the reason for the payment; and
- the amount

A trust EFT may only be issued after the following considerations were taken into account:

- The EFT is made in favour of the client or his beneficiary
- The supportive documentation is available
- The EFT is made regarding a specific trust matter

The trust cash payments journal is completed from the EFT supporting document in numerical sequence (source document).

EFT payments from trust creditors that are deposited in the trust bank account are credited on the trust bank statement.

An EFT payment cannot be made from the trust account if the client concerned has insufficient funds in his or her trust account. Insufficient funds in a client's trust account would imply a debit balance, which is not permissible in terms of the LPA and the LPC Rules. This means that another client's trust money is being used to finance that particular client's debit account. If a client requests an attorney to pay an amount from trust money on his or her behalf, the attorney must never rely on a promise by the client that money will be deposited at a later stage.

The following is an *example* of the columns usually found in a trust cash payments journal (TCPJ):

Trust cash payments journal of SA Attorneys – February 2020

TCPJ

Date	EFT no	Details	Fol.	Sundries R	Trust creditors account R	Transfer to business bank account R	Bank R
08/02	5001	E North – municipal rates	C6		45		45
	5002	F Cape/D West – transfer duty	C6		2 380		2 380

The column, "Transfer to business bank account", relates to transfers of trust money from trust creditors to business clients (debtors).

(c) Bank charges and interest received on the trust bank account

Bank charges are debited to a firm's bank statement.

An attorney's practice always has two accounts with the bank:

- ► a business bank account, and
- ► a trust bank account.

Bank charges in respect of a trust bank account can be dealt with in three ways:

- by debiting the *trust* bank statement with the bank charges in respect of the trust bank account; or
- by debiting the *business* bank statement with the bank charges in respect of the trust bank account; or
- a separate bank account can be opened. Interest earned on the trust bank account is then deposited into this account. All bank charges will be paid from this account.

If the trust bank statement contains bank charges, the firm must transfer money from the business bank account to the trust bank account to cover these bank charges and thus prevent a deficit on the trust bank account. This is called the buffer system.

If the business and trust accounts are kept at the same bank, the attorney's practice can also instruct its bankers not to debit the trust bank account with bank charges, but to debit its business bank account with such charges. This method of dealing with bank charges ensures that there is no deficit on the trust bank account as a result of bank charges being debited to the latter account without the necessary transfer of funds being made. Keep in mind that trust money is held in trust on behalf of clients and may never be used for any other purpose. This method is thus preferred.

At the end of a financial year, the attorney's practice requests its bank to certify the amount of bank charges in respect of the trust bank account that has been debited to its business bank statement. This certificate enables the auditors to vouch for the bank charges incurred in respect of the trust bank account. All money held in trust by an attorney earns interest. Unless otherwise stipulated by a client (e.g. in the case of an offer to purchase, where the interest accrues to the purchaser), this interest is paid over to the Legal Practitioners Fidelity Fund.

Such interest is applied to cover bank charges on the trust bank account, the insurance of trust creditors against fraudulent use of their money, and audit fees relating to the trust accounts. The auditors issue an audit report (to the Law Society of the province concerned) regarding bank charges, interest earned and trust funds. The Law Society then refunds the bank charges and a portion of the audit fees to the firm.

In this module, we shall always assume that bank charges in respect of the trust bank account are debited to the business bank statement.

4.7 Books of first entry – Fees journal

The fees journal is probably the most important journal in an attorney's practice because fees charged to each client on whose behalf services are rendered is recorded in the fees journal.

It is possible, but not preferable, to debit fees through the fees journal to a trust creditors' account, if the latter reflects a credit balance. It is recommended that fees be debited to the client's account.

An *example* of the entries in the fees journal is as follows:

Fees journal of SA Attorneys for January 2020

FJ23

Date	Details	Fol.	Clients control R	Fees R
2	C Natal (Drawing up of will)	D4	3 600	
12	T Zulu (Consulting and drawing up of rental contract)	D15	4 100	
22	H Mpuma (Completion of income tax return)	D9	1 700	
			9 400	9 400
31	Dr – Clients control account		B4	
31	Cr – Fees account			N1

In the clients ledger, the individual accounts of clients will be debited, whilst in the general ledger, the clients control account will be debited and the fees earned account will be credited with the total amount.

The following source documents are relevant:

(i) Fees register – All attorneys' fees, together with the relevant details, are recorded in the fees register from the clients' files.

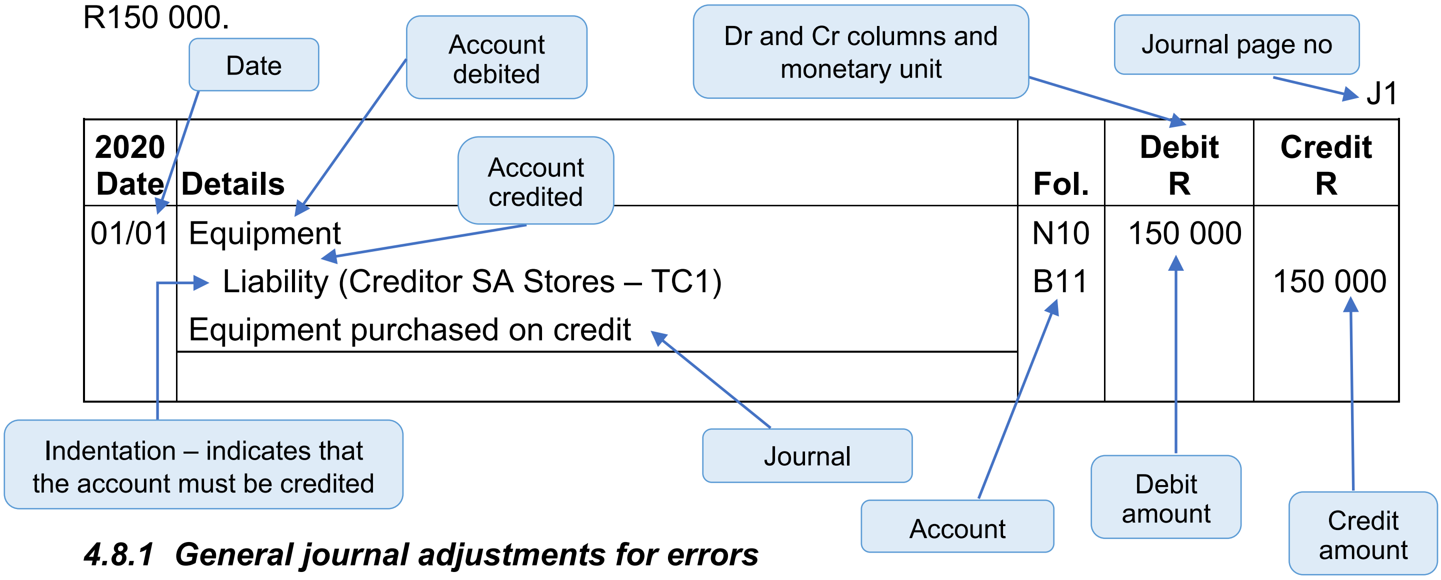
(ii) Debit notes or invoices – Pre-numbered debit notes or invoices are then issued in *triplicate* or *quadruplicate*.

(iii) Client files – The debit notes or invoices are recorded in the fees journal from clients' files. The files, therefore, serve as a source document for recording purposes.

4.8 Books of first entry – General journal

The following transaction is used to illustrate a basic entry in the general journal:

Equipment was purchased on credit from a supplier (SA Stores) on 1 January 2020 for R150 000.



2020 Date	Details	Fol.	Debit R	Credit R
01/01	Equipment	N10	150 000	
	Liability (Creditor SA Stores – TC1)	B11		150 000
	Equipment purchased on credit			

4.8.1 General journal adjustments for errors

The general journal may be used for adjustments between trust creditors when it is necessary to correct errors.

EXAMPLE 4.3

H Mpuma deposits R3 000 on 1 January 2020 towards the costs of handling his divorce and receipt no 6218 is issued to him. The account of W Mpuma is however, erroneously credited with the R3 000.

EXPLANATION 4.3

The error will be corrected via the general journal as follows:

Date 2020	Details	Fol.	Dr R	Cr R
01/01	H Mpuma (trust creditor)	L6	3 000	
	W Mpuma (trust creditor)	L16		3 000
	Adjustment of incorrect posting – refer receipt 6318			

4.8.2 General journal adjustments for uncommon transactions

Certain transactions take place that cannot be recorded in any one of the journals discussed so far. We will then make use of a **general journal** to record these transactions.

The following examples are typical transactions entered in the general journal:

- the purchase of consumable goods such as stationery on credit
- the purchase of fixed assets on credit
- the sale of fixed assets on credit
- transactions whereby the owner takes non-cash items from the business e.g. office computer taken for private use
- transactions whereby the owner contributes assets other than cash
- Interest charges to clients accounts that are in arrears
- closing year-end entries and other year-end adjustments

Work through the following examples of uncommon transactions that are recorded in the general journal:

(a) Interest charges to clients accounts that are in arrears

EXAMPLE 4.4

The client account of S Africa of R15 400 is 6 months in arrears. If the clients account has been outstanding for longer than 3 months SA Attorneys charges the client interest on the overdue account at 10% per annum. The account of S Africa was due for payment on 1 April 2020.

EXPLANATION 4.4

The interest on the overdue account of S Africa will be accounted for via the general journal as follows:

Date 2020	Details	Fol.	Dr R	Cr R
01/06	S Africa (client)	A6	385	
	Interest receivable	N6		385
	Interest charged on overdue account (15 400 x 10% x 3/12)			

QUICK NOTE

- *The name of the two accounts affected by the transaction is recorded in the details column. The name of the account to be debited is recorded on the first line whilst the name of the account to be credited is recorded on the second line.*
- *A short description of the transaction, a journal narration.*

(b) Closing year-end entries and other year-end adjustments

The financial statements are prepared at the end of the financial period but before the statements are prepared the correctness of the accounting records need to be assured. For example, all the income and expense items pertaining to a specific financial period must be taken into account. The following is relevant:

The cash received or paid during the period is not necessarily the period during which the income was earned or the expense incurred.	+	The income earned during an accounting period should match with the expenses incurred to earn the income during the accounting period. Adjust the accounts by allocating the income or expense items to the correct accounting period.	+	The adjustments ensure compliance with the matching concept by providing for expenses, by recording income received in advance, depreciation charges and expenses paid in advance.

► **Accrued expenses**

An accrued expense is an expenditure for which the underlying asset was consumed but was not yet paid. The business therefore incurred the expense and should recognise the expense together with the liability to pay the expense. The liability is called an accrued expense.

When adjusting accruals and prepayments, it is necessary to –

– identify the specific account to be adjusted
– determine the outstanding amount or the prepaid amount
– record the adjustment (general journal)

EXAMPLE 4.5

The financial year of SA Attorneys ends on 31 December each year. SA Attorneys pays monthly rent of R12 000 for their premises. The accounting records of the law practice showed that rent was paid for ten months during the financial year ended 31 December 2020.

REQUIRED:

1. Record the necessary adjustment and the closing entry in the general journal of SA Attorneys.
2. Post the journal entry to the general ledger of SA Attorneys.

EXPLANATION 4.5

1. General journal

GJ1

Date 2020	Details	Fol.	Dr R	Cr R
31/12	Rental expense	N1	24 000	
	Accrued expense	B1		24 000
	Adjustment for rent owing (12 000 x 2)			
31/12	Profit or loss account	N2	144 000	
	Rental expense	N1		144 000
	Closing transfer for the year ended 31 December 2020 (12 000 x 12)			

2. General ledger

Dr — Rental expense — N1 — Cr

2020			R	2020			R
31/12	Bank*	CRJ	120 000	31/12	Profit or loss account	GJ	144 000
31/12	Accrued expense	GJ	24 000				
			144 000				144 000

Dr — Accrued expense — B1 — Cr

2020			R	2020			R
31/12	Balance	c/d	24 000	31/12	Rental expense	GJ	24 000
			24 000				24 000
				01/01	Balance	b/d	24 000

* Total rent payments made during the financial year (given for the sake of completeness). The payments would have been recorded on a monthly basis on the date the payment was made. The entries were recorded in the CPJ and then posted to the Rental expense account.

Dr — Profit or loss account — N2 — Cr

2020			R	2020			R
31/12	Insurance	GJ1	144 000				

► Accrued income

Accrued income is income that has not been received in the accounting period when the underlying obligation was fulfilled. Since the services were rendered the business is entitled to receive payment and therefore the income is recognised (Cr – Services rendered) and a debtor is created for the amount receivable (Dr – Accounts receivable).

This is income earned by the business in respect of services rendered but for which no payment has been received. Accrued income is shown as *current assets*.

EXAMPLE 4.6

SA Business earned R12 500 in advertising income from advertising placed in magazines and newspapers for the year ended 31 December 2020. SA Business only received R9 850 during the year from the client S Africa.

REQUIRED:

1. Record the necessary adjustment and the closing entry in the general journal of SA Business.
2. Post the journal entries to the general ledger of SA Business.

EXPLANATION 4.6

The advertising income will be accounted for via the general journal as follows:

1. General journal

GJ1

Date 2020	Details	Fol.	Dr R	Cr R
31/12	Accrued income	B1	2 650	
	Advertising income	N6		2 650
	Adjustment for advertising earned but not yet received (12 500 – 9 850)			
31/12	Advertising income	N1	12 500	
	Profit or loss account	N2		12 500
	Closing transfer for the year ended 31 December 2020			

2. General ledger

Dr **Advertising income** **N1** **Cr**

Date	Details	Fol.	R	Date	Details	Fol.	R
2020				2020			
31/12	Profit or loss account	GJ1	12 500	31/12	Bank*	CRJ	9 850
				31/12	Accrued income	GJ1	2 650
			12 500				12 500

Dr **Accrued income** **B1** **Cr**

2020			**R**	2020			**R**
31/12	Advertising income	GJ1	2 650	31/12	Balance	c/d	2 650
			2 650				2 650
01/01	Balance	b/d	2 650				

Dr **Profit or loss account** **N2** **Cr**

2020			**R**	2020			**R**
				31/12	Advertising income	GJ1	12 500

► **Income received in advance**

Income received in advance is income received in one accounting period, but for which the underlying obligation will only be fulfilled in the next accounting period. When the obligation is eventually fulfilled, it is recognised as income.

Income received in advance is not yet earned so it must be deducted from total income to arrive at the correct income earned during the financial year. Income received in advance is shown as *current liabilities*.

EXAMPLE 4.7

SA Business sub-lets part of its premises for a monthly rental of R12 800. During the financial year ended 31 December 2020 the tenant made a total payment of R166 400.

REQUIRED:

1. Record the necessary adjustment and the closing entry in the general journal of SA Business.
2. Post the journal entries to the general ledger of SA Business.

Notes

EXPLANATION 4.7

The rental income received in advance will be accounted for via the general journal as follows:

1. General journal

GJ1

Date 2020	**Details**	**Fol.**	**Dr R**	**Cr R**
31/12	Rental income	N1	12 800	
	Income received in advance	B1		12 800
	Adjustment for rental income received in advance (166 400 – (12 800 x 12))			
31/12	Rental income	N1	153 600	
	Profit or loss account	N2		153 600
	Closing transfer for the year ended 31 December 2020			

2. General ledger

Dr **Rental income** **N1** **Cr**

2020			R	2020			R
31/12	Income received in advance	GJ1	12 800	31/12	Bank*	CRJ	166 400
31/12	Profit or loss account	GJ1	153 600				
			166 400				166 400

Dr **Income received in advance** **B1** **Cr**

2020			R	2020			R
31/12	Balance	c/d	12 800	31/12	Rental income	GJ1	12 800
			12 800				12 800
				01/01	Balance	b/d	12 800

Dr **Profit or loss account** **N2** **Cr**

2020			R	2020			R
				31/12	Rental income	GJ1	153 600

► **Prepaid expenses**

A prepaid expense is an expenditure paid for in one accounting period, but for which the underlying asset will not be consumed until a future period. When the asset is eventually consumed, it is charged to expense. The nature of certain expenses may compel a business to pay for them in advance. Insurance premiums are good examples of such expenses. Prepaid expenses are shown as *current assets*.

EXAMPLE 4.8

SA Business paid R9 000 for insurance on 1 January 2020. This payment was for insurance cover for 18 months. The financial year of SA Business ends on 31 December each year.

REQUIRED:

1. Determine the amount that was prepaid for insurance.
2. Record the necessary adjustment and the closing entry in the general journal of SA Business.
3. Post the journal entries to the general ledger of SA Business.

EXPLANATION 4.8

Monthly insurance cover	= R9 000/18	= R500
Insurance expense	= R500 x 12	= R6 000
Prepaid expense	= R500 x 6	= R3 000

The prepaid expense of SA Business will be accounted for via the general journal as follows:

GJ1

Date 2020	Details	Fol.	Dr R	Cr R
31/12	Prepaid insurance Insurance Adjustment for prepaid insurance	B1 N1	3 000	 3 000
31/12	Profit or loss account Insurance Closing transfer for the year ended 31 December 2020	N2 N1	6 000	 6 000

2. General ledger

Dr — Insurance expense — N1 — Cr

2020			R	2020			R
31/12	Bank*	CPJ	9 000	31/12	Prepaid expense	GJ1	3 000
				31/12	Profit or loss account	GJ1	6 000
			9 000				9 000

Dr		Prepaid expenses				B1	Cr
2020			R	2020			R
31/12	Insurance	GJ1	3 000	31/12	Balance	c/d	3 000
			3 000				3 000
01/01	Balance	b/d	3 000				

Dr		Profit or loss account				N2	Cr
2020			R	2020			R
31/12	Insurance	GJ1	6 000				

4.8.3 General journal transactions

A journal entry signed by an authorised person and a journal voucher in the client files, serve as source documents for the recording of transactions. For example, support of a credit loss (a bad debt written off), correspondence from an attorney may be attached (e.g. a correspondent).

Amounts are posted separately to the various accounts in the general ledger, clients and trust creditors ledgers.

The accounting system should also be adjusted to allow for the control accounts. In the cash books, petty cash book, fees journal, transfer journal, trust journal, sheriffs journal, advocates journal and general journal summaries should be made for client and trust creditor accounts, so that these totals, as summarised in paragraph 6.7 (in learning unit 6), can be posted to the appropriate control accounts in the general ledger. The individual amounts in the books of prime entry are posted to the personal accounts of the clients and trust creditors in the subsidiary ledgers, and do not form part of the double entry system.

Notes

EXAMPLE 4.9

The following transactions relate to the accounting records of S Africa for March 2020. The business is registered as a VAT vendor. VAT at 15% is included where applicable.

Date	Details	Amount (Incl. VAT) R
1	Purchase stationery on credit from Langa Stores	690
5	The account of a client, E North was debited with fees earned instead of the client J North. A correction is necessary.	2 300
8	S Africa takes a business computer for private use	4 025
27	Charge interest to a client, H Mpuma's overdue account @ 15% p.a. for 6 months. The client owes S Africa R6 000.	?

REQUIRED:

Prepare the general journal of S Africa for March 2020.

EXPLANATION 4.9

When a clients account is debited or credited, the entry is a two-legged entry. The clients account (H Mpuma – CL2) in the clients ledger is debited and the clients control account (B5) is debited in the general ledger. The clients control account represents the clients ledger.

General journal of S Africa for March 2020

Date	Details	Fol.	Debit R	Credit R
1	Stationery	N10	600	
	VAT control (Input VAT)	B8	90	
	Creditors control/Langa stores (See explanation in bubble)	B11/C1		690
	Stationery purchased on credit			
5	J North (Client)	CL1	2 300	
	E North (Client)	CL6		2 300
	Reallocation of fees earned from J North to E North			
8	Drawings	B2	4 025	
	VAT control (Output VAT)	B8		525
	Equipment	B4		3 500
	Business computer taken by S Africa for private use			
27	Clients control/H Mpuma	B5/CL2	450	
	Interest receivable	N1		450
	Interest charged on overdue account (R6 000 x 15% x 6/12)			

EXAMPLE 4.10

The following transactions relate to the accounting records of A South for May 2020. The business is registered as a VAT vendor. VAT is included at 15% where applicable. The financial year-end is 31 May 2020.

Date	Details	Amount (Incl. VAT) R
10	A South takes stationery for own use	920
20	Purchase a cash register credit from PC Electronics	9 775
31	Depreciation on the delivery vehicles	10 000
31	Rental for premises (June 2020)	14 950

REQUIRED:

Prepare the general journal of A South for May 2020.

EXPLANATION 4.10

General journal of A South for May 2020

Date	Details	Fol.	Debit R	Credit R
10	Drawings	B2	920	
	VAT control (Output VAT)	B8		120
	Stationery	N10		800
	Stationery taken by the owner for personal use			
20	Computer hardware Asset	B7	8 500	
	VAT control (Input VAT)	B8	1 275	
	Creditors' control (PC Electronics – TC 8)	B11		9 775
	Cash register purchased on credit			
31	Depreciation – delivery vehicles Expense	N6	10 000	
	Accumulated depreciation – delivery vehicles	B6		10 000
	Provision for depreciation			
31	Rental for premises paid in advance Asset	N11	14 950	
	VAT control (Input VAT)	B8		1 950
	Rental for premises Expense (Matching concept[3])	B12		13 000
	Rental for premises for June 2020 paid 31 May 2020			

[3] This journal entry is crediting the "Rental of premises account" and thereby reducing the "Rental of premises expense" for the year ended 31 May 2020. This because the expense that was paid on 31 May was actually the expense for June 2020, the next financial year.

4.8.4 Sheriffs' and advocates' journals

The purpose of the sheriffs' and advocates' journals is to record all items regarding claims for services rendered by advocates and sheriffs. The sheriffs' and advocates' journals are completed from statements received from the sheriffs and advocates for services rendered to the clients of the law firm.

The following entries are an example of the sheriff's journal:

Sheriffs' journal – January 2020

Date	Details	Fol.	Dr R	Cr R
30	Client – A South	CL1	200	
	Client – S Africa	CL2	175	
	Sheriff (Randburg West)	BC1		375
31	Dr – Clients control account	GL4	375	

The advocates' journal will be similar to the sheriff's journal. These journals are not essential since the general journal can be used for the same purpose. However, in a simplified system, it is useful to keep the sheriffs' and advocates' journals separate. If the sheriff or advocate is not regularly used by the law practice, their accounts need not be recorded in the sheriffs and advocates' journals or in the general journal, if the payment from the business bank account takes place immediately on receipt of the invoice.

The advocate and sheriff fees must be paid out of the business bank account unless the trust money for the specific client is earmarked for these expenses, in which case the payment must be made from the trust bank account.

Notes

4.8.5 Books of first entry in an attorney's practice – combined example

The following example deals with the recording of trust transactions in the books of first entry of an attorney's practice.

EXAMPLE 4.11

The following information for July 2020 relates to SA Attorneys, an attorney's practice:

1. Trial balance at 30 June 2020

Details	Debit R	Credit R
Capital		50 000
Equipment	28 000	
Law library	15 000	
Business bank	5 550	
Trust bank	4 827	
Trust creditors control:		4 827
A South		2 465
S Africa		1 500
C Natal		862
Clients control:	1 075	
S Africa	325	
T Zulu	750	
Sheriff costs		25
Stationery on hand	400	
	54 852	54 852

2. Transactions that took place during July 2020

Date	Transaction
1	Paid the net amount of R2 465, collected from J Jan, to the instructing attorneys A South Attorneys.
2	Paid the water and electricity account of SA Attorneys, R664.
4	Received R7 650 from J East in respect of the registration of a bond. It is expected that the registration will take place in August 2020.
6	Paid Advocate H Mpuma R1 100 with a trust EFT (Advocate H Mpuma is to act as the defence counsel for S Africa in a forthcoming court case).
9	Debited fees of R2 450 in respect of D Western's divorce case, to his account.
13	Received R3 450 from F Cape, a client, who requested SA Attorneys to act as his defence counsel in a forthcoming court case.
14	Paid the Sheriff's office R25 for the delivery of a summons to N Berry.

16	Charges interest of R410 on the arrear account of T Zulu.
21	Paid S Stationers R464 for the supply of stationery.
28	Paid the office rent for July, R3 600. Paid the telephone account received from Telkom SA Limited, R295.
31	Issued a debit note of R245 to G Langa in respect of fees for drawing up his will.

REQUIRED:

Prepare the following in the accounting records of SA Attorneys for July 2020:

The subsidiary journals, properly totalled:

1. Trust cash receipts journal
2. Trust cash payments journal
3. Business cash payments journal
4. Fees journal
5. General journal

EXPLANATION 4.11

SA ATTORNEYS

1. Trust cash receipts journal – July 2020

TCRJ7

Date	Details	Fol.	Trust creditors control R	Bank R
04/07	J East (trust creditor)	TCL4	7 650	7 650
13/07	F Cape (trust creditor)	TCL5	3 450	3 450
			11 100	11 100
31/07	Cr – Trust creditors control		GL15	
31/07	Dr – Trust bank account			GL6

Notes

2. Trust cash payments journal – July 2020

TCPJ7

Date	Details	Fol.	Trust creditors R	Bank R
01/07	A South (trust creditor)	TCL1	2 465	2 465
06/07	S Africa (trust creditor) (Advocate H Mpuma)	TCL2	1 100	1 100
			3 565	3 565
31/07	Dr – Trust creditors control		GL15	
31/07	Cr – Trust bank account			GL6

3. Business cash payments journal – July 2020

BCPJ7

Date	Details	Fol.	Sundries R	Bank R
02/07	Water and electricity	GL8	664	664
14/07	Sheriff's fee (client)	GL5	25	25
21/07	Stationery	GL9	464	464
28/07	Office rent	GL10	3 600	3 600
28/07	Telephone	GL11	295	295
			5 048	5 048
31/07	Cr – Business bank account			GL7

4. Fees journal – July 2020

FJ7

Date	Details	Fol.	Trust creditors R	Bank R
09/07	D Western (client) (fees i.r.o. divorce)	CL3	2 450	
31/07	G Langa (client) (setting of will)	CL1	245	
31/07	Dr – Clients control	GL14	2 695	
31/07	Cr – Fees account	GL12		2 695

5. General journal – July 2020

GJ7

Date	Details	Fol.	Dr R	Cr R
16/07	T Zulu (client)/ Clients control	CL4/GL14	410	
	Interest receivable	GL13		410
	Interest charged on account in arrears			

4.8.6 Petty cash journal

Petty cash refers to a small amount of cash that a business uses to pay small amounts without having to make use of an EFT. Such items (payments) do not justify the issue of a EFT. In such instances, items are paid from petty cash. "Petty" means "small", and this is what the petty cash system was designed for – to pay for small expenses. Examples of typical petty cash expenses are postage, milk, tea, coffee and stationery.

Usually, a business makes use of an imprest system, whereby a fixed amount is made available at the beginning of each month of trading (i.e. R1 000). The amount recorded as petty cash in the general ledger is equivalent to the fixed amount. Under the imprest system, the petty cash custodian should at all times have a combination of cash and petty cash receipts that equals R1 000 (the imprest petty cash balance).

EXAMPLE 4.12

A business started the month of January with a R1 000 imprest amount in the petty cash box. During January petty cash expenses amounted to R800. How much money needs to be drawn to make up the petty cash imprest amount for February?

EXPLANATION 4.12

R800 is needed. (The amount that was spent is replaced to arrive at R1 000.) All petty cash expenses should be recorded in the **petty cash journal.**

EXAMPLE 4.13

The following information relates to the attorney's practice of SA Attorneys. The practice is registered as a VAT vendor. VAT at 15% is included where applicable. The petty cash account showed a debit balance of R150 on 1 March 2020.

The following petty cash transactions took place during March 2020:

Date	Item purchased / payment made	Amount (incl. VAT)	Voucher no.
2	Pens & Pencils	R69	20
5	Stamps	R23	21
11	Milk and sugar	R12	22
24	Registration of letter to G Langa (a client)	R15	23
31	Restore the imprest amount	?	

REQUIRED:

Prepare the petty cash journal of SA Attorneys for March 2020.

EXPLANATION 4.13

Petty cash journal of SA Attorneys for March 2020

Date	Doc no.	Receipts		Fol.	Total R	Date	Doc no.	Payments	Fol.	Total R	Sta-tion-ery R	Pos-tage R	VAT R	Enter-tain-ment R	Clients control R
1		Balance		b/d	150	2	20	Pens & pencils		69	60		9		
						5	21	Stamps		23		20	3		
						11	22	Milk & sugar		12				12	
31		Bank (restore imprest)			119	24	23	Registration of letter (Langa)		15					15
										119	60	20	12	12	15
						31		Balance	c/d	150					
					269					269					
Apr 1		Balance		b/d	150										

QUICK NOTE

Although SA Attorneys is a registered VAT vendor there is no VAT claimable on the expense – Registration of letter, as the expense is not an expense incurred for SA Attorneys, but an expense incurred on behalf of a client – Langa. The expense is therefore claimed back from the client.

Notes

EXAMPLE 4.14

The following information relates to the practice of SA Attorneys. The practice is registered as a VAT vendor. VAT at 15% is included where applicable. The petty cash account showed a debit balance of R400 on 1 May 2020.

Petty cash transactions during May 2020:

Date	Item purchased / payment made	Amount (incl. VAT)	Voucher no.
4	Stamps	R46	86
8	Printing paper	R115	87
11	Milk and sugar	R136	88
25	Registration of letter to B Gauteng	R30	89
31	Restore the imprest amount	?	

REQUIRED:

Prepare the petty cash journal for SA Attorneys for May 2020

EXPLANATION 4.14

Petty cash journal of SA Attorneys for May 2020

Date	Doc no.	Receipts	Fol.	Total R	Date	Doc no.	Payments	Fol.	Total R	Sta-tionery R	Postage R	VAT R	Enter-tain-ment R	Clients control R
1		Balance	b/d	400	4	86	Stamps		46		40	6		
31		Bank (restore imprest)		327	8	87	Printing paper		115	100		15		
					11	88	Milk & sugar		136				136	
					25	89	Registration of letter (Gauteng)		30					30
									327	100	40	21	136	30
					31		Balance	c/d	400					
				727					727					
Jun 1		Balance	b/d	400										

4.8.7 Transfer journal

There are several different types of journals and a journal specific to a legal practitioner is a transfer journal. The transfer journal will be discussed in Learning Unit 7.

4.9 Match the name of the journal to the description of the journal

Match the description of the journal given in Column B with the name of the journal given in Column A:

Column A
Business cash receipts journal
Business cash payments journal
Trust cash receipts journal
Trust cash payments journal
Fees journal
Transfer journal
Sheriff's' journal
Advocates' journal
General journal

Column B
A journal for recording all items regarding claims for services rendered by sheriffs.
A journal used to record unique journal entries that cannot be processed in any other journal.
A journal used to record all cash paid out by the business.
A journal for recording all items regarding claims for services rendered by advocates.
A journal used to record all cash paid out from the trust account.
A journal used to record all cash received by the business.
A journal used to record all cash received in trust and deposited in the trust bank account.
A journal for recording the transfers of amounts or balances of trust creditors
A journal for recording the services rendered to clients.

Notes

Solution to matching name of journal with description of journal

Column A	Column B
Business cash receipts journal	A journal for recording all items regarding claims for services rendered by sheriffs.
Business cash payments journal	A journal used to record unique journal entries that cannot be processed in any other journal.
Trust cash receipts journal	A journal used to record all cash paid out by the business.
Trust cash payments journal	A journal for recording all items regarding claims for services rendered by advocates.
Fees journal	A journal used to record all cash paid out from the trust account.
Transfer journal	A journal used to record all cash received by the business.
Sheriff's' journal	A journal used to record all cash received in trust and deposited in the trust bank account.
Advocates' journal	A journal used for recording the transfers of amounts or balances of the trust creditors
General journal	A journal for recording the services rendered to clients.

4.10 Self-assessment exercises

Question	Answer
Why is there a distinction between cash and credit transactions?	
What is a cash receipts journal?	

What is a cash payments journal?	
What is trust money?	
What are trust accounts of a law practitioner?	
What is the difference between a business cash receipts journal and a trust cash receipts journal?	
Are trust funds the property of the legal practitioner?	
What is the difference between a business cash payments journal and a trust cash payments journal?	
What is a fees journal?	

When would it be necessary for funds to be transferred from the trust creditor ledger accounts to the clients business account?	`
What is a transfer journal?	
What is a general journal?	

4.11 Flashcards

1. *Name the two bank accounts, which an attorney must open in order to comply with section 84 to 86 of the Legal Practice Act, 28 of 2014.*	*A business bank account and a trust bank account.*

2. *State if payments on behalf of clients can also be made from other cash sources. If so, name the book of first entry in which you would record such payments.*	*Yes. Such payments are recorded in the petty cash journal.*

3. *List the source documents that an attorney uses to complete the cash receipts journal, and explain the control measures that are employed in respect of these source documents.*	*Receipts and bank statements* *Receipts must be pre-numbered and issued in triplicate, with* • *the person who made the payment receiving the original;* • *the first copy being filed in the client's file; and* • *the permanent copy remaining in the receipt book, from where the entry is made in the cash receipts journal.*

4. *When business money is received, a pre-numbered receipt is issued. List the details that should be indicated on this receipt.*	*The following details should be clearly indicated on the receipt:* • *the date* • *from whom the money was received* • *the amount in words and in figures* • *the purpose of the receipt (nature)* • *the account concerned* • *the issuer of the receipt*

5. *With what should the balance of the petty cash book tally*	*The balance of the petty cash book should tally with the physical cash in the petty cash box.*

6. *From which bank account is petty cash funded?*	*The business bank account.*

7. *List the source documents applicable to fees levied, and name the book of first entry in which these are recorded.*	*The fees register, debit notes and client files. Fees charged are recorded in the fees journal.*

8. *List an example of an entry made in the general journal.*	*The charging of interest on clients accounts, which are in arrears.*

9. *Name the source document from which the sheriffs' journal is completed.*	*Statements received from the sheriffs.* *.*

10. *Name the source document from which the advocates' journal is completed.*	*Statements received from advocates.*

11. Define the term "trust money" and give three examples of such money.	Trust money is money entrusted to an attorney, to be held in trust by him or her and to be dealt with according to the instructions of the client, for example: • deposits of clients for services still to be rendered, as well as for expenses incurred in this regard • money deposited by a third party (e.g. the purchaser) in respect of a purchase transaction • money which has been deposited and must be paid over to another party

12. Why does trust money not form part of the assets of an attorney's practice?	Trust money does not form part of the assets of an attorney's practice because it belongs to a third party.

13. Explain what section 86 of the Legal Practice Act, 28 of 2014 requires of a legal practitioner as regards to the handling of trust money.	A legal practitioner is obliged to keep a separate trust bank account with a banking institution in the Republic and must deposit any money held or received on behalf of any person in this account.

14. Interest earned on trust money is applied to cover certain expenses of an attorney. Name these expenses	Bank charges on the trust bank account. Insurance of trust creditors against fraudulent use of their money. Audit fees relating to trust accounts.

15. *Explain three requirements that must be complied with before money may be transferred from the trust creditors account of a client to his or her account in the clients ledger.*	– *No amount exceeding the debit balance on the client's account may be transferred from the clients trust account.* – *No amount exceeding the credit balance on the clients trust account may be transferred.* – *The client must be aware of such a transfer and must have no objection to it.*

16. *Name the three subsidiary journals involved in a transfer from a trust creditors account to an account in the clients ledger.*	*The transfer journal* *The trust cash payments journal* *The business cash receipts journal*

17. *Name the journals from which postings to the trust creditors' ledger are made.*	*The trust cash receipts journal* *The trust cash payments journal* *The transfer journal* *The general journal*

18. *Name the two accounts of which the balances must tally in respect of trust money.*	*The trust creditors control account* *The trust bank account*

FINANCIAL ACCOUNTING PRINCIPLES FOR LAW PRACTITIONERS

LEARNING UNIT

5 LEDGER ACCOUNTS, TRIAL BALANCES AND FINANCIAL STATEMENTS

Contents

Learning outcomes

After working through this learning unit, you should be able to:

- Prepare the accounts in the general ledger.
- Prepare a clients' control account and the trust creditors' control account.
- Reconcile the balance of the clients' control account with the total of the clients' list.
- Reconcile the balance of the trust creditors' control account with the total of the trust creditors' list.
- Prepare a trial balance

Key concepts

- ledger account
- general ledger
- clients' ledger (accounts receivable/debtors ledger)
- trust creditors' ledger (accounts payable)
- business creditors' ledger (accounts payable)
- balancing ledger accounts
- trial balance
- statement of profit or loss and other comprehensive income
- statement of financial position

5.1 Introduction

The general ledger is a collection of all the accounts and transactions of a business. Each account in the general ledger has an identification number and a name. The accounts are generally listed in the order – assets, liabilities, equity, revenues, and expenses.

The transactions of the business are posted from the journals (*) to the general ledger. Thus, the information contained in the journals is recorded in the ledger accounts. The journal's list the information for each transaction. By posting the information to the ledger accounts, the cumulative information for each type of transaction is recorded in a single account.

(*) Business cash receipts journal, Business cash payments journal, Trust cash receipts journal, Trust cash payments journal, Fees journal, General journal…

Notes

5.2 Accounting cycle

The accounting cycle details the formal accounting process. The steps discussed in this learning unit are as follows (indicated by yellow shading):

Transactions	The accounting process starts once a transaction has taken place.
Source documents	Source documents provide the evidence for a transaction having taken place
Books of prime entry	The source document is prepared and the information is entered into the books of prime entry
Ledger accounts	The entries from the books of prime entry are posted to the general ledger, creditors' ledger, and debtors' ledger.
Trial balance	The trial balance is drawn up from the accounts in the general ledger
Financial statements	The financial statements are drawn up from the trial balance

RECAP

When a business transaction requires a journal entry, the following rules apply:

- *The journal entry must have at least 2 accounts with 1 DEBIT amount and at least 1 CREDIT amount.*
- *The DEBITS are listed first and then the CREDITS.*
- *The DEBIT amounts will always equal the CREDIT amounts.*

5.3 Legal accounting

When it comes to legal accounting (e.g. accounting records of an attorney's practice) there are subsidiary journals and general ledger accounts that are specific to legal accounting. Examples of the subsidiary journals required specific for legal accounting are the business cash payments journal (BCPJ) and the trust cash receipts journal (TCRJ). In addition, examples of general ledger accounts are the trust creditors' control and clients' control account. The Legal Practice Act 28 of 2014 (LPA) regulates legal accounting and one of the aims is to protect and promote the interests of the clients' of the legal practice who hold trust money with the attorney. The LPA contains rules relating to the handling of trust money that have to be applied to the accounting records of an attorney's practice.

5.4 Summary of subsidiary journals (books of first entry)

We have seen in Learning Unit 4 that the details of **each transaction** that takes place in a business should be recorded in a **journal**, also known as a book of first entry**.**

QUICK NOTE	*A journal entry is like a set of instructions. The carrying out of these instructions is known as* ***posting****.*

The following table summarises the purpose of the books of first entry:

Acro-nym	Subsidiary journals	Used for	Types of entries
BCRJ	Business cash receipts journal	Recording business receipts	– Receipts from clients for services rendered – Receipts from clients for payment of costs (reimbursing of costs paid by law firm) – Fee charged to a correspondent – Interest received
BCPJ	Business cash payments journal	Recording business payments	– Bank charges (Service fees) – Interest paid (Finance costs) – Printing costs – Rent – Telephone – Entertainment costs – Water and electricity
TCRJ	Trust cash receipts journal	Recording trust receipts	– Amounts received on behalf of a correspondent – Cash received in trust – Receipt of money that has to be paid over to a nominated person
TCPJ	Trust cash payments journal	Recording trust payments	– Investments of clients' funds – Payments to third parties on instruction of the client – Payment of expenses as determined by the client for a specific purpose – Transfer of money from the trust bank account to the business bank account
FJ	Fees journal	Recording fees charged to clients	– Fees charged for services rendered
SJ	Sheriff's journal	Recording of costs incurred on behalf of clients for using the services of a sheriff.	– Sheriff costs – If the law practitioner does not make significant use of the services of the sheriff then the costs can be recorded in the GJ
AJ	Advocate's journal	Recording of costs incurred on behalf of clients for using the services of an attorney.	– Advocate's costs – If the law practitioner does not make significant use of the services of an attorney then the costs can be recorded in the GJ
GJ	General journal	Records unique journal entries that cannot be processed in any other journal.	– Depreciation – Interest charged on client accounts – Correction of errors

5.5 Discussion of general ledger accounts

A ledger account is a **summary** of all the transactions that relate to a **specific** item, for example Office Furniture, Fees, Telephone etc. All these individual accounts are kept in a ledger. The general ledger consists of all the accounts of the business in the form of a T–account. The T-account is a visual representation of individual accounts in all of the different ledgers. The format used looks like a "T" thereby making it easy to show the effect of additions and subtractions (debits and credits) to the account.

The following T–account shows the aforementioned discussion (The red lines indicate the T-format):

Dr		Account name				Acc no.	Cr
Date	**Details**	**Fol.**	**R**	**Date**		**Fol.**	**R**
01/02	Assets - increase Liabilities - decrease Capital - decreases				Assets - decrease Liabilities - increase Capital - increase		
	[Account totalled]				[Account totalled]		

5.6 Posting to the general ledger

The next step after drawing up the subsidiary journals is to post the transactions to the general ledger. To "post" means to copy the entries listed in the journals into their respective ledger accounts. In other words, the debits and credits in the journal are accumulated and transferred to the appropriate debit and credit columns of the ledger account.

In reviewing the ledger accounts below, notice that the "description" column includes a cross-reference back to the journal page in which the transaction was initially recorded. This reduces the amount of detailed information that must be recorded in the ledger, and provides an audit trail back to the original transaction in the journal. The check marks in the journal indicate that a particular transaction has been posted to the ledger. Without these marks (in a manual system), it would be very easy to fail to post a transaction, or even post the same transaction twice.

At month-end *all journals* should be totalled, and these *totals* should be posted to the *general ledger*. The rules of double-entry and cross-referencing (In the example above you can see a column for folio numbers. These numbers are only inserted as references once the completed journal is posted to the general ledger) will now come into full use and should be applied throughout as we complete the general ledger.

The general ledger is where posting to the accounts occurs. Posting is the process of recording amounts as credits (right side), and amounts as debits (left side), in the pages of the general ledger.

5.7 Balancing of a ledger account

According to Rule 54.10 of the LPA, the accounting records of the practice are to be updated and balanced monthly. The requirements for this Rule are deemed to be complied with, if the accounting records have been written up by the end of the last day of the following month (i.e. the transactions for January should be written up by the last day of February).

As accounts have entries on both sides of the T-account i.e. debits and credits, it is necessary to perform a calculation to determine the balance on the account. If there is, only one entry entered in the account, that entry is the balance. If the amount on the debit side of the account and the amount on the credit side of the account are equal, the balance on the account is a nil (0) balance.

RECAP	*When the debit side is greater than the credit side — the balance is a debit balance.* *When the credit side is greater than the debit side — the balance is a credit balance.*

All ledger accounts have to be balanced at the end of each month.

STEPS	*To calculate the balance of an account, the following steps must be taken:* *Step 1 — Calculate the totals of the debit entries (left side of the account) and credit entries (right side of the account) separately.* *Step 2 — The bigger total is then used as the total on both sides of the account.* *Step 3 — The difference between the total amounts as calculated in the previous step and the smallest total will be the balance of the account.* *Step 4 — This balance is written on the side of the smallest total. The smallest total plus the balance inserted will then add up to the bigger total. The balance must be dated the last day of the month and referenced "c/d", the abbreviation for carried down or "c/f" for carried forward.* *Step 5 — The same balance (words and amount) is written on the opposite side below the total with "b/d" for brought down as reference. This balance is dated the first day of the following month.*

Notes

The balancing can be illustrated as follows:

Step 1 Step 1

Dr **Business bank account** **Cr**

Date	Details	Fol	Amount	Date	Details	Fol	Amount
2020			R	2020			R
01/02	Capital		130 000	06/02	Equipment		100 000
28/02	Clients' control	Add #	28 000	16/02	Wages	Add §	20 000
28/02	Bank interest received		2 000	28/02	Balance	c/d	40 000
			160 000				160 000
01/03	Balance	b/d	40 000				

Step 2 Step 4

Step 5 # (130 000 + 28 000 + 2 000) = 160 000 > § (100 000 + 20 000) = 120 000
∴ 160 000 – 120 000 = 40 000 is the balancing amount

Step 3

LBL	*Balancing a ledger account*	Balancing an account (online-audio-convert

EXAMPLE 5.1

The following transactions are used to illustrate the balancing of general ledger accounts:

1. A computer server was purchased and installed on credit by a supplier (SA Computers) on 1 January 2020 for R150 000.
2. SA Attorneys purchased three printers for cash on 1 February 2020 for R15 000.

REQUIRED:

Prepare the computer equipment account for the month ending 28 February 2020.

Notes

EXPLANATION 5.1

Date of transaction

Amounts debited to asset account

Credit side of account – always on the right of the T-account

Dr **Computer equipment** **Cr**

Date		Fol.	R	Date		Fol.	R
01/01	Creditors' control	GJ1	150 000	29/02	Closing balance		165 000
01/02	Cash payments	BCPJ1	15 000				
			165 000				165 000
	Opening balance		165 000				

Closing balance for the month is R165 000 and it is carried down to be the opening balance for the next month.

Accounts credited

Insert a line between the R15 000 and the R165 000.

Insert R165 000 on both sides of the account. The R165 000 is a total and there is a double line after R165 000.

Add up the left side of the account = R165 000

5.8 Clients' ledger, business creditors' ledger and trust creditors' ledger

Apart from the general ledger, we need to keep a separate clients' ledger, business creditors' ledger as well as a trust creditors' ledger. The clients' ledger keeps a record of transactions with each individual client. The business creditors' ledger and the trust creditors' ledger keep records of transactions with each individual business creditor and trust creditor respectively.

The total of the individual client's balances in the clients' ledger must be equal to the balance of the clients' control account in the general ledger. Likewise, the total of the individual business creditors' balances in the business creditors' ledger must be equal to the balance of the business creditors' control account in the general ledger.
The Rules require that a list of the individual trust creditors' balances be compiled on a regular basis of not more than three months. The balance must then be equal to the balances of the trust creditors' control account and trust bank account.

5.9 Trust creditors' control account and clients' control account

- The total balances of the individual clients' accounts (referred to as the list of clients) should agree with the balance of the clients' control account in the general ledger.

- The total balances of the individual trust creditors' accounts in the trust creditors' ledger, (referred to as the list of trust creditors) should agree with the balance of the trust creditors' control account in the general ledger.

Due to the removal of the client and trust creditor accounts from the general ledger, the general ledger will not balance. Therefore, two accounts are opened in the general ledger, called the *clients' control account* (containing all transactions with clients) and a *trust creditors' control account* (containing all transactions with trust creditors). The two subsidiary ledgers are therefore included in the general ledger by means of these control accounts and the general ledger will balance.

NB	*The trust creditors' accounts in the trust creditors' ledger do not decrease when the investments are made on behalf of the clients.*

QUICK NOTE	*A law practice delivers a service to its clients. Therefore, the business does not buy and sell goods.*

EXAMPLE 5.2

The following is a list of balances per the general ledger of Africa Attorneys at 31 January 2020:

Credits	**Fol.**	**R**
Capital	B1	223 920
Accumulated depreciation – Law library	B4	3 000
Accumulated depreciation – Computer equipment	B5	6 480
Trust creditors' control	B9	2 520
Debits		
Law library at cost	B2	15 000
Computer equipment at cost	B3	32 400
Business bank account	B6	184 296
Trust bank account	B7	2 520
Clients' control	B8	1 704

The folio number of each account Providing a folio no. is a form of referencing.

Note: The balance of the Trust bank account = the balance of the Trust creditors control account = R2 520

2. The following balances on 31 January 2020 appeared in the clients' ledger:

CL1	G Gau	R648 Debit
CL2	N Natal	R792 Debit (Re matter: court case filed by ABC Venture Capital.)
CL3	D West	R264 Debit

Law practitioners perform services for clients and charge fees for work done.

3. The following balances on 31 January 2020 appeared in the clients' ledger:

Trust creditors' ledger

There is only one trust creditor. Therefore the list of Trust creditors = Trust creditors' control account (per TB)

TCL1 E North R2 520 Credit (Re matter: transfer of property Erf 66, Arkasia.)

QUICK NOTE	*In the trial balance above, there is a folio no. referring to B1 - The Capital Account is the first account in the General Ledger. The B refers to the term Balance Sheet, the previous name for the Statement of Financial Position (This statement presents the financial position of the business at the end of the reporting period.)* *N stands for Nominal account (The nominal accounts are the statement of profit and loss accounts such as the accounts for recording revenues, expenses, gains, and losses. These accounts are closed off at the end of the reporting period and the balance transferred to a Statement of Financial Position equity account such as the proprietor's capital account or the entity's retained earnings account.* *TCL is for Trust creditor in the Trust Creditors' Ledger* *CL is for Client in the Clients' Ledger*

4. Transactions entered into by Africa Attorneys during February 2020:

Date	Detail
1	Pay office rent for February 2020, R14 440. [An expense – Cost to operate business on the premises]
1	Purchase by EFT, government gazettes amounting to R1 200 for the library. The carrying amount of the law library before the aforementioned purchase was R12 000. [Purchase of an asset]
1	Purchase computer equipment for R45 500 from SA Computing on credit.
1	A partner in Africa Attorneys, S Africa one of the new laptops home for his son to use. The laptop cost R9 500.
2	Receive payment of R648 from G Gau in settlement of his account.
5	G Gau is invoiced with fees in respect of the drafting of a will, R2 376. [This transaction is fees charged for services rendered to a client]
8	Z Zulu instructs the attorney's practice to issue a summons against his wife for a divorce. He pays a deposit of R1 620 to cover preliminary costs.
9	N Natal is invoiced with fees of R75 600 for defence in the court case filed by ABC Venture Capital and Africa Attorneys receives payment in cash, for the full amount. [This transaction is fees charged for services rendered to a client]
10	Receive a deposit of R3 432 from C Cape for the preparation of contracts regarding the registration of a company. [Client – Money paid into trust bank account]
11	Receive an account from P & C Stationers for stationery purchased on credit, R846.
12	N Natal instructs the attorney's practice to act on his behalf in a third-party case and pays a deposit of R720. The attorney's practice pays R60 for a police report from these funds. [Client – Money paid into trust bank account. Expenses on behalf of the client will be paid from the trust bank account if sufficient trust funds were received from the client at an earlier stage.] NB: Take note from which account the transaction was paid

17	Pay municipal taxes on behalf of E North in respect of the transfer of the property, R1 440. [E North is a client and previously paid money into the trust account. This transaction will be paid from the trust bank account] NB: Take note from which account the transaction was paid
18	The conveyancing transaction between trust creditor E North and the buyer, F East is concluded. The balance on the trust account of E North is paid out to him. [The amount for this transaction is not given. It must be calculated. See balance on trust creditors' account – E North]
20	N Natal is invoiced with fees in respect of the third party case, R1 728
20	Pay advocate G Langa in respect of the third party case of N Natal, R3 960. [The payment to advocate G Langa is made from the business bank account as there were insufficient funds in the trust account of N Natal to cover the payment. (Refer to learning unit 4)].
22	Pay sheriff fees from trust monies for issuing of summons for Z Zulu, R148.
22	Pay registration expenses from trust monies in respect of the company registration for C Cape, R2 360.
28	Receive office rent of R1 400 from A South for sub-letting a section of the premises.
28	Processed EFT payments for: [These are expenses incurred to operate the practice] Wages, R6 388. Water and electricity, R2 040. Telephone, R636.
28	At 28 February, Africa Attorneys calculates and accounts for depreciation on the computer equipment and the law library at 20% per annum on the straight-line method.

Additional information

1. All payments are made by electronic fund transfers (EFT's).
2. The legal practice does not make use of advocates' and sheriffs' journals as their services are not frequently used.
3. Africa Attorneys do not make use of a business creditors' control account as the majority of business expenses are cash transactions.
4. Africa Attorneys is not a registered VAT vendor.

Notes

REQUIRED:

Prepare the following in the books of Africa Attorneys for February 2020:

1. **Books of first entry**
   - Business cash journals
   - Trust cash journals
   - Fees journal
   - General journal
2. **Ledgers**
   - General ledger
   - Clients' ledger
   - Trust creditors' ledger

EXPLANATION 5.2

1. **Books of first entry**

Payments received from clients as payments for services rendered are deposited into the Business bank account

Business cash receipts journal of Africa Attorneys for February 2020 **BCRJ**

Date	Receipts	Fol.	Sundries R	Clients' control R	Bank R
02/02	G Gau	CL1		648	648
20/02	N Natal (Re matter: ABC Venture Capital)	CL2		75 600	75 600
28/02	Rent received	N2	1 400		1 400
			1 400	76 248	77 648
				B8	B6

Rent received from a lessee sub-leasing a part of the premises

RECAP

The Cash Book of a business is divided into a Cash Receipts Journal and a Cash Payments Journal. In the case of a lawyer's practice, there is also a Trust Cash Receipts Journal and Trust Cash Payments Journal.

Notes

EXPLANATION 5.2 (continued)

Acronym of Business Cash Payments Journal = BCPJ

Business cash payments journal of Africa Attorneys for February 2020 **BCPJ**

Date	Payments	Fol.	Sundries R	Clients' control R	Business bank R
1	Office rent	N7	14 440		14 440
2	Law library	B2	1 200		1 200
20	N Natal (advocate) [see note by transaction]	CL2		3 960	3 960
28	Wages	N6	6 388		6 388
28	Water and electricity	N5	2 040		2 040
28	Telephone	N4	636		636
			24 704	3 960	28 664
				B8	B6

Trust cash receipts journal of Africa Attorneys for February 2020

Acronym for Trust Cash Receipts Journal = TCRJ

Deposits received from clients that are to be held in trust are deposited into the trust bank account.

TCRJ

Date	Receipts	Fol.	Sundries R	Trust creditors' control R	Trust bank R
8	Z Zulu (divorce)	TCL2		1 620	1 620
10	C Cape (company)	TCL3		3 432	3 432
12	N Natal (Re matter: third-party case)	TCL4		720	720
				5 772	5 772`
				B9	B7

Acronym for Trust Cash Payments Journal = TCPJ

Trust cash payments journal of Africa Attorneys for February 2020 **TCPJ**

Date	Payments	Fol.	Sundries R	Trust creditors' control R	Trust bank R
16	N Natal (police report)	TCL4		60	60
17	E North (taxes – Akasia property)	TCL1		1 440	1 440
18	E North (Akasia property) [Calculation]	TCL1		1 080	1 080
22	Z Zulu (sheriff)	TCL2		148	148
22	C Cape (company registration)	TCL3		2 360	2 360
				5 088	5 088
				B9	B7

[Calculation – 2 520 (opening balance) – 1 440 (payment - taxes) = 1 080 Payment of balance on trust account to E North]

EXPLANATION 5.2 (continued)

Fees journal of Africa Attorneys for February 2020

Fees journal

FJ

Date	Details	Fol.	Clients' control R	Fees R
5	G Gau – (Re matter: drafting of will)	CL1	2 376	2 376
9	N Natal – (Re matter: court case)	CL2	75 600	75 600
20	N Natal – (Re matter: third party case)	CL4	1 728	1 728
			79 704	79 704
			B8	N1

General journal of Africa Attorneys for February 2020

GL

These transactions are credit purchase transactions

Day	Details	Fol.	Debit R	Credit R
01/02	Computer equipment	B3	45 500	
	Accounts payable	B3		45 500
	Computer equipment purchased on credit			
01/02	Drawings		9 500	
	Computer equipment			9 500
	Computer equipment taken by partner, S Africa for son's use			
11/02	Stationery	N3	846	
	Accounts payable	B9		846
	Stationery purchased on credit			
28/02	Depreciation – Law library	N8	270	
	Accumulated depreciation – Law library	B5		270
	Provision for depreciation on the law library (16 200 x 20% x 1/12)			
28/02	Depreciation – Computer equipment	N8	1 140	
	Accumulated depreciation – Computer equipment	B4		1 140
	Provision for depreciation on the computer equipment (68 400 x 20% x 1/12)			

RECAP	*Nominal accounts in the General Ledger record expenses, profits, losses and gains and is shown by an N. The chart of accounts is a list of all the accounts in the ledger. The accounts usually appear in the following order: assets, liabilities, equity, dividends, revenues, and expenses and they are numbered in that order. The computerised accounting packages also use B's and N's.*

EXPLANATION 5.2 (continued)

2. Ledgers

General ledger of Africa Attorneys

Equity

Dr **Capital** **B1** **Cr**

			R	2020			**R**
				01/02	Balance	b/d	223 920

Asset

See glossary for definition of Historical cost

Dr **Law library at cost** **B2** **Cr**

2020			**R**	2020			**R**
01/02	Balance	b/d	15 000	28/02	Balance	c/d	16 200
01/02	Business bank	BCPJ	1 200				
			16 200				16 200
01/03	Balance	b/d	16 200				

Asset

Dr **Computer equipment at cost** **B3** **Cr**

2020			**R**	2020			**R**
01/02	Balance	b/d	32 400	01/02	Drawings	GJ	9 500
01/02	Purchase on credit	GJ	45 500	28/02	Balance	c/d	68 400
			77 900				77 900
01/03	Balance	b/d	68 400				

Part of asset category in BAE (reduction of asset value to carrying amount)

Dr **Accumulated depreciation – Law library** **B4** **Cr**

2020			**R**	2020			**R**
01/02	Balance	c/d	3 270	01/02	Balance	b/d	3 000
				28/02	Depreciation	GJ	270
			3 270				3 270
				01/03	Balance	b/d	3 270

Notes

EXPLANATION 5.2 (continued)

Part of asset category in BAE (reduction of asset value to carrying amount)

Dr Accumulated depreciation – Computer equipment B5 Cr

2020			R	2020			R
01/02	Balance	c/d	7 620	01/02	Balance	b/d	6 480
				28/02	Depreciation	GJ	1 140
			7 620				7 620
				01/03	Balance	b/d	7 620

Asset

Dr Business bank account B6 Cr

2020			R	2020			R
01/02	Balance	b/d	184 296	28/02	Payments	BCPJ	28 664
28/02	Receipts	BCRJ	77 648	28/02	Balance	c/d	233 280
			261 944				261 944
01/03	Balance	b/d	233 280				

Asset

Dr Trust bank account B7 Cr

2020			R	2020			R
01/02	Balance	b/d	2 520	28/02	Payments	TCPJ	5 088
28/02	Receipts	TCRJ	5 772	28/02	Balance	c/d	3 204
			8 292				8 292
01/03	Balance	b/d	3 204				

The general ledger of an attorney's practice has BOTH a Trust creditors' control account (Cr) and a Clients' control account (Dr)

Asset

Dr Clients' control B8 Cr

2020			R	2020			R
01/02	Balance	b/d	1 704	28/02	Business bank	BCRJ	76 248
28/02	Fees earned	FJ	79 704	28/02	Balance	c/d	9 120
28/02	Business bank	BCPJ	3 960				
			85 368				85 368
01/02	Balance	b/d	9 120				

The general ledger of a lawyer's practice has BOTH a Trust creditors' control account (Cr) and a Clients' control account (Dr)

Liability – Practice owes money to the clients of the practice

Dr Trust creditors' control B9 Cr

2020			R	2020			R
28/02	Trust bank	TCPJ	5 088	01/02	Balance	b/d	2 520
28/02	Balance	c/d	3 204	28/02	Trust bank	TCRJ	5 772
			8 292				8 292
				01/03	Balance	b/d	3 204

EXPLANATION 5.2 (continued)

Liability – Trade creditor

Dr				**Accounts payable**		**B10**	**Cr**
2020			**R**	2020			**R**
28/02	Balance	c/d	46 346	01/02	Computer equipment	GJ	45 500
				11/02	Stationery	GJ	846
			46 346				46 346
				28/02	Balance	b/d	46 346

Part of equity

Dr				**Drawings**		**B11**	**Cr**
2020			**R**				**R**
01/02	Computer equipment	GL	9 500				

Income

Dr				**Fees earned**		**N1**	**Cr**
			R	2020			**R**
				28/02	Clients' control	FJ	79 704

Dr				**Rental received**		**N2**	**Cr**
			R	2020			**R**
				28/02	Business bank	BCRJ	1 400

Expense

Dr				**Stationery**		**N3**	**Cr**
2020			**R**				**R**
11/02	Accounts payable	GJ	846				

Expense

Dr				**Telephone**		**N4**	**Cr**
2020			**R**				**R**
28/02	Business bank	BCPJ	636				

Expense

Dr				**Water and electricity**		**N5**	**Cr**
2020			**R**				**R**
28/02	Business bank	BCPJ	2 040				

Expense

Dr				**Wages**		**N6**	**Cr**
2020			**R**				**R**
28/02	Business bank	BCPJ	6 388				

EXPLANATION 5.2 (continued)

Expense

Dr		Office rent paid				N7	Cr
2020			R	2020			R
01/02	Business bank	BCPJ	14 440				

Dr		Depreciation				N8	Cr
2020			R	2020			R
28/02	AD - Law library	GL	270	28/02	Balance	c/d	1 410
28/02	AD - Computer equipment	GL	1 140				
			1 410				1 410
01/03	Balance	b/d	1 410				

AD = Accumulated depreciation

Clients' ledger of Africa Attorneys

QUICK NOTE

- *If the attorney's firm receives instructions from a client on different matters, each matter should be separately accounted for. (Refer to Mr. N Natal below.)*
- *As Africa Attorneys only used the sheriff once on 22 February 2020 the legal firm did not make use of a sheriffs' journal. On receipt of the invoice and account statement from the sheriff, Africa Attorneys immediately paid the account from the business bank account. (Also refer to learning unit 4)*

Dr		G Gau				CL1	Cr
2020			R	2020			R
01/02	Balance	b/d	648	02/02	Business bank	BCRJ	648
05/02	Fees earned	FJ	2 376	28/02	Balance	c/d	2 376
			3 024				3 024
01/03	Balance	b/d	2 376				

Dr		N Natal (Re matter: ABC Venture Capital)				CL2	Cr
2020			R	2020			R
01/02	Balance	b/d	792	09/02	Business bank	BCRJ	75 600
09/02	Fees earned	FJ	75 600	28/02	Balance	c/d	792
			76 392				76 392
01/03	Balance	b/d	792				

EXPLANATION 5.2 (continued)

Dr			D West			CL3	Cr
2020			R				R
01/02	Balance	b/d	264				

Dr	N Natal (Re matter: Third party case)					CL4	Cr
2020			R	2020			R
20/02	Fees	FJ	1 728	28/02	Balance	c/d	5 688
	Business bank (Advocate)	BCPJ	3 960				
			5 688				5 688
01/03	Balance	b/d	5 688				

Trust creditors' ledger of Africa Attorneys

Dr			E North			TCL1	Cr
2020			R	2020			R
17/02	Trust bank (taxes)	TCPJ	1 440	01/02	Balance	b/d	2 520
18/02	Trust bank (E North)	TCPJ	1 080				
			2 520				2 520

Dr			Z Zulu			TCL2	Cr
2020			R	2020			R
22/02	Trust bank (Sheriff)	TCPJ	148	08/02	Trust bank (Divorce)	TCRJ	1 620
28/02	Balance	c/d	1 472				
			1 620				1 620
				01/03	Balance	b/d	1 472

Dr			C Cape			TCL3	Cr
2020			R	2020			R
22/02	Trust bank (Company registration)	TCPJ	2 360	10/02	Trust bank (Company registration)	TCRJ	3 432
28/02	Balance	c/d	1 072				
			3 432				3 432
				01/03	Balance	b/d	1 072

EXPLANATION 5.2 (continued)

Dr N Natal (Re matter: Third party case) TCL4 Cr

2020			R	2020			R
12/02	Trust bank (Police report)	TCPJ	60	12/02	Trust bank (Deposit)	TCRJ	720
28/02	Balance	c/d	660				
			720				720
				01/03	Balance	b/d	660

EXAMPLE 5.3

The following information relates to the practice of Cape Attorneys. The business is registered as a VAT vendor. VAT is included at 15% where applicable:

Transactions during August 2020:

Date	Details	R
1	Pay office rent for August 2020 to N Nem per EFT 527 Pay the increase in the deposit for office rent to N Nem per EFT 528 Levy fees for services rendered to L Lee (C1) and receive payment in cash (Receipt 45 is issued)	4 025 4 000 19 320
2	Purchase postage stamps from petty cash (voucher A10) Debit R Rote (C3) with fees in respect of a third party case	402 1 265
7	Pay for advertisements of the firm by EFT 529	230
10	M Mpuma (T4) instructs Cape Attorneys to issue a summons against his wife for divorce, and pays a deposit in this regard (trust receipt 34)	456
11	Purchase milk and sugar from petty cash (voucher A11)	57
15	Debit G Geo (C4) in respect of fees charged for collection from L Mope	747
20	Pay a deposit for purchasing property on behalf of L Langa (T3) – issue Trust EFT 40 Pay the following from petty cash: Tea and coffee (voucher A12) Pens and pencils (voucher A13)	45 600 114 276
23	Receive a EFT from L Lee as a payment on his account (Receipt 46 is issued)	1 265
25	Pay costs regarding the divorce case of M Mpuma Pay registration of a letter to L Lee from petty cash (voucher A14) Pay short-term insurance for August 2020 per EFT 530	456 18 1 725

27	Pay the following: Water and electricity (EFT 531) Telephone (EFT 532) Salaries and wages (EFT 533)	 977 1 840 5 130
28	Charge the overdue account of client, B Ben (C3) with interest @ 20% p.a. for 9 months. She owes the firm R4 000.	?
29	Purchase stationery on credit from SA Suppliers	805
31	Issue EFT 534 to make up the petty cash imprest amount	?

Additional information

The following list of balances was taken from the records of Cape Attorneys on 31 July 2020:

List of balances on 31 July 2020

Account details **Debits**	**# Account no.**	**R**
Drawings	B2	13 050
Deposit – Office rent	B3	1 800
Clients' control	B4	22 970
Trust bank account	B5	75 000
Business bank account	B7	80 000
Petty cash	B8	1 000
Land and buildings	B9	200 000
Equipment	B10	47 800
Furniture	B11	14 000
Postage	N1	500
Advertisements	N2	2 000
Entertainment	N3	480
Water and electricity	N4	13 400
Telephone	N5	1 560
Stationery	N6	900
Office rent	N9	24 500
Insurance	N10	10 500
Salaries and wages	N11	18 800
Credits		
Capital	B1	246 782
Trust creditors' control	B6	75 000
VAT control account	B12	22 778
Fees	N8	183 700

Note: The balance of the Trust bank account = the balance of the Trust creditors' control account = R75 000

\# B = Statement of financial position accounts (previously known as balance sheet)
\# N = Statement of profit or loss accounts (previously known as income statement)

List of trust creditors on 31 July 2020:

Details	Ac no.	R
S Africa	TCL1	2 500
A South	TCL2	21 000
L Langa	TCL3	51 500
		75 000

List of clients on 31 July 2020:

Details	Ac no.	R
L Lee	C1	14 500
B Ben	C2	4 000
R Rote	C3	820
G Geo	C4	3 650
		22 970

REQUIRED:

1. Record the above transactions in the undermentioned books of first entry for the month of August 2020.
   - Business cash journals
   - Trust cash journals
   - Fees journal
   - Petty cash journal
   - General journal
2. Post the completed journals to the general ledger of Cape Attorneys.
3. Update the clients' ledger and trust creditors' ledger for August 2020.

EXPLANATION 5.3

Business cash receipts journal of Cape Attorneys for August 2020 **BCRJ**

Date	Doc no.	Receipts	**Fol	Sundries R	VAT R	Clients' control R	Bank R
1	45	L Lee	C1			19 320	19 320
23	46	L Lee	C1			1 265	1 265
						20 585	20 585
31		Cr – Clients' control account in general ledger				B4	
31		Dr – Business bank account in general ledger					B7

** Credit individual client accounts in clients' ledger

EXPLANATION 5.3 (continued)

Business cash payments journal of Cape Attorneys for August 2020

BCPJ

Date	Doc no.	Payments	**Fol	Sundries R	VAT R	Bank R
1	527	Office rent	N8	3 500	525	4 025
	528	Deposit: Office rent	B3	4 000		4 000
7	529	Advertisements	N2	200	30	230
25	530	Insurance	N9	1 500	225	1 725
27	531	Water and electricity	N4	850	127	977
	532	Telephone	N5	1 600	240	1 840
	533	Salaries and wages	N10	5 130		5 130
31	534	Petty cash	B8	867		867
				17 647	1 147	18 794
31	Dr – VAT control account in general ledger				B12	
31	Cr – Business bank account in general ledger					B7

** Dr – Individual accounts in general ledger

Trust cash receipts journal of Cape Attorneys for August 2020

TCRJ

Date	Doc no.	Receipts	** Fol.	Sundries R	Trust creditors' control R	Bank R
10	34	M Mpuma - divorce	T4		456	456
					456	456
31	Cr – Trust creditors' control account in general ledger				B6	
31	Dr – Trust bank account in general ledger					B5

** Credit individual trust creditors' accounts in trust creditors' ledger

Trust cash payments journal of Cape Attorneys for August 2020

TCRJ

Date	Doc no.	Payments	**Fol	Sundries R	Trust creditors' control R	Bank R
20	40	L Langa – property	T3		45 600	45 600
25	41	M Mpuma – divorce	T4		456	456
					46 056	46 056
31	Dr – Trust creditors' control account in general ledger				B6	
31	Cr – Trust bank account in general ledger					B5

** Debit individual trust creditors' accounts in trust creditors' ledger

EXPLANATION 5.3 (continued)

Fees journal of Cape Attorneys for August 2020

FJ

Date	Details	**Fol	Clients' control R	VAT R	Fees R
1	L Lee – services rendered	C1	19 320	2 520	16 800
2	R Rote – third party case	C3	1 265	165	1 100
15	G Geo – collection	C4	747	97	650
			21 332	2 782	18 550
31	Dr – Clients' control account in general ledger		B4		
31	Cr – VAT control account in general ledger			B12	
31	Cr – Fees account in general ledger				N7

** Debit individual client's accounts in clients' ledger

Petty cash journal of Cape Attorneys for August 2020

PCJ

Date	Doc no.	Rec-eipts	Fol.	Total	Date	Doc no.	Payments	Fol.	Total	Sta-tionery	Postage	VAT	Entertain-ment	Clients
31	534	Bank	BCPJ	867	2	A10	Postage stamps	N6	402		350	52		
					11	A11	Milk and sugar	N3	57				57	
					20	A12	Tea and coffee	N3	114				114	
						A13	Pens and pencils	N6	276	240		36		
					25	A14	L Lee	C1**	18					18
				867					867	240	350	88	171	18
31	Credit petty cash account in general ledger								B8					
31	Debit individual accounts in general ledger									N6	N1	B12	N3	B4
31	** Debit individual client's accounts in clients' ledger													

General journal of Cape Attorneys for August 2020

Day	Details	Fol.	Debit R	Credit R
28	B Ben (Clients' control)	C2/(B4)	600	
	Interest received	N11		600
	(Account charged with interest – R4 000 x 20% x 9/12)			
29	Stationery	N6	700	
	VAT control (Input VAT)	B12	105	
	SA Suppliers (Business creditors' control)	BC1/(B13)		805
	(Stationery purchased on credit)			

EXPLANATION 5.3 (continued)

General ledger

Dr — Capital — B1 — Cr

			R	2020			R
				01/08	Balance	b/d	246 782

Dr — Drawings — B2 — Cr

2020			R				R
01/08	Balance	b/d	13 050				

Dr — Deposit: Office rent — B3 — Cr

2020			R				R
01/08	Balance	b/d	1 800				
31/08	Bank	BCPJ	4 000				
			5 800				

Dr — Clients' control — B4 — Cr

2020			R	2020			R
01/08	Balance	b/d	22 970	31/08	Bank	CB	20 585
28/08	Interest received	GJ	600	31/08	Balance	c/d	24 335
31/08	Fees and VAT	FJ	21 332				
31/08	Petty cash	PCJ	18				
			44 920				44 920
01/09	Balance	b/d	24 335				

Dr — Trust bank account — B5 — Cr

2020			R	2020			R
01/08	Balance	b/d	75 000	31/08	Payments	TCPJ	46 056
31/08	Receipts	TCRJ	456	31/08	Balance	c/d	29 400
			75 456				75 456
01/09	Balance	b/d	29 400				

Dr — Trust creditors' control — B6 — Cr

2020			R	2020			R
01/08	Trust bank	TCPJ	46 056	01/08	Balance	b/d	75 000
31/08	Balance	c/d	29 400	31/08	Trust bank	TCRJ	456
			75 456				75 456
				01/09	Balance	b/d	29 400

EXPLANATION 5.3 (continued)

Dr — Business bank account — B7 — Cr

2020			R	2020			R
01/08	Balance	b/d	80 000	31/08	Payments	BCPJ	18 794
31/08	Receipts	BCRJ	20 585	31/08	Balance	c/d	
			100 585				100 585
01/09	Balance	b/d	81 791				

Dr — Petty cash — B8 — Cr

2020			R	2020			R
01/08	Balance	b/d	1 000	31/08	Payments	PCJ	867
31/08	Receipts	PCJ	867	31/08	Balance	c/d	1 000
			1 867				1 867
01/09	Balance	b/d	1 000				

Asset (Debit balance)

Dr — Land and buildings — B9 — Cr

2020			R				R
01/08	Balance	b/d	200 000				

Asset (Debit balance)

Dr — Equipment — B10 — Cr

2020			R				R
01/08	Balance	b/d	47 800				

Asset (Debit balance)

Dr — Furniture — B11 — Cr

2020			R				R
01/08	Balance	b/d	14 000				

Opening balance is a credit. The amount is owed to SARS

Dr — VAT control — B12 — Cr

2020			R	2020			R
29/08	Creditors	GJ	105	01/08	Balance	b/d	22 778
31/08	Bank	BCPJ	1 147	31/08	Clients' control	FJ	2 782
31/08	Petty cash	PCJ	88				
31/08	Balance	b/d	24 220				
			25 560				25 560
				01/09	Balance	b/d	24 220

Dr — Business creditors' control — B13 — Cr

			R	2020			R
				29/08	Stationery and VAT	GJ	805

This is an amount owing to a supplier. Therefore, it is a credit balance and it includes VAT.

EXPLANATION 5.3 (continued)

Dr **Postage** **N1** **Cr**

2020			R				R
01/08	Balance	b/d	500				
31/08	Petty cash	PCJ	350				
			850				

Dr **Advertisements** **N2** **Cr**

2020			R				R
01/08	Balance	b/d	2 000				
07/08	Business Bank	BCPJ	200				
			2 200				

Dr **Entertainment** **N3** **Cr**

2020			R				R
01/08	Balance	b/d	480				
31/08	Petty cash	PCJ	171				
			651				

Dr **Water and electricity** **N4** **Cr**

2020			R				R
01/08	Balance	b/d	13 400				
27/08	Business Bank	BCPJ	850				
			14 250				

Dr **Telephone** **N5** **Cr**

2020			R				R
01/08	Balance	b/d	1 560				
27/08	Business Bank	BCPJ	1 600				
			3 160				

Dr **Stationery** **N6** **Cr**

2020			R				R
01/08	Balance	b/d	900				
29/08	Business creditors	GJ	700				
31/08	Petty cash	PCJ	240				
			1 840				

This is the opposite account to the Business creditors control account (above).
Stationary is an expense and the account is debited. The amount debited excludes VAT.

EXPLANATION 5.3 (continued)

Dr — Fees — N7 — Cr

			R	2020			R
				01/08	Balance	b/d	183 700
				31/08	Clients' control	FJ	18 550
							202 250

Dr — Office rent — N8 — Cr

2020			R				R
01/08	Balance	b/d	24 500				
	Business payments	BCPJ	3 500				
			28 000				

Dr — Insurance — N9 — Cr

2020			R				R
01/08	Balance	b/d	10 500				
25/08	Business payments	BCPJ	1 500				
			12 000				

Dr — Salaries and wages — N10 — Cr

2020			R				R
01/08	Balance	b/d	18 800				
27/08	Business payments	BCPJ	5 130				
			23 930				

Dr — Interest received — N11 — Cr

			R	2020			R
				28/08	Clients' control	GJ	600

Clients' ledger

Dr — L Lee — C1 — Cr

2020			R	2020			R
01/08	Balance	b/d	14 500	01/08	Business receipts	BCRJ	19 320
	Fees and VAT	FJ	19 320	23/08	Business receipts	BCRJ	1 265
	Petty cash	PCJ	18	31/08	Balance	c/d	13 253
			33 838				33 838
01/09	Balance	b/d	13 253				

EXPLANATION 5.3 (continued)

Dr — B Ben — C2 — Cr

2020			R				R
01/08	Balance	b/d	4 000				
28/08	Interest received	GJ	600				
			4 600				

Dr — R Rote — C3 — Cr

2020			R				R
01/08	Balance	b/d	820				
02/08	Fees and VAT	FJ	1 265				
			2 085				

Dr — G Geo — C4 — Cr

2020			R				R
01/08	Balance	b/d	3 650				
15/08	Fees and VAT	FJ	747				
			4 397				

Trust creditors' ledger

Dr — S Africa — T1 — Cr

			R	2020			R
				01/08	Balance	b/d	2 500

Dr — A South — T2 — Cr

			R	2020			R
				01/08	Balance	b/d	21 000

Dr — L Langa — T3 — Cr

2020			R	2020			R
20/08	Trust cash book (Deposit on property)	TCPJ	45 600	01/08	Balance	b/d	51 500
31/08	Balance	c/d	5 900				
			51 500				51 500
				01/09	Balance	b/d	5 900

Dr — M Mpuma — T4 — Cr

2020			R	2020			R
25/08	Trust cash book (Divorce)	TCPJ	456	10/08	Trust cash book (Divorce)	TCRJ	456

EXPLANATION 5.3 (continued)

Business creditors' ledger

Dr		**SA Suppliers**				**BC1**	**Cr**
			R	2020			**R**
				29/08	Stationery and VAT	GJ	805

5.10 Preparation of a trial balance

The trial balance (TB) is an accounting report showing a list of balances. It reflects the balances of the various accounts in the *general ledger* and must be updated on a monthly or a shorter basis. Every account will either reflect a debit balance or a credit balance. Due to the fact that double-entries were made with each transaction, the total of the debit balances must be equal to the total of the credit balances in the trial balance.

A TB shows all the closing balances of the general ledger accounts prepared at a specific time in the financial year. A TB is prepared after posting all financial transactions from the different journals to the general ledger accounts.

In addition, a TB will indicate whether all the debits and all the credits had been posted to the general ledger. Since the TB the sum of the debit balances should equal the sum of the credit balances, the trial balance should balance as per the "mantra" – for every debit there must be a corresponding and equal credit.
The trial balance ensures that total debits equal the total credits in the financial records. In a digital system, this balancing is done automatically.

Trial balance process:

- The trial balance is a list of all the accounts in the general ledger.
- The trial balance is prepared at a specific period in time.
- Rule 54.10 of the LPA requires that the trial balance of a legal practice be prepared on a monthly basis.

EXAMPLE 5.4

See the information in Explanation 5.2.

REQUIRED:

Use the general ledgers prepared in Explanation 5.2 to prepare the trial balance, list of clients and list of trust creditors for Africa Attorneys at 28 February 2020.

EXPLANATION 5.4

Trial balance at 28 February 2020

Column of debit account balances

Column of credit account balances

	Fol.	Dr R	Cr R
Capital	B1		223 920
Law library at cost	B2	16 200	-
Computer equipment at cost	B3	68 400	-
Accumulated depreciation – Law library	B4	-	3 270
Accumulated depreciation – Computer equipment	B5	-	7 620
Business bank account Statement of financial position items	B6	233 280	-
Trust bank account	B7	3 204	-
Clients' control	B8	9 120	-
Trust creditors' control	B9	-	3 204
Accounts payable	B10	-	46 346
Drawings	B11	9 500	
Fees earned	N1	-	79 704
Rental received	N2	-	1 400
Stationery	N3	846	-
Telephone Statement of profit or loss items	N4	636	-
Water and electricity	N5	2 040	-
Wages	N6	6 388	-
Office rent paid	N7	14 440	-
Depreciation	N8	1 410	-
		364 064	364 064

List of client balances at 28 February 2020

Details	R
G Gau	2 376
N Natal (Re matter: ABC Venture Capital Ltd)	792
D West	264
N Natal (Re matter: Third party case)	5 688
Balance per clients' control	9 120

List of trust creditors' balances at 28 February 2020

Details	R
E North	-
Z Zulu	1 472
C Cape	1 072
N Natal (Re matter: Third party case)	660
Balance per trust creditors' control	3 204

EXAMPLE 5.5

See the information in Explanation 5.3.

REQUIRED:

Use the general ledgers prepared in Explanation 5.3 to prepare the trial balance, list of clients and list of trust creditors for Cape Attorneys at 28 February 2020.

EXPLANATION 5.5

CAPE ATTORNEYS

Trial balance on 31 August 2020

Details	Ac no.	Debit R	Credit R
Capital	B1		246 782
Drawings	B2	13 050	
Deposit: Office rent	B3	5 800	
Clients' control	B4	24 335	
Trust bank account	B5	29 400	
Trust creditors' control	B6		29 400
Business bank account	B7	81 791	
Petty cash	B8	1 000	
Land and buildings	B9	200 000	
Equipment	B10	47 800	
Furniture	B11	14 000	
VAT control account	B12		24 220
Business creditors' control	B13		805
Postage	N1	850	
Advertisements	N2	2 200	
Entertainment	N3	651	
Water and electricity	N4	14 250	
Telephone	N5	3 160	
Stationery	N6	1 850	
Fees	N7		202 250
Office rent	N8	28 000	
Insurance	N9	12 000	
Salaries and wages	N10	23 930	
Interest received	N11		600
		504 057	504 057

EXPLANATION 5.5 (continued)

List of clients' balances:	**R**
L Lee B Ben R Rote G Geo	13 253 4 600 2 085 4 397
Balance of clients' control account	24 335

List of trust creditors' balances:

31 August 2020	**R**
S Africa A South L Langa	2 500 21 000 5 900
Balance of trust creditors' control account	29 400

5.11 Preparation of adjusting and closing accounting entries

An adjusting journal entry is an entry in an entity's general ledger that occurs at the end of an accounting period to record any unrecognised income or expenses for the period (Refer to Learning unit 4). When a transaction is started in one accounting period and ended in a later period, an adjusting journal entry is required to properly account for the transaction.

The financial statements are prepared from the information contained in the general ledger. In the general ledger, there are nominal accounts (temporary accounts) and there are permanent accounts. The nominal accounts are for income and expense items. The permanent accounts are for assets and liabilities.

Temporary accounts (nominal accounts) are general ledger accounts that accumulate income and expense transactions over a single accounting period. The accumulated income and expenses accounts are used to prepare the statement of profit or loss at the end of the financial year. These accounts are closed off at the end of the accounting period (financial year) by means of closing journal entries and the balances are transferred to the profit and loss account (permanent account). A closing journal entry is a journal entry that is made at the end of an accounting period to transfer balances from a temporary account to a permanent account.

Businesses use closing entries to reset the balances of temporary accounts (accounts that show balances over a single accounting period) to zero. By doing so, the business moves these balances into permanent accounts on the statement of financial position.

The following accounts extracted from the general ledger are used to illustrate the closing off entries and the preparation of the profit or loss account:

Dr **Fee income** **N1** **Cr**

2020			**R**	2020			**R**
				30/06	Clients' control	FJ	80 000

Dr **Salaries** **N2** **Cr**

2020			**R**	2020			**R**
30/06	Bank	BCPJ	6 000				

Dr **Telephone** **N3** **Cr**

2020			**R**	2020			**R**
30/06	Bank	BCPJ	1 200				

The first step is to prepare the journal entry that will be required to process the closing off entries:

General journal of ……..

Day	**Details**	**Fol.**	**Debit R**	**Credit R**
30	Profit and loss account (new GL account)	C3/(B4)		72 800
	Fee income	N1	80 000	
	Salaries	N2		6 000
	Telephone	N3		1 200
	(Account charged with interest – R4 000 x 20% x 9/12)			

The second step is to post the general journal to the general ledger accounts:

The fees account is debited and therefore the account is closed off.

Dr **Fees** **N1** **Cr**

2020			**R**	2020			**R**
30/06	Profit or loss account	GJ	80 000	30/06	Clients' control	FJ	80 000
			80 000				80 000

The salaries account is credited and therefore the account is closed off.

Dr **Salaries** **N2** **Cr**

2020			**R**	2020			**R**
30/06	Bank	BCPJ	6 000	30/06	Profit or loss account	GJ	6 000
			6 000				6 000

The telephone account is credited and therefore the account is closed off.

Dr **Telephone** **N3** **Cr**

2020			**R**	2020			**R**
30/06	Bank	BCPJ	1 200	30/06	Profit or loss account	GJ	1 200
			1 200				1 200

The profit or loss account is as follows:

Dr		**Profit or loss account**				**N10**	**Cr**
2020			**R**	2020			**R**
30/06	Telephone expenses	GJ	1 200	30/06	Fees	GJ	80 000
30/06	Salaries	GJ	6 000				
30/06	Profit for the year		72 800				
			80 000				80 000

A business makes a profit when the income the business has earned is more than the expenditure it has incurred in generating or producing the income. SA Attorneys has made a profit for the month because the income earned, R80 000, is more than the expenses incurred in generating the income (R1 200 + R6 000 = R7 200). The profit is R80 000 – R7 200 = R72 800.

STEPS

To calculate the profit or loss (P/L) for the month (the same as calculating the balance c/d):

Step 1: Add the debit side of the P/L account and write down the total in pencil ► R1 200 + R6 000 = R7 200

Step 2: Add the credit side of the P/L account and write down the total in pencil ► R80 000

Step 3: The total of the credit side of the P/L account is more than the total of the debit side. To equalise the two sides the debit side needs an amount of ► R72 800 (R80 000 – R7 200).
This is the balancing amount. It is a profit because the income is greater than the expenses.

Step 4: Total the account (Which column adds up to the greater total? The greater amount is ► R80 000 (credit side)). R80 000 is entered on both sides of the GL account and a single line is drawn above the amount and a double line below the amount.

Step 5: Resulting from the entry calculated in Step 3 this account is debited and the account to be credited is the capital account. Therefore, the reference on the debit side of the P/L account will be capital account (This reflects the profit made by the business for the year).

The profit or loss account is a final account in the general ledger and the statement of profit or loss and other comprehensive income is one of the financial statements an entity has to prepare. It uses the same information, but the one is an account while the other is a statement § See below (no debit side or credit side).

5.12 Preparation of financial statements

After the finalisation of the adjusted trial balance, the financial statements (Refer to Learning unit 1 for a detailed discussion of the financial statements) will be prepared. The financial statements are how a business communicates its financial results and financial position with the users of its financial statements. The financial statements consist of the following five components (shown for completeness sake):

1. **Statement of profit or loss and other comprehensive income (§)**:

   Calculates the net income or loss of a company by showing revenues – expenses. If revenues are greater than expenses, you have net income. If revenues are less than expenses, there will be a net loss.

2. **Statement of changes in equity (#)**:

   Calculates the closing balance in the retained earnings account using the net income or loss calculated on the statement of profit or loss. This statement takes the opening balance in retained earnings plus (+) net income (or minus (–) net loss) minus (–) dividends to arrive at the closing retained earnings balance. The closing retained earnings balance is reported on the statement of financial position. Included in the equity of a business includes a record of any funds that have been invested into the business/entity by the owners/stakeholders plus the accumulated profits or losses (referred to as retained earnings) of the business/entity.

3. **Statement of financial position (β)**:

   The statement of financial position reports on the assets, liabilities and equity of the business/entity. The assets and liabilities are divided into two categories being non-current and current. (This is a reflection of the accounting equation → Assets = Liabilities + Equity).

4. **Statement of cash flows:**

   The statement of cash flows reflects how cash moves in and out of the business. The statement begins with the closing cash balance as per the statement of financial position for the end of the previous year (i.e. opening balance for the current year) and ends with the cash balance as per the statement of financial position for the end of the current year. The cash flows are divided into three categories cash for operations, investing, and financing activities.

5. **Notes to the financial statements**:

   The notes to the financial statements provide additional information concerning the items reflected in the financial statements. The notes provide information about the basis of preparation of the financial statements and the accounting policies that were applied in the preparation. It is not possible to provide detailed information in the financial statements (Refer 1 to 3 above) so additional information is provided in the notes. The notes are referenced to the prepared financial statements.

NB	*The preparation of the statement of cash flows and the notes to the financial statements fall outside the scope of this module.*

The following table illustrates how the first three financial statements relate to each other:

		R
§Statement of profit or loss and other comprehensive income	Revenue/Income	250 000
	Expenses	(80 000)
	Profit for the year	170 000
	Taxation	(45 000)
	Profit after taxation	125 000
#Statement of changes in equity	Retained earnings at the beginning of the year (Accumulated profits at beginning of year)	100 000
	Retained earnings at the end of the year (Accumulated profits at end of year)	225 000
βStatement of financial position	Capital	150 000
	Drawings current period	(30 000)
		345 000
	Liabilities	
	Long-term loan	60 000
	Trust creditors (Accounts payable)	40 000
		445 000
	Assets	
	Property, plant and equipment	246 000
	Trust receivables (Accounts receivable)	85 000
	Trust bank account	40 000
	Business bank account	74 000
		445 000

The statement of profit or loss and other comprehensive income will now be prepared using the information included in the profit or loss account. The aim of the statement of profit or loss and other comprehensive income is to reflect the financial performance (profit/loss) for a financial period.

Notes

The statement of profit or loss and other comprehensive income is as follows:

SA ATTORNEYS

§ STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 30 JUNE 2020

Notes	**R**
Services rendered	250 000
Distribution, administrative and other expenses	(80 000)
Profit for the month	170 000
Taxation	(45 000)
Profit after taxation	125 000
Other comprehensive income for the year*	–
Total comprehensive income for the year	125 000

* Other comprehensive income for the year falls outside the scope of the FAC1503 syllabus.

The last transfer is the entry for the profit for the period that must be credited to the capital account (profit or loss account is debited) because SA Attorneys owes the profit to the owner (attorney). The profit for the month is the owner's reward for the capital he has invested and the entrepreneurial spirit he has shown. It therefore increases the equity.

Dr **Capital** **B10** **Cr**

2020			**R**	2020		**R**
30/06	Drawings		30 000	30/06	Opening balance	250 000
	Closing balance	c/d	345 000	30/06	Profit for the period	125 000
			375 000			375 000

Notes

In order to complete the set of financial statements the statement of changes in equity and statement of financial position will also be compiled.

The statement of changes in equity is as follows:

SA ATTORNEYS

#STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 30 JUNE 2020

	Capital R	Retained earnings R	Drawings R	Total capital R
Balance at beginning of year	150 000	100 000	–	250 000
Profit for the period	–	125 000	–	125 000
Drawings for the period	–	–	(30 000)	(30 000)
	150 000	225 000	(30 000)	345 000

The statement of financial position is as follows:

SA ATTORNEYS

β STATEMENT OF FINANCIAL POSITION AS AT 30 JUNE 2020

	Notes	R
ASSETS		
Non-current assets		246 000
Computer equipment		246 000
Current assets		199 000
Accounts receivable		85 000
Cash and cash equivalents (40 000 + 74 000)		114 000
Total assets		445 000
EQUITY AND LIABILITIES		
Equity		345 000
Capital		345 000
Total liabilities		100 000
Non-current liabilities		60 000
Long-term loan: Africa Bank		60 000
Current liabilities		40 000
Accounts payable		40 000
Total equity and liabilities		445 000

5.13 Self-assessment exercises

Question	Answer
Explain the reasons for using a ledger.	
List the various ledgers.	
What is a trial balance?	
How is the financial result calculated in financial accounting terms?	
Which financial report reflects the financial result?	
Which financial report reflects the financial position?	
Give as many examples of income as you can.	

Give as many examples of expenditure as you can.	
Does a loss increase or decrease the equity of the owner?	
The financial position of T Pay, an attorney, at 30 May 2019 is as follows: A = E + L 50 000 = 30 000 + 20 000 For the year ended 30 May 2020 he had the following income and expenditure: **R** Fees earned 180 000 Salaries 100 000 Administrative expenses 20 000 Insurance expenses 10 000 Calculate the profit for the year ended 30 May 2020.	
The financial position of T Pay, an attorney, at 30 May 2019 is as follows: A = E + L 50 000 = 30 000 + 20 000 Income and expenditure for the year ended 30 May 2020: **R** Fees earned 180 000 Salaries 100 000 Administrative expenses 20 000 Insurance expenses 10 000 Calculate T Pay’s equity as at 30 May 2020.	

5.14 Self-evaluation of processes

The following processes are important for a thorough understanding of this learning unit. Evaluate for yourself whether you are able to implement the following processes:

	YES	NO
1. Understand the procedure of posting to the trust and business ledgers		
2. Do the recording of a transaction from books of prime entry to the ledger accounts.		
3. Prepare listings of trust creditors, clients and business creditors.		
4. Balance a ledger account.		
5. Prepare a trial balance		

If your answer to any of the above questions is “NO” it is necessary to return to the learning unit and work through the learning unit again to ensure that you can apply the required process.

FINANCIAL ACCOUNTING PRINCIPLES FOR LAW PRACTITIONERS

LEARNING UNIT

6 TRANSFERS OF TRUST MONEY

Contents

Learning outcomes

After studying this learning unit, you should be able to:

- explain the function of the transfer journal
- know and comply with the transfer rules and requirements in terms of the Legal Practice Act, 28 of 2014 and the Rules for the Attorneys' Profession
- define the objectives of transfer procedures
- follow the transfer procedures
- calculate the amounts that must be transferred from the trust creditors' ledger to the client ledger for each client, and
- calculate the total amount that must be transferred from the trust bank account to the business bank account.

Key concepts

- Transfer journal
- Transfer rules
- Transfer procedures
- Amount to be transferred
- Payments from business bank account on behalf of trust creditor
- Funds earmarked
- Trust creditor

Acronyms

B	Balance sheet account (Statement of financial position)
BCRJ	Business cash receipts journal
BCPJ	Business cash payments journal
CL	Clients' ledger
FJ	Fees journal
GJ	General journal
LPA	Legal Practice Act, 28 of 2014
N	Nominal account (Statement of profit and loss)
TB	Trial balance
TJ	Transfer journal
TCL	Trust creditors' ledger
TCRJ	Trust cash receipts journal
TCPJ	Trust cash payments journal

6.1 Introduction

A legal practice differs from other businesses in that the legal practitioner receives money from clients, which must be kept in trust. Section 86(2) of the LPA requires that a separate bank account is opened for trust monies. Trust money may never be deposited into the business bank account except for the payment of fees levied by the practitioner for services rendered and the refund of expenses paid on behalf of the client out of the business bank account. The legal practitioner can only levy fees once his obligation to the client is met in full. Interim fees may therefore not be transferred from the trust bank account to the business bank account. For ensuring that the legal fees will be paid, the attorney and his client can, however, enter into an agreement that interim fees be deposited into the trust account to be transferred to the business account as soon as the fees are levied. Please note that a pro-forma invoice issued by an attorney is to give a client an estimate of the fees that will be rendered. Once his obligation to the client is met in full, a proper invoice will be issued.

Two separate sets of accounting records are kept, one for the business and one for trust money. The two sets are not linked and therefore the transfer procedures discussed under 6.2 below should be followed.

In terms of the Rules for the Attorneys' Profession with regard to the transfer of trust funds from the trust bank account to the business bank account, a legal practice shall ensure that the **debit** balance on its trust bank account shall at any date be equal to or exceed the total **credit** balances of the trust creditors in its accounting records.

Law practices mostly require that clients deposit money into the trust bank account in advance before any services are rendered or payments are made to third parties e.g. transfer duties, rates and taxes, deposits payable by property buyers, etc. In simple terms, this means that a transfer to the business bank account can only be done if there are sufficient funds in the trust bank account to the credit of the client.

The amount of the transfer must thus not create a debit balance in the trust creditor account. The trust bank account is debited when the funds are received from the client and the trust creditor account of the client is credited. When the funds are transferred to the business bank account, the trust creditor account of the client is debited (via the trust transfer journal) and the trust bank account is credited via the trust cash payments journal.

6.2 The transfer procedure

The transfer procedure is as follows:

- As soon as the attorney levies his fees or pay third parties on behalf of a client through his business bank account, the trust creditors' account and the clients' account of the client are cleared or are set off against each other.

- By comparing the balance on a clients' account with the balance on his or her corresponding trust creditors' account, one can determine whether there are any funds available in the trust bank account to transfer to the business bank account.
- If there are trust funds available, an entry is made in the transfer journal. The trust creditor account is debited and the client account is credited. (The calculation of the amount to be transferred is discussed in 6.4 below.)
- An electronic fund transfer (EFT) is made in respect of the amount to be transferred. A business receipt is issued and the money is transferred from the trust bank account to the business bank account.
- If the client account still reflects a debit balance after the transfer and the attorney's responsibilities towards the client have been fulfilled, the client should settle his account as a business client.
- If a credit balance on the trust creditor account exists after the transfer and the attorney's responsibilities towards the client have been fulfilled, a refund of funds is made to the trust creditor.
- When an irregular trust debit balance is corrected, the opposite procedure is followed. The effect of this is that an amount is transferred from the business bank account to the trust bank account. In this case, a reverse transfer entry is recorded in the transfer journal, cashbooks and various ledgers.

Transfer of funds from trust account to business account

Legal practitioners receive trust monies from clients and these funds must be kept in a trust as per Section 86(2) of the LPA. A separate bank account must be opened for the trust monies received.

The rules of the trust bank account

Trust Bank Account	➢ Funds may be transferred from the trust bank account to the business bank account if: – A client has instructed the attorney to transfer funds from the trust account to the business account for fees that are due. Fees are only due and payable to the attorney when the attorney has rendered a service to the client. – The attorney has paid expenses on behalf of the client from the business account and the client owes the attorney for the payment. – The client has instructed the attorney to make a payment to a third party. – A payment is due to the instructing attorney in respect of correspondent transactions. ➢ Surplus clients' trust funds may be transferred from the trust bank account to a separate trust savings account or other interest-bearing account. (i.e., an investment in terms of section 86(4) of the LPA made under the written instruction of the client.)

Trust Bank Account	➢ The amount drawn from the trust bank account may not exceed the amount kept in trust on behalf of the client. ➢ The trust bank account should always reflect a debit balance (i.e., the trust bank balance may never be a credit balance since an irregularity may occur).

Who are the trust creditors?

Trust creditors	➢ Trust creditors are the clients of the attorney practice. A trust creditors' account is opened for each client, as we owe the funds of the client when they become due therefore, they are known as trust creditors. ➢ The total of the trust creditors' account must be equal to or greater than the total credits balance of the trust creditors.

What is the journal entry when a customer transfers funds into a trust bank account?

Date	Details	Dr R	Cr R
	Trust bank account (Funds received from client)	XXX	
	Trust creditors' account		XXX

What is the journal entry when we transfer funds to the business bank account?

Date	Details	Dr R	Cr R
	Business bank account	XXX	
	Trust bank account		XXX

Notes

6.3 Transfer requirements

To comply with the Rules mentioned above, the following requirements should be met before the transfer is made:

	Clients' business account (a)		**Clients trust creditors' account (b)**
Requirement 1	The client should owe an amount to the practice on the clients' business account. (Dr balance on the clients' business account).	= Transfer from (b) to (a)	Funds should be available on the clients trust creditors' account in order to do the transfer. (Cr balance on the clients trust creditors account).
Requirement 2	Amount owing on his/her clients business account	> Amount transferred to (a) is limited to the amount available on (b).	Amount available on his/her clients trust creditors account
Requirement 3	Amount owing on his/her clients business account	< Amount transferred from (b) is limited to the amount owing on (a).	Amount available on his/her clients trust creditors account
Requirement 4	Although a client may have a debit balance on the client account and a credit balance on the trust creditors' account	→	There is no transfer if the funds available as a credit on (b) have been earmarked for another purpose.*

* i.e. a guarantee could have been issued against the credit balance available or the funds could have been earmarked for the purchase of a certain property.

By adhering to the Rules and requirements, it ensures that there is no deficit in the trust bank account, which prevents the obligations towards the remaining trust creditors from being met. The contrary is also true – that is, that there will be no surplus funds in the trust bank account that should have been transferred to the business bank account.

It is advisable to determine the overall trust position at least once a month (i.e. when the accounts are balanced at the end of the month) to ensure that no deficit exists. All trust cash available (i.e. the trust bank account balance and any trust investments) must be compared with the total trust liability (total of the trust creditors' balances). If the trust funds exceed the trust liabilities, a trust excess exists and is referred to as a trust surplus. The opposite indicates a trust deficit, which may **never** occur.

6.4 Calculation of the amount to be transferred from the trust bank account to the business bank account

Information for calculating the transfer of funds:

Client accounts	Opening balance R	Fees levied per FJ R	Disburse-ments obo^ clients per BCPJ R	Deposited amounts per TCRJ R	Earmarked funds R
S Africa	20 000 (Fees levied)	–	–		
A South	4 500 (Disbursement)	–	–		
C Cape	–	16 000	–		
D West	–	13 500	3 000		
Trust creditor accounts					
S Africa	–			20 000	
A South	–			2 000	
C Cape	15 000			5 000	15 000*
D West	10 000			10 000	

* Funds earmarked for payment of transfer fees (Re matter: purchase of property)
^ On behalf of.

Notes

The following table can be used to calculate the amount to be transferred:

Step		S Africa	A South	C Cape	D West	Total transfer
1	Does the client account have an opening balance	Yes	Yes	No	No	
	Opening balance	20 000	4 500	–	–	
2	Does the client owe an amount **(a)**	Yes	Yes	Yes	No	
	Amount owed	20 000	4 500	16 000	16 500	
	Fees levied	20 000	–	16 000	13 500	
	Disbursements on behalf of client	–	4 500	–	3 000	
3	Are there funds available in **(b)**	Yes	Yes	Yes	Yes	
	Amounts deposited	20 000	2 000	20 000	20 000	
4	Does the amount owing by the client **(a)** equal the amount available in **(b)**	Yes	No	No	No	
	Transfer to **(a)** is equal to amount available on **(b)**. Transfer is equal to ►	20 000	–	–	–	20 000
5	Does the amount owing by the client **(a)** exceed the amount available in **(b)**	–	Yes	No	No	
	Transfer is limited to amount available on **(b)**. Transfer is equal to ►	–	2 000	–	–	2 000
6	Are there funds in the trust account that are earmarked for specific purpose	No	No	Yes	No	
	Transfer is equal to ►	–	–	5 000	–	5 000
	Funds available to transfer			20 000		
	Less: Earmarked funds*			(15 000)		
7	Does the amount available **(b)** exceed the amount owed by the client **(a)**?	–	–	–	Yes	
	Transfer is limited to amount owing on **(a)**. Transfer is equal to ►	–	–	–	16 500	16 500
		20 000	2 000	5 000	16 500	43 500

(a) = clients' business account. A client only owes amount for fees if the fee note has been issued (i.e. services have been rendered to the client).

(b) = clients trust creditors' account

Notes

QUICK NOTE	
	1. *The trust banking account may only be used for money held by the law practitioner's practice on behalf of a client.* 2. *The client should give consent for their funds to be transferred from their trust creditor's account to their business account. The trust funds may not be transferred if they are earmarked for a specific purpose.* 3. *The Rules (Rule 54.14.14.2) make provision for withdrawals (transfers) to be made from the law practitioner's trust banking account to the law practitioner's business account, <u>only if</u> the transfers are made in respect of money due to the practice.* 4. *Transfers are not allowed in respect of disbursements (e.g., counsel's fees) or fees of the firm unless:* – *the disbursements were incurred, and the client has been charged; or* – *there is a contractual obligation on the part of the practice to pay the disbursement; or* – *fees and disbursements have been debited to the client's accounts in the accounting records.* 5. *The Rules (Rule 54.11) state that money, other than trust money, in the trust banking account shall be transferred to the business banking account without undue delay.*

6.5 Learning activities and feedback

EXAMPLE 6.1

The following information for the month ended 30 April 2020 relates to SA Attorneys:

TRIAL BALANCE OF SA ATTORNEYS ON 31 MARCH 2020

		Folio	**Debit R**	**Credit R**
Business bank		B1	9 150	
Trust bank		B2	9 450	
Trust creditors control:	Assets	B3		9 450*
G Langa – R5 700				
F Cape – R3 750 9 450				
Clients control:		B4	6 345	
H Mpuma – R1 770 (for fees)				
G Langa – R2 550 (for fees) 6 345				
F Cape – R2 025 (for fees)				
Capital		B8		129 360#
Equipment		B5	82 500	
Law library	Assets	B6	27 000	
Stationery on hand		B7	4 365	
			138 810	138 810

Capital (the capital account shows the net worth of a business at a specific point in time)
* Liabilities (amounts owed by the legal practice)

Additional information

1. The following totals appeared in the **subsidiary journals** of SA Attorneys on 30 April 2020:

Trust cash receipts journal	**R**	**Trust cash payments journal**	**R**
Trust creditors	18 315	Trust creditors	7 305
J East	15 000	G Langa	5 805
G Langa	3 315	F Cape	1 500
Bank	18 315	Bank	7 305
		Fees journal	
Business cash payments journal		Clients' control	4 390
Sundries	8 475	G Langa	1 890
Bank	8 475	F Cape	2 500
		Fees	4 390

NB: The information from four different journals has been provided above.

2. The following entry was made in the general journal of SA Attorneys on 30 April 2020:

General journal

GJ

	Dr R	**Cr R**
H Mpuma (client)	225	
Interest received		225
Interest levied on account in arrears		

REQUIRED:

PART A

Open the following ledger T-accounts in the general ledger of SA Attorneys as at 30 April 2020 and post the subsidiary journals in additional information 1 and 2 above, to these ledger accounts.

(i) Business bank
(ii) Trust bank
(iii) Trust creditors' control
(iv) Clients' control
(v) Fees

NB: All accounts must be properly balanced on 30 April 2020 up until the month end transfer of trust funds (Rule 54.11.1).
Commence the general ledger accounts with the opening balances as given in the trial balance above.

PART B

1. Calculate, for each trust creditor, the amount that should be transferred from the trust account to the business account on 30 April 2020, after all the information given in the question has been taken into account. The calculation can be done in tabular format as laid out in 6.4.
2. Prepare the relevant books of first entry recording the transfer of trust funds
   - Transfer journal
   - Trust cash payments journal
   - Business cash receipts journal
3. Prepare the relevant general ledger accounts recording the transfer of trust funds
   - Business bank account
   - Trust bank account
   - Clients' control account
   - Trust creditors' control account
4. Prepare the clients' ledger and the trust creditors' ledger recording the transfer of trust funds.

Please note: Show all calculations.

EXPLANATION 6.1

STEPS	
	Step 1 – As per the question, the trial balance is presented for the month ended 31 March 2020. ∴ The trial balance contains the opening balances for the month ending 30 April 2020 (i.e. 1 April 2020). *Step 2 – Open the following ledger T-accounts, Trust bank, Business bank, Clients' control, Trust creditors' control and Fees.* *Step 3 – Insert the opening balances for the ledger accounts. The b/d as a folio reference signifies that the amount has been brought down (b/d) from the month before.* *Step 4 – Insert the information from point 1 of Additional information.* *Step 5 – Insert the information from point 2 of Additional information.*

Amount per TB in bank at beginning of April.
An asset with a favourable balance ∴ a Debit

PART A
(i)

Dr **Business bank** **B1** **Cr**

2020			R	2020			R
01/04	Balance	b/d	9 150	30/04	Payments	BCPJ	8 475
				30/04	Balance	c/d	675
			9 150				9 150
30/04	Balance	b/d	675				

EXPLANATION 6.1 (continued)

Amount per TB in bank at beginning of April. An asset with a favourable balance ∴ a Debit

(ii)

Dr **Trust bank** **B2** **Cr**

2020			R	2020			R
01/04	Balance	b/d	9 450	30/04	Trust payments	TCPJ	7 305
30/04	Trust receipts	TCRJ	18 315	30/04	Balance	c/d	20 460
			27 765				27 765
30/04	Balance	b/d	20 460				

(iii)

Dr **Clients' control** **B3** **Cr**

2020			R	2020			R
01/04	Balance	b/d	6 345	30/04	Balance	c/d	10 960
30/04	Fees	FJ	4 390				
30/04	Sundry journal	GJ	225				
			10 960				10 960
30/04	Balance	b/d	10 960				

The trust creditors' control amount per the TB at the beginning of April is a liability (an amount owing) ∴ a Credit

(iv)

Dr **Trust creditors' control** **B4** **Cr**

2020			R	2020			R
30/04	Trust bank	TCPJ	7 305	01/04	Balance	b/d	9 450
30/04	Balance	c/d	20 460	30/04	Trust bank	TCRJ	18 315
			27 765				27 765
				30/04	Balance	b/d	20 460

(v)

Dr **Fees** **N1** **Cr**

2020			R	2020			R
30/04	Balance	c/d	4 390	30/04	Fees journal		4 390
			4 390				4 390
				30/04	Balance	b/d	4 390

EXPLANATION 6.1 (continued)

PART B

1. Calculation of the amount to be transferred from the trust bank account to the business bank account:

Step		G Langa	F Cape	H Mpuma	Total transfer
1	Does the client owe an amount **(a)**	Yes	Yes	Yes	
	Total amount owed **(a)**	4 440	4 525	1 995	
	Opening balance	2 550	2 025	1 770	
	Fees earned (FJ)	1 890	2 500	–	
	Interest charged (GJ)	–	–	225	
2	Are there trust funds available in trust account **(b)**	Yes	Yes	No	
	Total trust funds available **(b)**	3 210	2 250	–	
	Opening balance	5 700	3 750	–	
	Deposits per TCRJ	3 315	–	–	
	Payments per TCPJ	(5 805)	(1 500)		
3	Are there trust funds				
3	Does the amount owing by the client **(a)** equal the amount available in **(b)**	No	No	No	
4	Does the amount owing by the client **(a)** exceed the amount available in **(b)**	Yes	Yes	Yes	
	Transfer is limited to amount available on **(b)**. Transfer is equal to ►	3 210	2 250	–	5 460
5	Does the amount available **(b)** exceed the amount owed by the client **(a)**?	Yes	Yes	No	
	Transfer is limited to amount owing on **(a)**. Transfer is equal to ►	–	–	–	–
		3 210	2 250	–	5 460

(a) = clients' business account

(b) = clients trust creditors' account

Reconciliations

Trust bank account [20 460 – 5 460 (transfer to business bank account)]	= R15 000
Trust creditors [J East]	= R15 000
Clients' control account [10 960 – 5 460 (transfer from trust creditors' control)]	= R5 500
Clients' accounts	= R5 500
[G Langa 1 230 (4 440 – 3 210) + F Cape 2 275 (4 525 – 2 250) + H Mpuma 1 995]	

Notes

EXPLANATION 6.1 (continued)

2. Books of first entry

Transfer journal

TJ

	Dr R	Cr R
G Langa (Trust creditors' control) F Cape (Clients' control) G Langa (Trust creditors' control) F Cape (Clients' control) *Transfer of trust funds to clients' business account*	3 210 2 250	 3 210 2 250

Trust cash payments journal of SA Attorneys for April 2020 — TCPJ

Date	Payments	Fol.	Sundries R	Trust creditors' control R	Trust bank R
30	Business bank	B1	5 460		5 460
			5 460		5 460
					B2

Business cash receipts journal of SA Attorneys for April 2020 — BCPJ

Date	Receipts	Fol.	Sundries R	Clients' control R	Business bank R
30	Trust bank	B2	5 460		5 460
			5 460		5 460
					B1

3. General ledger

Dr — Trust bank — B2 — Cr

2020			R	2020			R
30/04	Balance	b/d	20 460	30/04	Trust transfer	TCPJ	5 460
				30/04	Balance	c/d	15 000
			20 460				20 460
01/05	Balance	b/d	15 000				

Dr — Business bank — B1 — Cr

2020			R	2020			R
01/04	Balance	b/d	675	30/04	Balance	c/d	6 135
30/04	Trust transfer	TCRJ	5 460				
			6 135				6 135
01/05	Balance	b/d	6 135				

EXPLANATION 6.1 (continued)

Dr — Clients' control — B7 — Cr

2020			R	2020			R
30/04	Balance	b/d	10 960	30/04	Trust transfer	TJ	5 460
				30/04	Balance	c/d	5 500
			10 960				10 960
01/05	Balance	b/d	5 500				

The trust creditors' control amount per the TB at the beginning of April is a liability (an amount owing) ∴ a

Dr — Trust creditors' control — B6 — Cr

2020			R	2020			R
30/04	Trust transfer	TJ	5 460	30/04	Balance	b/d	20 460
30/04	Balance	c/d	15 000				
			20 460				20 460
				01/05	Balance	b/d	15 000

Clients' ledger

Dr — G Langa — Cr

2020			R	2020			R
01/04	Balance	b/d	2 550	30/04	Trust transfer	TJ	3 210
30/04	Fees	FJ	1 890	30/04	Balance	b/d	1 230
			4 440				4 440
01/05	Balance	b/d	1 230				

Dr — F Cape — Cr

2020			R	2020			R
01/04	Balance	b/d	2 025	30/04	Trust transfer	TJ	2 250
30/04	Fees	FJ	2 500	30/04	Balance	c/d	2 275
			4 525				4 525
01/05	Balance	b/d	2 275				

Dr — H Mpuma — Cr

2020			R	2020			R
30/04	Balance	b/d	1 995	30/04	Balance	c/d	1 995
			1 995				1 995
01/05	Balance	b/d	1 995				

EXPLANATION 6.1 (continued)

Trust creditors' ledger

Dr **G Langa** **Cr**

2020			**R**	2020			**R**
30/04	Trust bank	TCPJ	5 805	01/04	Balance	b/d	5 700
30/04	Trust transfer	TJ	3 210	30/04	Trust bank	TCRJ	3 315
			9 015				9 015

Dr **F Cape** **Cr**

2020			**R**	2020			**R**
30/04	Trust bank	TCPJ	1 500	01/04	Balance	b/d	3 750
30/04	Trust transfer	TJ	2 250		`		
			3 750				3 750

Dr **J East** **Cr**

2020			**R**	2020			**R**
30/04	Balance	c/d	15 000	30/04	Trust bank	TCRJ	15 000
			15 000				15 000
				01/05	Balance	b/d	15 000

Notes

EXAMPLE 6.2

Use the same information as in example 6.1 but add the following:

1. Assume that the information in example 6.1 was before the bank reconciliation of the trust bank account was done. The only differences between the trust bank statement and the trust bank account in the accounting records of SA Attorneys were the following:
   - An electronic funds transfer on 29 April 2020 of R2 000 on behalf of J East to the City Council for rates and taxes; and
   - The reversal by the bank of the R15 000 paid into the trust bank account by J East due to insufficient funds in the private bank account of J East.

   These two transactions must still be accounted for in the trust bank account of SA Attorneys.

2. R1 600 of the R3 750 opening balance on the account of F Cape in the trust creditor's ledger is specifically for transfer duties payable once the property is transferred to F Cape. Mr Naidoo expects that the property will be transferred during the second week of May 2020.

REQUIRED:

PART A
Open the following ledger accounts in the general ledger of SA Attorneys as at 30 April 2020 and post the subsidiary journals in additional information 1 and 2 above, to these ledger accounts.

(i) Business bank
(ii) Trust bank
(iii) Clients' control
(iv) Trust creditors' control
(v) Fees

NB: Properly balance all accounts as at 30 April 2020. Commence the general ledger accounts with the opening balances as given in the trial balance above and close off before the transfer entries.

PART B
Calculate, for each trust creditor, the amount that should be transferred from the trust bank account to the business bank account on 30 April 2020, after all the information given in the question have been taken into account.

NB: Show all calculations.

EXPLANATION 6.2

PART A

(i)

Dr				Business bank		B1	Cr
2020			R	2020			R
01/04	Balance	b/d	9 150	30/04	Payments	BCPJ	8 475
				30/04	Balance	c/d	675
			9 150				9 150
01/05	Balance	b/d	675				

(ii)

Dr				Trust bank		B2	Cr
2020			R	2020			R
01/04	Balance	b/d	9 450	30/04	Trust payments	TCPJ	*24 305
30/04	Trust receipts	TCRJ	18 315	30/04	Balance	c/d	3 460
			27 765				27 765
01/05	Balance	b/d	3 460				

* 7 305 + 2 000 + 15 000 = 24 305

(iii)

Dr				Clients' control		B3	Cr
2020			R	2020			R
01/04	Balance	b/d	6 345	30/04	Balance	c/d	10 960
30/04	Fees	FJ	4 390				
30/04	Sundry journal	GJ	225				
			10 960				10 960
01/05	Balance	b/d	10 960				

(iv)

Dr				Trust creditors' control		B4	Cr
2020			R	2020			R
30/04	Trust bank	TCPJ	24 305	01/04	Balance	b/d	9 450
30/04	Balance	c/d	3 460	30/04	Trust bank	TCRJ	18 315
			27 765				27 765
				01/05	Balance	b/d	3 460

(v)

Dr				Fees		N1	Cr
2020			R	2020			R
30/04	Balance	c/d	4 390	30/04	Fees journal		4 390
			4 390				4 390
				30/04	Balance	b/d	4 390

EXPLANATION 6.2 (continued)

PART B

The following table can be used to calculate the amount that must be transferred from the trust bank account to the business bank account:

	G Langa	F Cape	H Mpuma	J East	Total transfer
1 Does the client owe an amount **(a)**	Yes	Yes	Yes	No	
Total amount owed (a)	4 440	4 525	1 995	–	
Opening balance *	2 550	2 025	1 770		
Interest levied on account in arrears (GJ)	–	–	225	–	
Fees earned (FJ)	1 890	2 500	–	–	
2 Are there funds available in trust account	Yes	Yes	No	No	
Trust funds available	3 210	2 250	–	(2 000)	
Opening balance **#**	5 700	3 750	–	–	
Receipts for month (TCRJ)	3 315	–	–	15 000	
Disbursements (TCPJ)	(5 805)	(1 500)	–	2 000	
Reversal of funds received	–	–	–	(15 000)	
3 Are the trust funds earmarked for a specific purpose?	No	Yes	No	No	
Trust funds earmarked	–	1 600	–	–	
Total trust funds available (b) (2 plus 3)	3 210	650	–		
4 Does the amount owing by the client **(a)** equal the amount available on **(b)**	No	No	No	No	
Transfer is equal to amount available on **(b)**. Transfer is equal to ▶	–	–	–	–	–
5 Does the amount owing by the client **(a)** exceed the amount available on **(b)**	Yes	Yes	Yes	Yes	
Transfer is limited to amount available on **(b)**. Transfer is equal to ▶	3 210	650	–	(2 000)	1 860
6 Does the amount available **(b)** exceed the amount owed by the client **(a)**?	No	No	No	No	
Transfer is limited to amount owing on **(a)**. Transfer is equal to ▶	–	–	–	–	–
	3 210	650	–	(2 000)	1 860

(a) = clients' business account
(b) = clients trust creditors' account
* 2 550 + 2 025 + 1 770 = 6 345 (amount per opening TB)
\# 5 700 + 3 750 = 9 450 (amount per opening TB)

EXPLANATION 6.2 (continued)

The trust creditors' ledger and clients' ledger are shown below for completeness only and need not be included in your answer.

Trust creditors' ledger

Dr — J East — Cr

2020			R	2020			R
30/04	Trust bank	TCPJ	*17 000	30/04	Trust bank	TCRJ	15 000
				30/04	Balance before transfer	c/d	2 000
			17 000				17 000
30/04	Balance	b/d	2 000	30/04	J East (transfer)		2 000

* R2 000 + R15 000 = R17 000

Dr — G Langa — Cr

2020			R	2020			R
30/04	Trust bank	TCPJ	5 805	01/04	Balance	b/d	5 700
	Balance before transfer	c/d	3 210	30/04	Trust bank	TCRJ	3 315
			9 015				9 015
30/04	G Langa (transfer)		3 210	30/04	Balance	b/d	3 210

Dr — F Cape — Cr

2020			R	2020			R
30/04	Trust bank	TCPJ	1 500	30/04	Balance	b/d	3 750
30/04	Balance before transfer	c/d	2 250				
			3 750				3 750
30/04	F Cape (transfer)		650	30/04	Balance	b/d	2 250
30/04	Balance	c/d	1 600				
			2 250				2 250
				01/05	Balance	b/d	1 600

Clients' ledger

Dr — J East — Cr

2020		R	2020		R
30/04	J East (trust creditor)	2 000			

Dr — G Langa — Cr

2020			R	2020			R
01/04	Balance	b/d	2 550	30/04	G Langa (trust creditor)		3 210
30/04	Fees	FJ	1 890	30/04	Balance	c/d	1 230
			4 440				4 440
01/05	Balance	b/d	1 230				

EXPLANATION 6.2 (continued)

Dr			F Cape				Cr
2020			R	2020			R
01/04	Balance	b/d	2 025	30/04	F Cape (trust creditor)		650
30/04	Fees	FJ	2 500		Balance	c/d	3 875
	Balance before transfer	c/d	4 525				4 525
01/05	Balance		3 875				

Dr			H Mpuma				Cr
2020			R	2020			R
01/04	Balance	b/d	1 770	30/04	Balance	c/d	1 995
30/04	Interest received		225				
			1 995				1 995
01/05	Balance		1 995				

Reconciliations

Trust bank account [R3 460 – R1 860 (transfer to business bank account)]	=	R1 600
Trust creditors [F Cape]	=	R1 600
Clients' control account [R10 960 – R1 860 (transfer from trust creditors' control)]	=	R9 100
Clients' accounts [J East R2 000 + G Langa R1 230 + F Cape R3 875 + H Mpuma R1 995]	=	R9 100

EXAMPLE 6.3

The bookkeeper of SA Attorneys presented the following list of balances as at 31 March 2021 to you. The balances already include all transactions, including fees raised.

Client/Trust creditor	Trust creditors' ledger	Clients' ledger
A Africa	R22 000 (credit)	Rnil
S South	R29 800 (credit)	R36 800 (debit)
N North	Rnil	R8 400 (debit)
W West	R3 200 (debit)	R10 000 (debit)

REQUIRED:

1. What will the maximum amount be that can be transferred from the trust bank account to the business bank account to ensure that no trust deficit (shortage) will arise? The balance of the trust bank account before the transfer is R48 600.

2. Calculate the balances of each account after the transfer journals are posted to the ledger accounts and the funds transferred from the trust bank account to the business bank account.
3. Reconcile the trust creditors' control account with the trust bank account.

EXPLANATION 6.3

1. The following table can be used to calculate the amount that must be transferred from the trust bank account to the business bank account:

		A Africa	S South	N North	W West	Total transfer
1	Does the client owe an amount **(a)**	No	Yes	Yes	Yes	
	Total amount owed (a)	–	36 800	8 400	10 000	
2	Are there funds available in trust account	Yes	Yes	No	No	
	Trust funds available	22 000	29 800	–	(3 200)	
3	Are the trust funds earmarked for a specific purpose?	No	No	No	No	
	Trust funds earmarked	–	–	–	–	
	Total trust funds available (b) (2 plus 3)	22 000	29 800	–	–	
4	Does the amount owing by the client **(a)** equal the amount available on **(b)**	No	No	No	No	
	Transfer is equal to amount available on **(b)**. Transfer is equal to ►	–	–	–	–	–
5	Does the amount owing by the client **(a)** exceed the amount available on **(b)**	No	Yes	Yes	Yes	
	Transfer is limited to amount available on **(b)**. Transfer is equal to ►	–	29 800	–	(3 200)	26 600
6	Does the amount available **(b)** exceed the amount owed by the client **(a)**?	No	No	No	No	
	Transfer is limited to amount owing on **(a)**. Transfer is equal to ►	–	–	–	–	–
		–	29 800	–	(3 200)	26 600

(a) = clients' business account
(b) = clients trust creditors' account

2. Trust creditors' ledger

Client	Balance before transfer R	Transfer R	Balance after transfer R
A Africa	22 000	–	22 000
S South	29 800	(29 800)	–
N North	–	–	–
W West	(3 200)	3 200	–
	48 600	26 600	22 000

EXPLANATION 6.3 (continued)

Clients' ledger

Client	Balance before transfer R	Transfer R	Balance after transfer R
A Africa	–	–	–
S South	36 800	(29 800)	7 000
N North	8 400	–	8 400
W West	10 000	3 200	13 200
	55 200	(26 600)	28 600

3. Trust bank account

Client	Balance before transfer R	Transfer R	Balance after transfer R
Trust bank account	48 600	(26 600)	22 000

	R
Balance per trust creditors' control (above)	22 000

6.6 The recording process in the transfer journal

A transfer of funds must be made from the trust bank account to the business bank account. The following source documents are of relevance: EFT documentation, business receipts and clients' files.

The transfer of the trust funds to the business bank account can take place on the same day as the date on which the attorney levies the fees. It is recommended that the transfer is made as soon as possible, as the accumulation of the attorney's own money in the trust bank account may be seen as a failure to separate business and trust money properly and is a transgression of section 54.8 of Legal Practice Act 28 of 2014. The trust funds may not be used until the legal practice has earned them.

An attorney's trust account is essentially a business bank account, established by the attorneys' firm to hold client funds. Funds that are deposited into a trust account are neither the property of the individual attorney nor the property of the attorneys' firm.

Notes

6.7 Summary of trust fund management

The following comments are extremely important to take note of when an attorney is dealing with trust funds:

1. Keep trust funds separate from business funds. Rule 54.8 of the LPA rules states that trust transactions must be kept separate from business transactions.

2. Keep individual trust accounts so that the money of one client does not mix with the money of another client.

3. Trust funds may not be used until the attorneys' firm has earned it.

4. Funds received in advance from clients are deposited into the trust account. Fees can only be transferred from the trust account to the business account after the legal work has been done and the fees have been levied.

5. Trust money shall in no circumstances be deposited in or credited to the business banking account. Money other than trust money in the trust bank account at any time shall be transferred to the business bank account without undue delay.

6. The exact amount owing on the business account of the client should be transferred. The practice of transferring rounded amounts is not acceptable.

7. A law firm shall be deemed to have complied sufficiently with this rule if the law firm:

- makes transfers from its trust banking account to its business banking account at least once a month; and ensures that, when making a transfer from its trust banking account to its business banking account:
- the amount transferred is identifiable with, and does not exceed, the amount due to the firm;
- the trust creditor from whose account the transfer is made is identified; and
- the balance of any amount due to the firm remaining in its trust banking account is capable of identification with corresponding entries appearing in its trust ledger.

8. If the law firm utilises electronic banking (EFT's) in respect of payments from the trust account to the business account the law firm shall keep a proper audit trail, which shall include verification of the payee's banking account details. The law firm must ensure that adequate internal controls are implemented in order to ensure compliance with the rules as well as to ensure that trust funds are safeguarded.

9. When transfers are made for more than one client on a specific day, only one EFT, representing the total of individual transfers for the day, is recorded in the business cash receipts journal for the transfer to the business bank account.

10. All transfers to the clients' ledger and the trust creditors' ledger should be done via the transfer journal.

6.8 Self-assessment questions

After having worked through this learning unit, are you now able to do the following?

Questions	Answers
Define the objectives of trust accounts.	
Explain the function of the transfer journal.	
Describe the objectives of transfer procedures.	
Explain four requirements that must be complied with before money may be transferred from the trust creditors' account of a client to his or her account in the clients' ledger.	

Questions	Answers
Describe the transfer procedures.	

FINANCIAL ACCOUNTING PRINCIPLES FOR LAW PRACTITIONERS

LEARNING UNIT 7

TRUST INVESTMENTS

Contents

Learning outcomes

After studying this learning unit, you should be able to:

- demonstrate knowledge of the Legal Practice Act 28 of 2014 (LPA) and the Legal Practice Council (LPC) Rules for the Attorneys' Profession (and rulings where applicable)
- know the important subsections of section 86 of the LPA (subsections 86(2), 86(3), 86(4) and 86(5)(a))
- apply section 86 of the LPA to a given set of facts
- distinguish between a section 86(3) and 86(4) trust investment
- explain how the interest received is dealt with in each case
- identify the beneficiaries of investment interest
- record trust investment transactions in the accounting records

Key concepts

- Section 86(3) trust investment
- Section 86(4) trust investment
- Trust creditor
- Trust creditors ledger
- Trust creditors control account
- Trust investments
- Trust money
- Legal Practitioners Fidelity Fund (LPFF)

Acronyms

LPA	Legal Practice Act, 28 of 2014
LPFF	Legal Practitioners Fidelity Fund
LPC	Legal Practice Council

7.1 Introduction

In an attorneys practice, clients in most instances are required to deposit money into the trust bank account of the attorney for safekeeping, until the matter or court case has been concluded or has lapsed. Examples of these are:

- deposits in property transactions
- provisions for advocates' fees
- other expenses in court cases, and
- the provision for attorneys' fees especially where the amount of fees are material.

QUICK NOTE	
	• *Section 86(1) — Every legal practitioner referred to in section 84(1) must operate a trust account.* • *Section 86(2) — Every trust account practice must keep a trust account at a bank with which the Fund has made an arrangement as provided for in section 63(1)(g) and must deposit therein, as soon as possible after receipt thereof, money held by such practice on behalf of any person.*

Section 88(1) of the Legal Practice Act, 28 of 2014 states that trust money does not form part of the assets of the law practitioners practice. Thus, the creditors of the legal practice cannot claim against this money.

This means that if there are trust monies in the trust bank account which are not immediately needed for specific purposes and are not earning any interest may be invested. In terms of section 86 of the LPA, attorneys are authorised to invest the trust monies in trust investment accounts. The trust investments remain as part of the overall trust monies that must, together with the trust bank account, be equal to or more than the total of the trust creditors accounts.

Trust investments + Trust bank account ≥ Trust creditors control

The trust creditors ledger keep records of transactions with each individual trust creditor.

The "*trust creditors control account*" is one account in the general ledger which represents the total amount owed *to all* the *individual* trust creditors in the *trust creditors ledger*. The balance of the trust creditors control account must equal the total of the *trust creditors list*. The trust creditors list is a list of the individual trust creditors and the amount owed to them obtained from the individual balances in the trust creditors ledger (subsidiary ledger) accounts for each trust creditor.

Explanations of the terms discussed above:

In the trust creditors ledger (a subsidiary ledger) –

Dr				A South		TCL1	Cr
2020			R	2020			R
30/06	Trust bank	TCPJ6	XXX	01/06	Opening balance	b/d	XXX
30/06	Closing balance	c/d	AAA	30/06	Trust bank	TCRJ6	XXX
			XXX				XXX
				01/06	Opening balance	b/d	AAA

Dr				S Africa		TCL2	Cr
2020			R	2020			R
30/06	Trust bank	TCPJ6	XXX	30/06	Trust bank	TCRJ6	XXX
30/06	Closing balance	c/d	AAA				
			XXX				XXX
				01/06	Opening balance	b/d	AAA

From the cash payments journal – payments for month

From the cash receipts journal – receipts for the month

Opening balance which was the closing balance for the previous month/year

In the general ledger –

Dr				Trust creditors control		GL4	Cr
2020			R	2020			R
30/06	Trust bank account	TCPJ6	XXX	01/06	Opening balance	b/d	XXX
30/06	Closing balance	c/d	AAA	30/06	Trust bank account	TCRJ6	XXX
			XXX				XXX
				01/06	Opening balance	b/d	AAA

This control account represents the subsidiary ledger - Trust creditors ledger in the general ledger. The total of the trust creditors list must EQUAL the balance at the end of the month of the trust creditors control account

The trust creditors list –

Name of client	Account reference	R
Creditor 1	TCL1	XXX
Creditor 2	TCL2	XXX
Creditor 3	TCL3	XXX
Total		XXX

Law practices investing in terms of the LPC Rules should pay attention to the requirements of the LPC Rules as follows:

Rule 55.1 ➡ A firm shall for the purpose of this rule be deemed to be carrying on the business of an investment practice if it invests funds on behalf of a client or clients and it controls or manages such investments, whether directly or indirectly.

Rule 55.2 ➡ A client shall for the purpose of this investment practice rule include any person on whose behalf a firm invest funds or manages or controls investments, whether or not such person is otherwise a client of the firm concerned.

Rule 55.4 ➡ A legal practitioner carrying on an investment practice shall obtain an investment mandate from each client *before* or as soon as possible after investing funds on behalf of the client. The investment mandate must contain a statement that the client acknowledges that moneys so invested DO NOT enjoy the protection of the LPFF.

The trust banking of legal practitioners is regulated by Sections 84 and 86 of the Legal Practice Act 28 of 2014.

➡ **Section 84(1)** Every attorney or any advocate referred to in section 34(2)(b) of the LPA, who practises or is deemed to practise –

- ► for his or her own account either alone or in partnership; or
- ► as a director of a practice which is a juristic entity, must be in possession of a Legal Practitioners Fidelity Fund certificate.

➡ **Section 84(3)** The provisions of subsections (1) and (2) above *apply to a deposit taken on account of fees or disbursements in respect of legal services to be rendered*. (i.e. Trust money)

➡ **Section 84(2)** No legal practitioner referred to in subsection (1) or person employed or supervised by that legal practitioner may receive or hold funds or property belonging to any person unless the legal practitioner concerned is in possession of a Legal Practitioners Fidelity Fund (LPFF) certificate.

➡ **Section 86(1)** Every legal practitioner referred to in section 84(1) must operate a trust account. [A trust account is a separate bank account]

Section 86(2) Every trust account practice must keep a trust account at a bank with which the LPFF has made an arrangement as provided for in section 63(1)(g) and must deposit therein, as soon as possible after receipt thereof, money held by such practice on behalf of any person.

This is interest earned on the practice trust account

(a) Interest accrued must, in the case of money deposited in terms of this subsection, be paid over to the LPFF and vests in the LPFF,

NB!

(b) *100%* of trust interest earned, will be paid *monthly* to the LPFF as provided for by Rule 54.14.16.1 made under the authority of Section 95(1) of the Legal Practice Act 28 of 2014.

The legal practitioner can claim approved recoverable *bank charges* and *audit fees* on the **trust** accounts back from the LBF Fund, subject to certain formulas and requirements.

There are two types of trust investments, namely:

- Investments in terms of **section 86(3)** of the LPA; and
- Investments in terms of **section 86(4)** of the LPA.

QUICK NOTE	➢ *There is no limit to the number of trust investment accounts a law practice may open.* ➢ *The two trust investment accounts in terms of sections 86(3) and 86(4) of the LPA are trust creditors accounts and are not included in the general ledger but in the trust creditors ledger.* ➢ *The trust creditors control account forms part of the general ledger* ➢ *These two accounts are the only trust creditors accounts that may have debit balances.*

7.2 Section 86(3) of the Legal Practice Act 28 of 2014

It is this point that differentiates the type of investments

In terms of section 86(3) of the LPA, *a legal practitioner may transfer trust money* which is not immediately needed to a trust savings or other interest-bearing investment account at a South African banking institution. It may, however, not be invested on the security exchange or in unit trusts. This money is taken from the pool of funds and not from specific trust creditors. The decision to invest the surplus money is made by the legal practitioner and the following applies.

(a) The investments should be made with banks with which the LPFF has entered into an arrangement.

(b) These investments remain part of the entrusted monies and are recorded as such in the trust accounting records of the legal practice. These investments enjoy protection from the LPFF.

(c) The LPA requires that the bank statements be endorsed with a reference to section 86(3) of the LPA. The legislation also stipulates that the name of the trust investment account in the trust creditors ledger include a reference to the specific section of the legislation applicable, for example. S Africa sec 86(3) trust investment: ABC Bank.

(d) Interest accrued must, in the case of money deposited in terms of this subsection, be paid over to the LPFF and vests in the LPFF.

NB!

(e) *100%* of trust interest earned will be paid on an *annual basis to the LPFF* as provided for by Rule 54.14.16.3 made under the authority of Section 95(1) of the LPA.

(f) When the invested money is withdrawn from the trust investment account it is deposited back into the trust bank account. The trust creditors can then be paid from the trust bank account.

(g) Interest earned on *Section 86(3)* trust investments must be paid over to the LPFF and therefore is not the property of the legal practitioner nor the trust creditors.

LBL PAUSE	*Trust money may not be deposited directly into a trust investment account.* *All trust monies must flow through the trust bank account to the trust investment account.*	See Lessons Trust money

LBL PAUSE	*Interest earned on section 86(3) trust investments must be paid over to the Legal Practitioners Fidelity Fund (LPFF) or its nominee. It is therefore not the property of the legal practitioner nor the trust creditors.*	See Lessons Trust interest

Notes

EXAMPLE 7.1

SA Attorneys received R50 000 from a client, S Africa (client reference no TCL1) and R10 000 from client, A South (client reference no TCL2) for future services.

EXPLANATION 7.1

The trust cash receipts journal will be prepared as follows:

TCRJ6

Date	Details	Fol.	Trust creditors control R	Bank R
30/06	S Africa	TCL1	50 000	50 000
30/06	A South	TCL2	10 000	10 000
			60 000	60 000
30/06	Dr – Trust bank account			GL1
30/06	Cr – Trust creditors control		GL2	

The trust cash receipts journal will be posted to the general ledger and trust creditors ledger as follows:

General ledger

Dr **Trust creditors control** **GL2** **Cr**

2020			**R**	2020			**R**
				01/06	Trust cash receipts	TCRJ	60 000

Dr **Trust bank** **GL1** **Cr**

2020			**R**	2020			**R**
01/06	Trust cash receipts	TCRJ	60 000				

Trust creditors ledger

Dr **A South** **TCL1** **Cr**

2020			**R**	2020			**R**
				01/06		TCRJ	50 000

Dr **S Africa** **TCL2** **Cr**

2020			**R**	2020			**R**
				01/06		TCRJ	10 000

EXAMPLE 7.2

The accounting treatment of section 86(2) and section 86(3) trust investments

The following information was obtained from the accounting records of SA Attorneys for June 2020:

2020 June	
1	The balance of the trust bank account of SA Attorneys with South Bank amounted to R250 000. E North decided to invest funds of R80 000, which were not immediately required, in a special interest-bearing savings account with Africa Bank.
30	SA Attorneys withdrew R80 800 from the savings account with Africa Bank and deposited it in the trust bank account.
30	Interest of R700 was earned during the month on the trust bank account held in South Bank.

REQUIRED:

Prepare the following in the accounting records of SA Attorneys for June 2020:

1. Subsidiary journals, properly totalled:
   1.1. Trust cash receipts journal
   1.2. Trust cash payments journal
   1.3. Trust journal
2. Ledgers, properly balanced:
   2.1. General ledger
   2.2. Trust creditors ledger
   2.3. Trust creditors list

Notes

EXPLANATION 7.2

SA ATTORNEYS

1. Subsidiary journals

1.1 Trust cash receipts journal for June 2020

TCRJ6

Date	Details	Fol.	Trust creditors control R	Trust bank R
30/06	Sec 86(3) trust investment – Africa Bank [trust creditor]	TCL1	80 800	80 800
30/06	Interest received on trust bank account	TCL2	700	700
			81 500	81 500
30/06	Dr – Trust bank account			B1
30/06	Cr – Trust creditors control account		B2	

1.2 Trust cash payments journal for June 2020

TCPJ6

Date	Details	Fol.	Trust creditors control R	Trust bank R
30/06	Sec 86(3) trust investment – Africa Bank (trust creditor)	TCL1	80 000	80 000
30/06	Dr – Trust creditors control account		B2	
30/06	Cr – Trust bank account			B1

1.3 General journal for June 2020

GJ6

Date	Details	Fol.	Debit R	Credit R
30/06	Sec 86(3) trust investment – Africa Bank (trust creditor)	TCL1	800	
	Legal Practitioners Fidelity Fund (LPFF) (trust creditor)	TCL2		800
	Transfer of interest to the LPFF			
			800	800
30/06	Dr – Trust creditors control account		B2	
30/06	Cr – Trust creditors control account			B2

Journal narration

NB	*The LPFF is a trust creditor of the attorney's practice because the interest earned does not belong to the attorney's practice. The interest accrues to the LPFF and is held in trust by the practice until it is paid over to the LPFF.*

2. Ledgers

2.1 General ledger

Dr — Trust bank — B1 — Cr

2020			R	2020			R
01/06	Balance	b/d	250 000	01/06	Trust payments	TCPJ6	80 000
30/06	Trust receipts	TCRJ6	81 500	30/06	Balance	c/d	251 500
			331 500				331 500
Jun 30	Balance	b/d	251 500				

The balance of the Trust bank account must equal the Trust creditors control account at month end

Dr — Trust creditors control — B2 — Cr

2020			R	2020			R
30/06	Trust bank	TCPJ6	80 000	01/06	Balance [Per question]	b/d	250 000
30/06	Journal debits	GJ6	800	30/06	Trust bank	TCRJ6	81 500
30/06	Balance	c/d	251 500	30/06	Journal credits	GJ6	800
			332 300				332 300
				30/06	Balance	b/d #	251 500

2.2 Trust creditors ledger

100% of the interest earned on the Sec 86(3) investment (R80 000) is owed to the LPFF

Folio – Trust Creditors Ledger

Dr — Sec 86(3) trust investment – Africa Bank — TCL1 — Cr

2020			R	2020			R
01/06	Trust bank	TCPJ6	80 000	30/06	Trust bank	TCRJ6	80 800
30/06	LPFF	GJ6	800				
			80 800				80 800

Payment from trust bank account into an investment account

Withdrawal of investment and payment into trust bank account R80 000 (capital invested + R800 interest received on investment

Dr		Legal Practitioners Fidelity Fund			TCL2	Cr	
			R	2020			R
				30/06	Trust bank	TCRJ6	700
				30/06	Trust investment – South Bank	GJ6	800
							1 500

The credit is from the Trust Cash Receipts Journal. The reference to 6 indicates the page no of the TCRJ on which the transaction is recorded.

From P6 of the General Journal

NB	*The interest earned on the section 86(2) trust bank account and section 86(3) trust investment accrues to the LPFF but has not been paid to the LPFF. Therefore, the R1 500 is still owed to the LPFF on 30 June.*

Check the balance of the trust creditors control general ledger account –

2.3 Trust creditors list

Name of client	Account reference	R
Opening balance [No detail of the composition of this amount given in question]	TCL1	250 000
Legal Practitioners Fidelity Fund	TCL2	1 500
Total	#	251 500

7.3 Section 86(4) of the Legal Practice Act 28 of 2014

It is this point that differentiates the type of investments

A trust account practice may, on the *instructions of any person (i.e. client)*, open a separate trust savings account or another interest-bearing account for the purpose of investing therein any money deposited in the trust account of that practice, on behalf of such person over which the practice exercises exclusive control as trustee, agent or stakeholder or in any other fiduciary capacity. Therefore the requirements differ from section 86(3) as the decision to invest surplus trust money is made by the *client* and the following applies.

(a) The LPA requires that the bank statements be endorsed with a reference to section 86(4) of the LPA. The name of the trust investment account in the trust creditors ledger must also include a reference to the specific section of the legislation, for example, S Africa sec 86(4) trust investment – ABC Bank.

(b) As is the case with section 86(3) the trust money may not be deposited directly into a trust investment account but must flow through the trust bank account. The same rule is applicable to the withdrawal of the money invested.

(c) Interest accrued on money deposited in terms of this section must be paid as follows:

- *5%* of the interest accrued on money in terms of this paragraph must be paid over to the LPFF and vests in the LPFF.
- *95%* of the interest accrued on the above money must be paid over to the person who gave instructions for the investment to be made.

(d) With effect from 1 March 2019, the *5%* of the trust interest earned will be paid *monthly* to the LPFF in terms of section 86(5), as provided for by Rule 54.14.16.4 made under the authority of Section 95(1) of the LPA.

(e) Only *5%* of the interest earned on *Section 86(4)* trust investments vests with the LPFF and therefore is not the property of the legal practitioner nor the trust creditors.

7.4 Schematic summary of the process of investing trust money:

Client deposits money into the practices' trust bank account

A legal practitioner of their own accord decides to invest the money, currently not required for a specific purpose in LPFF approved bank until it is needed for fees and costs.

Every trust account practice must keep a trust account at a bank with which the LPFF has entered into an arrangement.

The client, instructs legal practitioner to invest the money in LPFF approved bank until it is needed for fees and costs.

Paid into a trust investment account. Either a savings account or other interest-bearing account.

Paid into a trust investment account. Either a savings account or other interest-bearing account

Section 86(3) investment

Section 86(2) investment

Section 86(4) investment

Interest earned on the investment to be paid over annually to the LPFF (100%)

Interest earned on the investment to be paid over monthly to the client (95%) and LPFF (5%)

EXAMPLE 7.3

The accounting treatment of section 86(4) trust investments

The following information was obtained from the accounting records of SA Attorneys for May 2020:

2020	
30/04	The balance of the trust bank account after the deposit into the trust bank account but before the transfer to the trust investment account was R440 000.
01/05	Client E North deposited R280 000 into the trust bank account of SA Attorneys. The R280 000 was the deposit payable by E North on a property purchased from the City Council.
01/05	E North instructed SA Attorneys to invest the total amount of R280 000 in an interest-bearing investment account at Africa Bank in terms of section 86(4) of the LPA, until the transfer of property is affected.
30/05	The property was registered in the name of E North.
31/05	SA Attorneys withdrew the investment of E North and received R282 400, which was deposited into the trust bank account.

REQUIRED:

Prepare the following in the accounting records of SA Attorneys for May 2020:

1. Subsidiary journals, properly totalled:
   1.1. Trust cash receipts journal
   1.2. Trust cash payments journal
   1.3. Trust journal
2. Ledgers, properly balanced:
   2.1. General ledger
   2.2. Trust creditors ledger

Notes

EXPLANATION 7.3

SA ATTORNEYS

1. Subsidiary journals

1.1 Trust cash receipts journal for May 2020

TCRJ5

Date	Details	Fol.	Trust creditors control R	Bank R
31/05	E North sec 86(4) investment – Africa Bank	TCL1	282 400	282 400
31/05	Cr – Trust creditors control account		GL2	
31/05	Dr – Trust bank account			GL2

1.2 Trust cash payments journal for May 2020

TCPJ5

Date	Details	Fol.	Trust creditors control R	Bank R
01/05	E North sec 86(4) investment – Africa Bank	TCL1	280 000	280 000
31/05	Dr – Trust creditors control account		GL2	
31/05	Cr – Trust bank account			GL1

1.3 Trust journal for May 2020

GJ5

Date	Details	Fol.	Debit R	Credit R
31/05	E North sec 86(4) investment: Africa Bank	TCL1	2 400	
	E North (95% of interest received)	TCL2		2 280
	LPFF (5% of interest received)	TCL3		120
	Transfer of interest received to trust creditor and LPFF			
			2 400	2 400
31/05	Dr – Trust creditors control account		GL2	
31/05	Cr – Trust creditors control account			GL2

2. Ledgers

2.1 General ledger

Dr **Trust bank account** **GL1** **Cr**

2020			**R**	2020			**R**
01/05	Opening balance	b/d	720 000	01/05	Trust payments	TCPJ5	280 000
31/05	Trust receipts	TCRJ5	282 400		Closing balance	c/d	722 400
			1 002 400				1 002 400
31/05	Opening balance	b/d	722 400				

Dr **Trust creditors control** **GL4** **Cr**

2020			**R**	2020			**R**
31/05	Trust bank account	TCPJ5	280 000	01/05	Opening balance	b/d	720 000
	Journal debits	GJ5	2 400	31/05	Trust bank account	TCRJ5	282 400
	Closing balance	c/d	722 400		Journal credits	GJ5	2 400
			1 004 800				1 004 800
				31/05	Opening balance	b/d	722 400

2.2 Trust creditors ledger

Dr **E North sec 86(4) investment – Africa Bank** **TCL1** **Cr**

2020			**R**	2020			**R**
01/05	Trust bank account	TCPJ5	280 000	31/05	Trust bank account	TCRJ5	282 400
31/05	E North/LPFF	GJ5	2 400				
			282 400				282 400

Dr **E North** **TCL2** **Cr**

			R	2020			**R**
				01/05	Balance	b/d	280 000
				31/05	E North sec 86(4) trust investment - Africa Bank	TJ5	2 280
							282 280

Dr **Legal Practitioners Fidelity Fund (LPFF)** **TCL3** **Cr**

			R	2020			**R**
				30/05	E North sec 86(4) trust investment – Africa Bank	TJ5	120
							120

The interest earned on the section 86(4) trust investment accrues to the LPFF but has not yet been paid to the fund. The R120 is therefore still owed to the LPFF on 30 May.

The trust creditor's account does not decrease when the investment is made. The trust bank account (trust asset) decreases whilst the client's *investment account (trust asset)* increases.

EXAMPLE 7.4

The accounting treatment of Section 86(3) and Section 86(4) trust investments.

The following information was obtained from the accounting records of SA Attorneys for August 2020:

Balances at 1 August 2020:

	R
Trust bank	337 500
Trust creditors	337 500

The trust creditors consist of:

	R
A South	112 500
B Mpuma	93 750
C Kwazulu	56 250
D Western	75 000

The following transactions took place during August 2020:

Aug 2020	
1	SA Attorneys invested R150 000 of the trust funds not immediately required, in a special savings account at Africa Bank until 31 August 2020.
3	B Mpuma requested SA Attorneys to invest the amount in his trust account in a special savings account to his benefit. SA Attorneys invested the amount in West Bank.
5	A South requested SA Attorneys to invest R58 000 of his trust funds in a savings account at Africa Bank. SA Attorneys acted accordingly.
22	SA Attorneys withdrew the investment made on 3 August 2020 and received R95 625. On request of B Mpuma, SA Attorneys paid R48 750 to F Cape, his daughter, and the rest of the amount in the trust account of B Mpuma to him.
31	SA Attorneys redeemed half the trust investment made on 1 August 2020 and received R76 825 which was paid into the trust bank account.

REQUIRED:

Prepare the following in the accounting records of SA Attorneys for August 2020:

1. Subsidiary journals, properly totalled:
   - 1.1 Trust cash receipts journal
   - 1.2 Trust cash payments journal
   - 1.3 Trust journal
2. Ledgers, properly balanced:
   - 2.1 General ledger
   - 2.2 Trust creditors ledger

SA ATTORNEYS

1. Subsidiary journals

1.1 Trust cash receipts journal for August 2020

TCRJ8

Date	Details Trust creditor	Fol.	Trust creditors control R	Bank R
22/08	B Mpuma sec 86(4) trust investment – West Bank	TCL6	95 625	95 625
31/08	Sec 86(3) trust investment – Africa Bank	TCL5	76 825	76 825
			172 450	172 450
31/08	Dr – Trust bank account			GL1
31/08	Cr – Trust creditors control account		GL2	

1.2 Trust cash payments journal for August 2020

TCPJ5

Date	Details Trust creditor	Fol.	Trust creditors control R	Bank R
01/08	Sec 86(3) trust investment – Africa Bank	TCL5	150 000	150 000
03/08	B Mpuma sec 86(4) trust investment – West Bank	TCL6	93 750	93 750
05/08	A South sec 86(4) trust investment – Africa Bank	TCL7	58 000	58 000
22/08	B Mpuma (Payment of F Cape)	TCL2	48 750	48 750
22/08	B Mpuma	TCL2	46 875	46 875
			397 375	397 375
31/08	Dr – Trust creditors control account		GL2	
31/08	Cr – Trust bank account			GL1

1.3 Trust journal for August 2020

GJ8

Date	Details	Fol.	Debit R	Credit R
31/08	Sec 86(3) trust investment – Africa Bank (trust creditor)	TCL5	1 825	
	LPFF (trust creditor)	TCL7		1 825
	Transfer of interest received to the LPFF			
31/08	B Mpuma sec 86(4) investment – West Bank			
	(trust creditor)	TCL6	1 875	
	B Mpuma (trust creditor)	TCL2		1 875
	Transfer of interest received to client			
			3 700	3 700
31/08	Dr – Trust creditors control account		GL2	
31/08	Cr – Trust creditors control account			GL2

2. Ledgers

2.1 General ledger

Dr — Trust bank account — GL1 — Cr

2020			R	2020			R
01/08	Balance	b/d	337 500	31/08	Trust payments	TCPJ8	397 375
31/08	Trust receipts	TCRJ8	172 450		Balance	c/d	112 575
			509 950				509 950
31/08	Balance	b/d	112 575				

Dr — Trust creditors control — GL4 — Cr

2020			R	2020			R
31/08	Balance	TCPJ8	397 375	01/08	Balance	b/d	337 500
	Journal debits	GJ8	3 700	31/08	Trust receipts	TCRJ8	172 450
	Balance	c/d	112 575		Journal credits	GJ8	3 700
			513 650				513 650
				31/08	Balance	b/d	112 575

2.2 Trust creditors ledger

Dr — A South — TCL1 — Cr

			R	2020			R
				01/08	Balance	b/d	112 500

Dr B Mpuma TCL2 Cr

2020			R	2020			R
22/08	Trust payments	TCPJ8	48 750	01/08	Balance	b/d	93 750
	Trust payments	TCPJ8	46 875	31/08	B Mpuma Sec 86(4) investment – West Bank	GJ8	1 875
			95 625				95 625

Dr C Kwazulu TCL3 Cr

			R	2020			R
				01/08	Balance	b/d	56 250

Dr D Western TCL4 Cr

			R	2020			R
				01/08	Balance	b/d	75 000

Dr Sec 86(3) trust investment – Africa Bank TCL5 Cr

2020			R	2020			R
01/08	Trust payments	TCPJ8	150 000	31/08	Trust receipts	TCRJ8	76 825
31/08	LPFF	GJ8	1 825	31/08	Balance	c/d	75 000
			151 825				151 825
31/08	Balance	b/d	75 000				

Dr B Mpuma sec 86(4) investment – West Bank TCL6 Cr

2020			R	2020			R
03/08	Trust payments	TCPJ8	93 750	31/08	Trust receipts	TCRJ8	95 625
31/08	B Mpuma (trust creditor)	GJ8	1 875				
			95 625				95 625

Dr A South sec 86(4) trust investment – Africa Bank TCL7 Cr

2020			R				R
05/08	Trust payments	TCPJ8	58 000				

Dr **Legal Practitioners Fidelity Fund** **TCL8** **Cr**

			R	2020			**R**
				31/08	Sec 86(3) trust investment – Africa Bank	GJ8	1 825

QUICK NOTE

- *The interest earned on the section 86(3) trust investment accrues to the LPFF but has not yet been paid to the fund. The R1 825 is therefore still owed to the LPFF on 31 August.*
- *A trust investment is made from the trust bank account and not the trust creditor's account.*
- *Investments made in accordance with section 86 are the only trust creditors accounts that may reflect debit balances.*
- *The balance of the trust creditors control account and the total of the list of trust creditors balances should be the same.*

Trust reconciliation

Trust creditors:	**R**
A South	112 500 Cr
C Kwazulu	56 250 Cr
D Western	75 000 Cr
Legal Practitioners Fidelity Fund	1 825 Cr
Sec 86(3) trust investment: Africa Bank	(75 000) Dr
A South sec 86(4) trust investment: Africa Bank	(58 000) Dr
	112 575
Trust assets – Trust bank account	112 575 Dr

Notes

7.5 The LPC Rules for the Attorneys' Profession in respect of trust monies

7.5.1 Introduction

A practising attorney is a member of the Law Society of South Africa (LSSA) and must abide by the Legal Practice Council (LPC) Rules (hereafter referred to as the LPC Rules). The LPC Rules may by no means supersede the provisions made in section 86 of the Legal Practice Act, 28 of 2014 regarding the trust bank account or trust investments.

The LPC Rules furthermore prescribe that proper accounting records be kept in an official language of South Africa that comply with generally accepted accounting practice and these records are to be kept for at least five years. The accounting records should clearly differentiate between monies **received** for, or on account of any person or monies **paid** for, or on account of any person.

LPC Rules 54.14.16.1 to 54.14.16.5 determine the payment of interest to the LPFF.

7.5.2 Appointment of an auditor/public accountant

The attorney's practice has a legal obligation to appoint an auditor/public accountant who has to report to the Law Society. The auditor has to perform the duties and responsibilities imposed by the LPA, the Companies Act, 61 of 2008 (as amended), as well as the Public Accountants and Auditors Act, 51 of 1951 (as amended).

The LPA, as well as the LPC Rules require an annual audit report to be rendered by the auditor. The report must be issued on the prescribed form of the LSSA and submitted to the LSSA within six months after the reporting period, usually the year end of the legal practice. Although it is the auditor's responsibility to issue and submit the report, the legal practice is obliged to ensure that the report is issued and submitted to the LSSA in time. The report must be submitted to the Law Society by the auditor and not the legal practice. In the report, the auditor must state whether the accounting records and specifically the trust records, complied with the LPA and the LPC Rules.

The auditor has an obligation to report on the following:

- A trust deficit as soon as it is detected. A trust deficit will arise when the total of the trust creditors balances exceeds the trust monies.
- The result of queries by the auditor on any material issue regarding the accounting records of the attorney's practice that was not dealt with to his satisfaction.
- Restricted access to the accounting records of the legal practice after, reasonable requests by the auditor.

Notes

7.5.3 Accounting to clients

The attorney's practice should, within a reasonable time after the performance or earlier termination of any mandate, account to his client in writing and retain a copy of each such account for not less than five years. The following information must be included in the account statement:

- All amounts, appropriately explained, received in connection with the matter concerned.
- All expenses incurred and other payments regarding the matter.
- Fees and other charges levied or raised against the client and in instances where a fee has been agreed upon, the fact that it was agreed upon and the amount.
- The amount owing to or by the client.

7.5.4 Consequences of non-compliance with prescriptions

The consequences of non-compliance with section 86 of the LPA and the LPC Rules for the Attorneys' Profession can be:

- the removal from the roll;
- suspension from practice; and
- other kinds of instruction, for example, more frequent audit reports that state that the attorney's records were in order.

EXAMPLE 7.5

The recording of trust, business and transfer transactions in an attorney's practice

On 1 May 2020 the following information was obtained from the accounting records of SA Attorneys:

		R
Business bank		4 300
Trust bank	Note - the opening balance of the Trust bank account is equal to the opening balance of the Trust creditors control	37 000
Client control [Opening balance]		1 350
A South		250
S Africa		1 100
Trust creditors control [Opening balance]		37 000
E North		24 800
F Cape		11 710
B Mpuma		500

The following transactions occurred in the attorney's practice of SA Attorneys during May 2020:

2020 May	
1	B Mpuma is divorcing his wife and deposited a bank guaranteed cheque of R15 000 with SA Attorneys to cover fees and charges, including advocate fees.
2	B Mpuma gave a written instruction that R7 000 be invested in an interest-bearing account at SA Bank. SA Attorneys executed the instruction. [Section 86(4) investment]
5	SA Attorneys instructed advocate G Natal to handle B Mpuma's divorce and paid his account to the amount of R6 000. [Payment is made from the trust bank account, as B Mpuma has sufficient funds in his trust creditors account]
6	SA Attorneys decided to invest R10 000 of the trust monies in the trust bank account not needed for immediate use, in a special savings account at West Bank. [Section 86(3) investment, there was no instruction from the client to invest, but the practice may do so of its own accord]
14	SA Attorneys received a combined cheque from D Western, a client, to the amount of R700 for: • Settlement of his account for services rendered in a collection matter (fees have been charged during the previous month) – R250. • A deposit for fees still to be levied for the preparation of a purchase contract – R450.
24	The divorce case of B Mpuma was settled, and SA Attorneys levied a fee of R4 000. SA Attorneys withdrew the investment made on 2 May 2020 and received R7 100. The attorney's practice paid the amount due to B Mpuma after all transfers were made. [If the practice levies a fee for services rendered the transaction is recorded in the Fees Journal]
28	SA Attorneys withdrew R5 000 (excluding interest) of the trust investment made on 6 May 2020. Interest on the investment amounted to R100.
30	SA Attorneys received written instruction from E North to invest R12 000 of his funds held in trust, in an interest-bearing savings account at SA Bank. SA Attorneys obliged. [Section 86(4) investment – client instructed investment]

REQUIRED:

Prepare the following in the accounting records of SA Attorneys for May 2020:

1. Subsidiary journals, property totalled:

   1.1 Business cash receipts journal
   1.2 Trust cash receipts journal
   1.3 Trust cash payments journal
   1.4 Trust journal
   1.5 Fees journal
   1.6 Transfer journal

2. Ledgers, properly balanced:

   2.1 General ledger
   2.2 Trust creditors ledger
   2.3 Clients ledger

EXPLANATION 7.5

SA ATTORNEYS

1. Subsidiary journals

1.1 Business cash receipts journal for May 2020 **BCRJ5**

Date	Details	Fol.	Sundries R	Business bank R
14	Trust bank (transfer D Western)	TCPJ5	250	250
24	Trust bank (transfer B Mpuma)	TCPJ5	4 000	4 000
			4 250	4 250
31/05 Dr – Business bank				B2

Account number

Investment in SA Bank withdrawn from investment account and deposited in Trust bank account. The amount is the original investment of R7 000 plus the interest earned on investment of R100

1.2 Trust cash receipts journal for May 2020 **TCRJ5**

Date	Details	Fol.	Trust creditors control R	Trust bank R
01/05	B Mpuma (trust creditor)	TCL3	15 000	15 000
14/05	D Western (trust creditor)	TCL4	700	700
24/05	B Mpuma sec 86(4) investment – SA Bank (trust creditor)	TCL6	7 100	7 100
28/05	Sec 86(3) trust investment – West Bank (trust creditor)	TCL5	5 100	5 100
			27 900	27 900
31/05	Dr – Trust bank			B1
31/05	Cr – Trust creditors control		B4	

The amount is the original investment of R5 000 plus the interest earned on investment of R100

Credit trust creditors control

Debit trust bank account

1.3 Trust cash payments journal for May 2020

TCPJ5

Trust creditors – All the entries are to the Trust creditors ledger (TCL)

Date	Details	Fol.	Trust creditors control R	Trust bank R
02/05	B Mpuma sec 86(4) investment – SA Bank	TCL6	7 000	7 000
05/05	B Mpuma (trust creditor) – Adv F Cape	TCL3	6 000	6 000
06/05	Sec 86(3) trust investment) – West Bank	TCL5	10 000	10 000
14/05	Business bank (transfer D Western)	BCRJ5		250
24/05	B Mpuma	TCL3	5 595	5 595
24/05	Business bank (transfer B Mpuma)	BCRJ5		4 000
30/05	E North sec 86(4) investment – SA Bank	TCL7	12 000	12 000
			40 595	44 845
31/05	Dr – Trust creditors control		B4	
31/05	Cr – Trust bank			B1

Debit trust creditors control

Credit trust bank account

1.4 Trust journal for May 2020

TJ5

Trust creditors

Date	Details	Fol.	Dr R	Cr R
24/05	B Mpuma sec 86(4) investment – SA Bank	TCL6	100	
	B Mpuma (100 x 95%)	TCL3		95
	LPFF (100 x 5%)	TCL8		5
	Transfer of interest to client and LPFF			
28/05	Sec 86(3) trust investment – West Bank	TCL5	100	
	LPFF (100%)	TCL8		100
	Transfer of interest to the LPFF			
			200	200
31/05	Dr – Trust creditors control account		GL4	
31/05	Cr – Trust creditors control account			GL4

RECAP

Both of the journal entries above are for trust creditors. The interest earned on the trust investment in SA Bank (Section 86(4) investment) of R100 is allocated between the client B Mpuma (R95) and the LPFF (R5). The interest earned on the trust investment in West Bank (Section 86(3) investment) of R100 is only allocated to the LPFF.

1.5 Fees journal for May 2020

FJ5

Date	Details	Fol.	Clients control R	Fees R
24/05	B Mpuma (client)	CL3	4 000	
	Fees	GL5		4 000
	Fees charged for divorce			
			4 000	4 000
31/05	Dr – Clients control account		GL3	
31/05	Cr – Trust creditors control account			GL4

1.6 Transfer journal for May 2020

TJ5

Date	Details	Fol.	Debit R	Credit R
14/05	D Western (trust creditor)	TCL4	250	
	D Western (client)	CL1		250
	Transfer of fees from combined payment			
24/05	B Mpuma (trust creditor)	TCL3	4 000	
	B Mpuma (client)	CL3		4 000
	Transfer of account			
			4 250	4 250
31/05	Dr – Trust creditors control account		GL4	
31/05	Cr – Clients control account			GL3

2. Ledgers

2.1 General ledger

Dr **Trust bank account** **GL1** **Cr**

2020			R	2020			R
01/05	Opening balance	b/d	37 000	31/05	Trust payments	TCPJ5	44 845
31/05	Trust receipts	TCRJ5	27 900		Closing balance	c/d	20 055
			64 900				64 900
01/06	Opening balance	b/d	20 055				

Dr **Business bank account** **GL2** **Cr**

2020			**R**				**R**
01/05	Opening balance	b/d	4 300				
31/05	Receipts	BCRJ5	4 250				
			8 550				

Dr **Clients control account** **GL3** **Cr**

2020			**R**	2020			**R**
01/05	Opening balance	b/d	1 350	31/05	Journal credits	GJ5	4 250
31/05	Fees	FJ5	4 000	31/05	Closing balance	c/d	1 100
			5 350				5 350
01/06	Opening balance	b/d	1 100				

Dr **Trust creditors control account** **GL4** **Cr**

2020			**R**	2020			**R**
31/05	Trust payments	TCPJ5	40 595	01/05	Opening balance	b/d	37 000
31/05	Journal debits	GJ5	200	31/05	Trust receipts	TCRJ5	27 900
31/05	Journal debits	TJ5	4 250	31/05	Journal credits	GJ5	200
31/05	Closing balance	c/d	20 055				
			65 100				65 100
				01/06	Opening balance	b/d	20 055

Dr **Fees** **GL5** **Cr**

			R	2020			**R**
				31/05	Clients control	FJ5	4 000

2.2 Trust creditors ledger

Dr **E North** **TCL1** **Cr**

			R	2020			**R**
				01/05	Opening balance	b/d	24 800

NB	*The interest earned on the section 86(2) trust bank account and section 86(3) trust investment accrues to the LPFF but has not been paid to the LPFF. Therefore, the R1 500 is still owed to the LPFF on 30 June.*

Dr **F Cape** **TCL2** **Cr**

			R	2020			**R**
				01/05	Opening balance	b/d	11 700

Dr **B Mpuma** **TCL3** **Cr**

2020			**R**	2020			**R**
05/05	Trust bank – advocate	TCPJ5	6 000	01/05	Opening balance	b/d	500
24/05	B Mpuma (client)	TJ5	4 000	31/05	Trust receipts	TCRJ5	15 000
31/05	Trust payments	TCPJ5	5 595	31/05	B Mpuma sec 86(4) investment: SA Bank	GJ5	95
			15 600				15 600

Dr **D Western** **TCL4** **Cr**

2020			**R**	2020			**R**
14/05	D Western (client)	TJ5	250	14/05	Trust receipts	TCRJ5	700
31/05	Closing balance	c/d	450				
			700				700
				01/06	Opening balance	b/d	450

Dr **Sec 86(3) trust investment: West Bank** **TCL5** **Cr**

2020			**R**	2020			**R**
06/05	Trust payments	TCPJ5	10 000	28/05	Trust receipts	TCRJ5	5 100
31/05	LPFF	GJ5	100	31/05	Closing balance	c/d	5 000
			10 100				10 100
01/06	Opening balance	b/d	5 000				

Dr **B Mpuma sec 86(4) investment: SA Bank** **TCL6** **Cr**

2020			**R**	2020			**R**
02/05	Trust payments	TCPJ5	7 000	24/05	Trust receipts	TCRJ5	7 100
24/05	B Mpuma (trust creditor)	GJ5	100				
			7 100				7 100

Dr **E North sec 86(4) investment: SA Bank** **TCL7** **Cr**

2020			**R**				**R**
30/05	Trust payments	TCPJ5	12 000				

Dr — Legal Practitioners Fidelity Fund — TCL8 — Cr

			R	2020			R
				31/05	B Mpuma sec 86(4) investment: SA Bank Sec 86(3) trust investment: West Bank	GJ5 GJ5	5 100
							105

NB	*The interest earned on the section 86(4) trust investment accrues to the LPFF, but the R5 has not yet been paid over to the fund per the question. Therefore, the R100 is still owed to the LPFF on 31 May. Interest earned on a section 86(4) trust investment must be paid over monthly to the LPFF.*

List of trust creditors balances on 31 May 2020

	R
E North	24 800
F Cape	11 700
B Mpuma	–
D Western	450
Sec 86(3) trust investment: West Bank	(5 000)
B Mpuma sec 86(4) investment: SA Bank	–
E North sec 86(4) investment: SA Bank	(12 000)
LPFF	105
Balance of trust bank account on 31 May 2020	20 055

2.3 Clients ledger

Dr — D Western — CL1 — Cr

2020			R	2020			R
01/05	Opening balance	b/d	250	14/05	D Western (trust creditor)	TJ5	250
			250				250

Dr — S Africa — CL2 — Cr

2020			R				R
01/05	Opening balance	b/d	1 100				

Dr — B Mpuma — CL3 — Cr

2020			R	2020			R
24/05	Fees	FJ5	4 000	24/05	B Mpuma (trust creditor)	TJ5	4 000
			4 000				4 000

EXAMPLE 7.6

The recording of trust investments and transfer transactions in the books of prime entry and ledgers of an attorney's practice

On 30 June 2020 the following information was obtained from the accounting records of South Attorneys:

1. The balance of the trust creditors control account and the trust bank accounts amounted to R800 000 each. [This is the opening balance of the trust creditors control account in the general ledger]
2. After South Attorneys investigated their trust creditors, the following was found:
   (a) On 1 June 2020, F Cape, a client of South Attorneys gave the instruction that R100 000 kept in trust on her behalf, be invested in an interest-bearing savings account until registration of the unmovable property. On the same day, South Attorneys invested R100 000 at African Bank on behalf of F Cape. On 30 June 2020 when closing the account, South Attorneys received an EFT transfer for R101 000 and paid the interest earned on the investment to the beneficiaries. [There is therefore no provision for the interest as in examples 8.1, 8.2 and 8.3 and learning activity 1]
   (b) On 1 June 2020 a client of South Attorneys, G Natal, gave written instruction for R200 000 held in trust on his behalf, to be invested in interest bearing accounts. South Attorneys immediately executed the instruction and invested the money in SA Bank.
   (c) On 1 June 2020 South Attorneys decided to invest R150 000 of the surplus funds not immediately needed, in an interest-bearing savings account with West Bank. When closing the account on 30 June 2020 South Attorneys received R152 000 and issued a cheque for R1 950 regarding the payment of interest earned on the investment, after bank charges were deducted.

REQUIRED:

Prepare the following in the accounting records of South Attorneys for June 2020:

1. Subsidiary journals, property totalled:
   1.1 Trust cash receipts journal
   1.2 Trust cash payments journal
   1.3 Trust journal
2. Ledgers, properly balanced:
   2.1 General ledger
   2.2 Trust creditors ledger

EXPLANATION 7.6

SOUTH ATTORNEYS

1. Subsidiary journals

1.1 Trust cash receipts journal for June 2020

TCRJ6

Date	Details	Fol.	Trust creditors control R	Bank R
30/06	F Cape sec 86(4) investment: African Bank (trust creditor)	TCL3	101 000	101 000
30/06	Sec 86(3) trust investment: West Bank (trust creditor)	TCL5	152 000	152 000
			253 000	253 000
30/06	Cr – Trust creditors control account		GL2	
30/06	Dr – Trust bank account			GL1

1.2 Trust cash payments journal for June 2020

TCPJ6

Date	Details	Fol.	Trust creditors control R	Bank R
01/06	F Cape sec 86(4) investment: African Bank (trust creditor)	TCL3	100 000	100 000
01/06	G Natal sec 86(4) investment: SA Bank (trust creditor)	TCL1	200 000	200 000
01/06	Sec 86(3) trust investment: West Bank (trust creditor)	TCL4	150 000	150 000
30/06	LPFF	TCL6	1 950	1 950
30/06	F Cape (trust creditor)	TCL5	950	950
30/06	LPFF	TCL6	50	50
			452 950	452 950
30/06	Dr – Trust creditors control account		GL4	
30/06	Cr – Trust bank account			GL1

1.3 Trust journal for June 2020

TJ6

Date	Details	Fol.	Debit R	Credit R
30/06	F Cape sec 86(4) investment: African Bank (trust creditor)	TCL3	1 000	
	F Cape (trust creditor)	TCL1		950
	LPFF	TCL6		50
	Transfer of interest to client and LPFF			
30/06	Sec 86(3) trust investment: West Bank (trust creditor)	TCL5	2 000	
	LPFF (trust creditor)	TCL6		2 000
	Transfer of interest to LPFF			
			3 000	3 000
30/06	Dr – Trust creditors control account		GL4	
30/06	Cr – Trust creditors control account			GL4

The following journal was not required but is shown for illustrative purposes:

Business general journal for June 2020

Date	Details	Fol.	Debit R	Credit R
30/06	LPFF (client)		50	
	Bank charges			50
	Trust bank charges claimed back from LPFF by deducting it from trust interest earned			

The R50 balance of the LPFF trust creditor account will be transferred to the business bank account in the same way as for the transfer of the attorney's fees.

2. Ledgers

2.1 General ledger

Dr — Trust bank account — GL1 — Cr

2020			R	2020			R
01/06	Balance	b/d	800 000	30/06	Trust payments	TCPJ6	452 950
30/06	Trust receipts	TCRJ6	253 000		Balance	c/d	600 050
			1 053 000				1 053 000
01/07	Balance	b/d	600 050				

Dr **Trust creditors control** **GL2** **Cr**

2020			**R**	2020			**R**
30/06	Trust payments	TCPJ6	452 950	01/06	Balance	b/d	800 000
	Journal debits	GJ6	3 000	30/06	Trust receipts	TCRJ6	253 000
	Balance	c/d	600 050	30/06	Journal credits	GJ6	3 000
			1 056 000				1 056 000
				01/07	Balance	b/d	600 050

2.2 Trust creditors ledger

Dr **F Cape** **TCL1** **Cr**

2020			**R**	2020			**R**
30/06	Trust payments	TCPJ6	950	01/06	Balance	b/d	100 000
30/06	Balance	c/d	100 000	30/06	F Cape sec 86(4) investment: African Bank	TJ6	950
			100 950				100 950
				01/07	Balance	b/d	100 000

Dr **G Natal** **TCL2** **Cr**

			R	2020			**R**
				01/06	Balance	b/d	200 000

Dr **F Cape sec 86(4) investment (African Bank)** **TCL3** **Cr**

2020			**R**	2020			**R**
30/06	Trust payments F Cape (trust creditor)	TCPJ6	100 000	01/06	Trust receipts	TCRJ6	101 000
30/06	F Cape/LPFF	TJ6	1 000				
			101 000				101 000

Dr **G Natal sec 86(4) investment (SA Bank)** **TCL4** **Cr**

2020			**R**				**R**
30/06	Trust payments	TCPJ6	200 000				

Dr		Sec 86(3) trust investment: West Bank				TCL5	Cr
2020			R	2020			R
30/06	Trust payments	TCPJ6	150 000	30/06	Trust receipts	TCRJ6	152 000
30/06	LPFF	TJ6	2 000				
			152 000				152 000

Dr		Legal Practitioners Fidelity Fund				TCL6	Cr
2020			R	2020			R
30/06	Trust payments	TCPJ6	1 950	30/06	Sec 86(3) trust investment (West Bank)	TJ6	2 000
30/06	Trust payments	TCPJ6	50				
30/06	Balance	c/d	50	30/06	F Cape – sec 86(4) trust investment (African Bank)	TJ6	50
			2 050				2 050
				01/07	Balance	b/d	50

2.3 List of trust creditors balances on 30 June 2020

	R
F Cape	100 000
G Natal	200 000
Other trust creditors	500 000
F Cape sec 86(4) trust investment: African Bank	-
G Natal sec 86(4) trust investment: SA Bank (Debit balance)	(200 000)
Surplus funds Sec 86(3) trust investment: West Bank	-
LPFF	50
Balance of trust bank account on 30 June 2020	600 050

2.4 List of trust creditors balances on 1 June 2020 (Check opening balance)

	R
F Cape	100 000
G Natal	200 000
Other trust creditors [balancing amount]	500 000
Balance of trust bank account on 1 June 2020	800 000[1]

1 Opening balance of the trust creditors control account in the general ledger (per question)

7.6 Self-assessment exercises

Questions	Answers
What is the acronym for Legal Practice Act 28 of 2014?	
What is the acronym LPFF?	
State the requirements of section 86(2) of the Legal Practice Act 28 of 2014.	
State the requirements of section 86(3) of the Legal Practice Act 28 of 2014.	
State the requirements of section 86(4) of the Legal Practice Act 28 of 2014.	
State the requirements of section 86(5)(a)) of the Legal Practice Act 28 of 2014.	
What is a section 86(3) trust investment?	

What is a section 86(4) trust investment?	
Who are the beneficiaries of the investment interest on a section 86(3) trust investment?	
Who are the beneficiaries of the investment interest on a section 86(4) trust investment?	
How do you treat the interest received on a section 86(3) trust investment?	
How do you treat the interest received on a section 86(4) trust investment?	
If the interest received on a section 86(3) trust investment amounted to R1 200, indicate who is entitled to the interest.	

If the interest received on a section 86(4) trust investment amounted to R5 000, indicate who is entitled to the interest.	

LEARNING UNIT

8 CORRESPONDENTS

Contents

Learning outcomes

After studying this learning unit, you should be able to:

- define the term “correspondent”
- distinguish between the instructing and instructed correspondent
- prepare the instructed attorney’s correspondent account statement
- demonstrate an understanding of the correspondent allowance
- calculate the correspondent allowance
- calculate collection commission
- record all correspondent transactions in the accounting records of the instructing and instructed correspondent

Key concepts

- correspondents
- instructing attorney
- instructed attorney
- Collection costs
- Collection fees

Acronyms

BCRJ	Business cash receipts journal
BCPJ	Business cash payments journal
CL	Clients ledger
FJ	Fees journal
GJ	General journal
GL	General ledger
LPA	Legal Practice Act 28 of 2014
TB	Trial balance
TJ	Transfer journal
TCL	Trust creditors ledger
TCRJ	Trust cash receipts journal
TCPJ	Trust cash payments journal

8.1 Introduction

Every attorney's practice has to make use of the services of a correspondent at some point. The reason being that in some instances the instruction from the client to the attorney can only be executed in a jurisdiction where the attorney does not have an office. A law firm must be within a 15km radius of the office of the registrar of the Court.

For example a client, E North, who resides in Mbombela, requests Mr Langa, an attorney, to collect child maintenance money from her ex-husband in Midrand and to register a trust for her children. As Mr Langa only has an office in Mbombela, he has to instruct SA Attorneys, an attorneys firm in Midrand, to collect the money and register the trust. The attorney who gives the instruction is known as the *instructing* attorney (the attorney, Mr Langa, in Mbombela in the above example) and the attorney who receives the instruction and renders the service, is known as the *instructed* attorney (the attorneys firm, SA Attorneys, in Midrand in the above example).

8.2 Categories of instructions

The instructions given to the instructed attorney can be divided into two categories, namely:

- Instructions where *no trust monies* are involved.

  Examples of this category are inter alia, the registration of patents and companies, the settlement of divorce cases, the settlement of disputes and third-party claims.

- Instructions where *trust monies* are involved

  Examples of this category are inter alia, the collection of debts and child maintenance.

It is important to distinguish between the two categories, as the entries in the accounting records of both the instructed and the instructing attorneys differ for each category.

Notes

8.3 Types of costs incurred by clients from a legal practice

Some legal documents such as hire purchase agreements, loan agreements and other trade debts usually have clauses protecting creditors against defaulting debtors. As part of their terms, a provision is included that binds the debtor to pay any legal costs or collection commission that the creditor may incur when attempting to sue for the debt.

The collection commission fee is agreed on beforehand with the client. When an account is handed over for collections, the client must provide information as to what he/she requires from the legal team. Collection commission is earned when an instruction was given to collect debt. The legal practitioner is entitled to collect 10% of the capital amount (VAT excluded) for each payment.

Soft collections:

1. Include phone calls, messages and email correspondence to set up an arrangement.
2. This could be billed as a retainer or per-item-billing. (* see descriptions below.)

Hard collections:

1. Include letter of demand, acknowledgement of debt, summons.
2. These items are billed as per company rates and are based on amount of time spent on the items, as well as the amount of information that is required.

General costs (examples) of above-mentioned items:

1. Letter of demand (LOD): from R250 – R600.
2. Acknowledgement of debt (AOD): from R300 – R800
3. Summons: from R2 000 – R3 500.
4. Receiving instruction – R328 per 1/4 hour
5. Collection fee – 10% of the amount collected up to a maximum amount of R1 000.
6. Tracing costs – ±R450
7. Sheriff costs R600 to R1 500 for normal service, and between R1 000 and R35 000 for urgent service.

* Legal practitioners make use of per-item-billing whereby the client is billed per item, e.g. phone calls with the debtor are calculated per minute. An amount for collection commission will be added to every item.

RECAP	*Collection commission is also added when the debtor pays directly into the company's trust account. A percentage thereof is kept for costs. It may be up to 10% of the amount collected, but the calculated amount may not exceed R1 000.*

A correspondent allowance may be granted by the instructed attorney to the instructing attorney. A maximum of 1/3 of the fees (professional and collection commission) charged may be granted. This allowance may be less than 1/3 of the fees charged, but not more. The correspondent allowance may only be granted between practitioners.

The 1/3 allowance is only payable on the fees of the attorney. It is not calculated on any expenses that are paid directly to third parties, such as advocate costs and sheriff costs. These are seen as costs, disbursements or expenses, and not as fees of the attorneys.

Calculation of the 1/3 correspondent allowance:

	R
Information:	
The amount collected by the instructed attorney	8 000
Professional fees charged by the instructed attorney (excluding VAT)	1 300
Tracing costs	450
Sheriff costs	600
Calculation of the 1/3 correspondent allowance:	
Professional fees charged	1 300
Collection commission (10% x R8 000)	800
Tracing costs (Not part of professional fees and collection commission, are costs)	–
Sheriff costs (Not part of professional fees and collection commission, are costs)	–
	2 100

Correspondent allowance:
= 1/3 x (Professional fees + Collection commission)
= 1/3 x 2 100
= R700

If the instructed attorney is a VAT vendor, then the calculation of the 1/3 correspondent allowance based on an amount collected of R8 000, will be as follows:

	R
Fees levied	1 300
Collection commission levied (R8 000 x 10%)	800
	2 100

The correspondent allowance = 1/3 x (R1 300 + R800)
= R700 × 115/100 (VAT on the 1/3 allowance)
= R805

8.4 Flow of activities

The flow of activities when an attorney makes use of the services of a correspondent is described with reference to the example below:

Correspondent account statement

Instructed attorney

Accounting statement
SA Attorneys

P O Box 1234
MIDRAND
30 April 2020

Langa Attorneys ← Instructing attorney
MBOMBELA

		R	**R**
Collection – E North vs Z North			7 500
Fees for receiving instruction	Fees charged and costs incurred	330	
Fees for issuing summons – Z North		66	
Tracing costs paid – Z North		450	
Sheriff costs – Z North		600	
Collection commission		750	
Your ⅓ share of fees (allowance)			382*
Electronic fund transfer to yourselves		5 686	
		7 882	7 882

1) Mr Langa from Langa Attorneys receives a mandate from E North (client) to act on her behalf in the registration of the trust and to collect the child maintenance money.

2) As Mr Langa only has an office in Mbombela, he instructs SA Attorneys, the attorney in Midrand, to act on his behalf in the two matters.

3) SA Attorneys then executes his instructions and records the transactions entered into by him, in his accounting records on a day to day basis.

4) The instructing attorney, Mr Langa, will be SA Attorneys client and a trust creditor account and a client account will be opened for Mr Langa in SA Attorneys ledgers.

5) SA Attorneys then draws up his account statement from his accounting records and issues Mr Langa with a payment for the money collected, after deducting the fees he is entitled to and the refunds of expenses incurred on behalf of Mr Langa.

6) Mr Langa then records the information in the account statement which was received from SA Attorneys in his own accounting records.
   - Both SA Attorneys and E North will be accounted for as clients of Mr Langa.
   - As trust money is involved in the collection matter, trust creditor accounts will be opened for SA Attorneys and E North.

QUICK NOTE

*SA Attorneys acts on behalf of Mr Langa and **not** on behalf of E North. Therefore, there will not be a trust creditor account or a client account for E North in SA Attorneys accounting records.*

8.5 General format of a correspondent account statement

There are various formats of correspondent account statements, but for the purpose of this module, we shall deal only with the most common form.

For a better understanding of the above, it is necessary to provide a simplified correspondent account statement to explain what each entry entails, and to indicate how the instructed attorney compiles such a statement.

Correspondent account statement

The instructing attorney

The instructed attorney

Accounting statement
SA Attorneys

Langa Attorneys
MBOMBELA

P O Box 1234
MIDRAND
30 April 2020

		R	R
Collection – E North vs Z North	(1)		7 500
Fees for receiving instruction	(2)	330	
Fees for issuing summons – Z North	(3)	66	
Tracing fees paid – Z North	(4)	450	
Sheriff costs – Z North	(5)	600	
Collection commission [7 500 x 10% = 750]	(6)	750	
Your ⅓ share of fees (allowance)	(7)		382*
Electronic fund transfer to yourselves	(8)	5 686	
		7 882	7 882

* ⅓ of (R330 (Fees for receiving instruction) + R66 (Fees for issuing summons) + R750 (collection commission) = R382 (1 146 x ⅓)

NB

The collection commission is 10% of the amount collected up to a maximum amount of R1 000.

To understand the *instructed attorney's account statement*, it is essential that you realise that the statement is prepared from the accounting records of the *instructed* attorney, SA Attorneys.

Neither E North nor Z North are clients of SA Attorneys. SA Attorneys acts on behalf of Langa Attorneys and therefore sends the account statement to Langa Attorneys with details on what took place with regards to the instructions received.

The figures which are shown in brackets in the above correspondent account statement have been included for discussion purposes only and the discussion follows below:

(a) Money collected by the instructed attorney (1)

According to the account statement, SA Attorneys collected R7 500 in the matter of E North v Z North. Langa Attorneys is the beneficiary and the money cannot be paid out to another party. SA Attorneys acts on behalf of Langa Attorneys, its trust creditor, and not on behalf of E North. The collection of funds is made on behalf of a third party, E North, therefore there are trust funds involved and a trust creditors' account needs to be opened in the accounting records of the instructed attorney.

(b) Fees charged (2, 3 and 6)

Fees for receiving instruction – The instructed attorney charges a fee for receiving an instruction spending his/her time on the instruction. (Refer point (d)).
Fees for issuing summons – The instructed attorney charges a fee for issuing a summons which involved spending his/her time on the issue of the summons. (Refer point (d)).
Collection commission – The instructed attorney charges a fee based on the amount collected (10%) (Refer point (e)).

(c) Expenses incurred (4 and 5)

SA Attorneys incurred expenses in collecting the money from Z North, e.g., tracing costs and sheriff costs. It can be assumed that these types of expenses were incurred before the money was collected. SA Attorneys will therefore pay fees from its *business bank account* on behalf of Langa Attorneys, with the result that Langa Attorneys becomes an ordinary client regarding these expenses.

If money is collected from Z North on behalf of Langa Attorneys, SA Attorneys will have to set off the client account and trust creditor account of Langa Attorneys against each other to determine the net amount of the trust EFT payable to Langa Attorneys.

If SA Attorneys could not collect any money from Z North, Langa Attorneys will have to compensate SA Attorneys for the expenses incurred.

(d) Professional fees (2 and 3)

SA Attorneys devoted time to collect the money from Z North, for example, time was spent on receiving instructions and on issuing the summons. Langa Attorneys is responsible for the payment of the fees levied by SA Attorneys. If SA Attorneys is unable to collect money from Z North, Langa Attorneys will still be responsible for payment of the fees.

(e) Collection commission (6)

In terms of the rules of the LPA, an attorney is entitled to 10% of all money collected by the attorney, with a limit of R1 000 per collection. This amount is adjusted from time to time, but for the purpose of this module, the R1 000 limit must be used. For collections of **more** than R15 000 per client, the attorney can only levy collection commission to the amount of R1 000.

If an attorney has to collect R30 000 and the collection is done in **instalments** of R10 000 each, the attorney is entitled to 10% of each instalment, which means that the collection commission will eventually amount to R3 000.

When SA Attorneys collects the R7 500, the firm is entitled to R750 in collection commission.

(f) Distribution of fees (7)

In terms of rules of the LPA, the instructing attorney is entitled to one-third of *all fees* (professional and collection) *levied* by the instructed attorney.

The instructing attorney, Langa Attorneys, is not entitled to one-third of any advocate fees, sheriff costs or tracing costs. These are expenses incurred on behalf of third parties and are not fees charged by the instructed attorney.

At this stage,

– SA Attorneys debits the client account of Langa Attorneys with R1 146 (R330 + R66 + R750) in respect of fees.
– Langa Attorneys is therefore entitled to R382 (⅓ of R1 146) of these fees.
– A reverse entry for this amount must be made against the **client account** of Langa Attorneys, via the fees journal.

(g) Making an EFT to the instructing attorney (8)

To determine the amount of the net debits on the client account of Langa Attorneys, the fees received minus the expenses incurred by SA Attorneys must be set off against the trust creditor account of Langa Attorneys, via the transfer journal. This will be the amount of the EFT to be sent to Langa Attorneys (R5 686).

8.6 Summary of steps in process

Has there been a collection of funds?

Step	YES	R	R	NO
Step 1	Amount collected	20 000	–	
		§ 1 000		
Step 2	Calculate the commission earned from the collection - • 10% of the amount collected (10% x R20 000 = R2 000); • Limited to R1 000. [Collection commission]	1 000	–	
		§ 380	β 380	
Step 3	What is the fee levied for receiving the instruction? [Professional fee]	380	380	What is the fee levied for receiving the instruction? [Professional fee]
		§ 2 535	β 2 500	
Step 4	What is the fee levied for preparing and issuing the summons? [Professional fee]	2 535	2 500	What is the fee levied for performing the instruction? i.e. Fees levied for Registering of a company [Professional fee]
Step 5	What is the fee levied for performing any additional instructions? i.e. preparing and collecting an acknowledgement of debt. [Professional fee]	–	–	What is the fee levied for performing any additional instructions? i.e. Time spent in attendance at court. [Professional fee]
		1 800	–	
Step 6	What is the amount for costs: • Sheriff costs • Tracing costs • Advocates fees	600 450 750	–	There are no Sheriff costs nor tracing costs incurred for this type of instruction

Has there been a collection of funds?

	YES R	NO R
Amount collected	20 000	–
Deduct: Professional fees earned:		
• Debt collection (§1 000 + §380 + §2 535)	(3 915)	
• Other services (β 380 + β 2 500)		(2 880)
Deduct: Costs to be paid	(1 800)	–
Add: Fee to be shared with the instructing attorney. [⅓ x (Professional fees + Collection commission)] (⅓ x 3 915 = 1 305) (⅓ x 2 880 = 960)	1 305	960
Amount payable to / (receivable from) the instructing attorney	15 590	(1 920)

The right-hand side of the diagram reflects the process where there is no collection of funds which means there is no trust money involved and therefore no transfer of trust funds. The *instructing* attorney is responsible for settling the account with the *instructed* attorney.

NB	
	The collection of funds (trust money) is made on behalf of a third party, E North, therefore there are trust funds involved and a trust creditors' account needs to be opened in the accounting records of the instructed attorney. *If there are no collection of trust money involved then the instructing attorney is responsible for settling the full amount of the instructed attorney's account.* *Although the process for collection of trust money and the process for other instructions has been explained, you will only be tested on the process for the collection of debt.*

8.7 Recording of the correspondent account statement in the accounting records of the *instructed* attorney

In this section of the learning unit, the steps to be followed by the *instructed* attorney to account for the transactions entered into by the instructed attorney, will be discussed.

QUICK NOTE	
	In the accounting records of the instructed attorney there will only be transactions recorded in respect of the instructing attorney. *When the accounting records of the instructing attorney are prepared there will be accounts for BOTH the client and the instructed attorney.*

Notes

EXAMPLE 8.1

The accounting entries in the accounting records of the *instructed* attorney

The following information was obtained from the accounting records of SA Attorneys:

1. On the 15 April 2020 SA Attorneys received instruction from Langa Attorneys to collect debt owing by Z North to E North.

2. The instruction was completed by 30 April and SA Attorneys invoiced Langa Attorneys.

There is no account for either E North or Z North opened in the books of the instructed attorney, SA Attorneys.

Instructing attorney

Accounting statement
SA Attorneys

Instructed attorney

P O Box 1234
MIDRAND
30 April 2020

Langa Attorneys
MBOMBELA

Clients of Langa Attorneys

		R	**R**
Collection – E North vs Z North	(1)		7 500
Fees for receiving instruction	(2)	330	
Fees for issuing summons – Z North	(3)	66	
Tracing costs paid – Z North	(4)	450	
Sheriff costs – Z North	(5)	600	
Collection commission	(6)	750	
Your ⅓ share of fees (allowance) (330 + 66 + 750) x ⅓	(7)		382
Electronic fund transfer to yourselves	(8)	5 686	
		7 882	7 882

REQUIRED:

Part A
Explain the debt collection process of a law practitioner.

Part B
Record the information as contained in the correspondent account statement in the following accounting records of SA Attorneys (*instructed* attorney):

1. Subsidiary journals
2. Ledgers
3. Trial balance

EXPLANATION 8.1

Part A

The debt collection is the process of pursuing payments of debts owed by individuals or businesses. An organisation that specialises in debt collection is known as a collection agency or debt collector. An attorney can also collect amounts owed to clients of their law practice as a result of legal matters (e.g. collection of amounts from debtors, award of maintenance, alimony). The process involves consultations with the attorney (for advice on case), telephone calls to the debtor, drafting and delivery of a letter of demand by registered post and the institution of summons proceedings and service by Sheriff. Each of these services involves a cost to the client of the law practitioner.

Part B

The *instructing* attorney (SA Attorneys) are clients in the books of the *instructed* attorney Langa Attorneys. A business account i.e. clients' account is opened in the accounting records of both SA Attorneys and Langa Attorneys. A trust creditors' account will also be opened as there is a receipt of trust money.

Account numbering used in explanation:

B1 Business bank account
B2 Trust bank account
B3 Trust creditors' control account
B4 Clients' control account
N1 Fees account
TC1 Trust creditor – Langa Attorneys
C1 Client – Langa Attorneys

Accounting records of SA Attorneys

1. Subsidiary journals

1.1 Fees journal (FJ) for April 2020

Fees charged by the instructed attorney to the instructing attorney.

FJ4

Date	Details	Fol.	Clients R	Fees R
30	Langa Attorneys (client) **(2)(3)(6)**	C1	1 146	
	Fees	N1		1 146
	Being acceptance of instruction: R330; Issuing of summons: R66; and collection commission: R750 (E North v Z North)			
	Fees **(7)**	N1	382	
	Langa Attorneys (client)	C1		382
	⅓ share of fees			
			764	764
30	Dr – Clients' control account (R1 146 – R382)		B3	
30	Cr – Fees account R764			N1

The instructed attorney shares ⅓ of the fees with the instructing attorney. This reduces the fees receivable by Langa Attorneys (instructing attorney) R1 146 x 1/3 = R382.

EXPLANATION 8.1 (continued)

1.2 Transfer journal (TJ) for April 2020

TJ4

Date	Details	Fol.	Dr R	Cr R
30	Langa Attorneys (trust creditor)	TC1	1 814*	
	Langa Attorneys (client)	C1		1 814
	Amount of EFT to be paid into business bank account			
			1 814	1 814
30	Dr – Trust creditors' control account		B3	
30	Cr – Clients control			B4

* 330 + 66 + 750 – 382 + 450 + 600 = 1 814 (As shown in the clients' account of Langa Attorneys)

1.3 Trust cash receipts journal for April 2020

TCRJ4

Date	Details	Fol.	Trust creditors R	Bank R
30	Langa Attorneys (Z North) **(1)**	TC1	7 500	7 500
			7 500	7 500
30	Dr – Trust bank account (general ledger)			B2
30	Cr – Trust creditors' control account		B3	

Client of Langa Attorneys

1.4 Trust cash payments journal for April 2020

TCPJ4

Date	Details	Fol.	Trust creditors R	Bank R
30	Langa Attorneys (payment of collection i.r.o. E North v Z North) **(8)**	TC1	5 686	5 686
	Business bank account – transfer	B1		1 814
			5 686	7 500
30	Cr – Trust bank account (general ledger)			B2
30	Dr – Trust creditors' control account		B3	

1.5 Business cash receipts journal for April 2020

BCRJ4

Date	Details	Fol.	Bank R
30	Trust bank account – transfer	B2	1 814
			1 814
30	Dr – business bank account (general ledger)		B1

EXPLANATION 8.1 (continued)

1.6 Business cash payments journal (BCPJ) for April 2020

BCPJ4

Date	**Details**	**Fol.**	**Clients R**	**Bank R**
30	Langa Attorneys (Tracing costs Z North) **(4)**	C1	450	450
	Langa Attorneys (Sheriff costs Z North) **(5)**	C1	600	600
			1 050	1 050
30	Cr – Business bank account (general ledger)			B1
30	Dr – Clients' control account		B4	

2. Ledgers

2.1 General ledger

Dr Fees account N1 Cr

			R	2020			R
30/04	Fees journal	FJ4	382	30/04	Fees journal	FJ4	1 146
30/04	Balance	c/d	764				
			1 146				1 146
				30/04	Balance	b/d	764

Dr Trust creditors' control account B3 Cr

2020			R	2020			R
30/04	Trust bank	TCPJ4	5 686	30/04	Trust bank	TCRJ4	7 500
30/04	Clients' control	TJ4	1 814				
			7 500				7 500

Dr Clients' control account B4 Cr

2020			R	2020			R
30/04	Business bank	BCPJ4	1 050	30/04	Trust creditors' control	TJ4	1 814
30/04	Fees	FJ4	764*				
			1 814				1 814

* R1 146 – R382 = R764 (see fees journal)

Dr Trust bank account B2 Cr

2020			R	2020			R
30/04	Receipts	TCRJ4	7 500	30/04	Payments	TCPJ4	7 500

EXPLANATION 8.1 (continued)

Dr			Business bank account			B1	Cr
2020			R	2020			R
30/04	Receipts	BCRJ4	1 814	30/04	Payments	BCPJ4	1 050
				30/04	Balance	c/d	764
			1 814				1 814
01/05	Balance	b/d	764				

2.2 Clients' ledger

Dr			Langa Attorneys			C1	Cr
2020			R	2020			R
30/04	Fees **(2)(3)(6)**	FJ4	1 146*	30/04	Fees **(7)**	FJ4	382
30/04	Business bank **(4)**	BCPJ4	450	30/04	Langa Attorneys (trust creditor)	TJ4	1 814
30/04	Business bank **(5)**	BCPJ4	600				
			2 196				2 196

	R
* Instruction	330
Summons	66
Collection commission	750
	1 146

In the books of SA Attorneys (the instructed attorney), a client's account (business account) and a trust creditors account are opened for the instructing attorney, Langa Attorneys.

2.3 Trust creditors' ledger

Dr			Langa Attorneys			TC1	Cr
2020			R	2020			R
30/04	Langa Attorneys (client)	TJ4	1 814	30/04	Trust bank **(1)**	TCRJ4	7 500
30/04	Trust bank **(8)**	TCPJ4	5 686				
			7 500				7 500

3. Trial balance

The following will be the trial balance compiled from the **general** ledger accounts:

	Fol.	Dr R	Cr R
Business bank account	B1	764	
Fees account	N1		764
		764	764

Notes on the trial balance of SA Attorneys at 30 April 2020

The trial balance indicates that the accounting procedures have been implemented correctly. SA Attorneys did in fact receive R68 in fees for services rendered and this amount is included in the business bank account balance. If more than one collection is made on behalf of an instructing attorney, then more than one collection may appear on the account statement. This can now be illustrated by way of example 8.2.

EXAMPLE 8.2

The accounting entries in the accounting records of the *instructed* attorney as prepared from the correspondent account statement.

Natal Attorneys send the following account statement to the *instructing* attorneys, SA Attorneys.

Account statement
Natal Attorneys

P O Box 10
BELA BELA
16 February 2020

SA Attorneys
25 Pretoria Avenue
PRETVILLE

		R	R
Collection – A South v F Cape			11 000
Fees for receiving instruction		350	
Fees for issuing summons		540	
Sheriff costs (cash)		900	
Collection commission	11 000 x 10% = 1 100 (Limited to R1 000)	1 000	
Your ⅓ share of fees	(350 + 540 + 1 000) x 1/3 = 630		630
Collection – G Langa v D West			2 800
Fees for receiving instruction		335	
Collection commission	2 800 x 10% = 280 (Limited to R1 000)	280	
Your ⅓ share of fees	(335 + 280) x 1/3 = 205		205
Electronic fund transfer to yourselves		11 230	
		14 635	14 635

REQUIRED:

Record the information as contained in the account statement in the following accounting records of Natal Attorneys (*instructed* attorneys):

1. Subsidiary journals
2. Ledgers
3. Trial balance

STEPS	*Steps in answering the question:* *Step 1 – Prepare the subsidiary journals (books of first entry). TCPJ, TCRJ, BCPJ, FJ and TJ.* *Step 2 – Prepare the general ledger accounts Fees account, Trust creditors' control account, Clients' control account, Trust bank account, Business bank account.* *Step 3 – Prepare the clients' ledger with SA Attorneys account (Client of Natal Attorneys)* *Step 4 – Prepare the Trust creditors' ledger with SA Attorneys account.* *Step 5 – Prepare the trial balance. The trial balance will balance if you have processed the transactions correctly.*

EXPLANATION 8.2

Accounting records of Natal Attorneys

Account numbering used in explanation:

B1 Business bank account
B2 Trust bank account
B3 Trust creditors' control account
B4 Clients' control account
N1 Fees account
TC1 Trust creditor – SA Attorneys
C1 Client – SA Attorneys

1. Subsidiary journals

1.1 Trust cash payments journal for February 2020

TCPJ2

Date	Details	Fol.	Trust creditors R	Bank R
16/02	SA Attorneys (A South v F Cape and G Langa v D West)	TC1	11 230	11 230
	Business bank account – transfer	B1		2 570
			11 230	13 800
28/02	Cr – Trust bank account (general ledger)			B2
28/02	Dr – Trust creditors' control account		B3	

EXPLANATION 8.2 (continued)

1.2 Trust cash receipts journal for February 2020

TCRJ2

Date	Details	Fol.	Trust creditors R	Bank R
16/02	SA Attorneys (A South v F Cape)	TC1	11 000	11 000
	SA Attorneys (G Langa v D West)	TC1	2 800	2 800
			13 800	13 800
28/02	Dr – Trust bank account (general ledger)			B2
28/02	Cr – Trust creditors' control account		B3	

1.3 Business cash payment journal for February 2020

BCPJ2

Date	Details	Fol.	Clients R	Bank R
16/02	SA Attorneys (Sheriff costs: F Cape)	C1	900	900
			900	900
28/02	Cr – Business bank account (general ledger)			B1
28/02	Dr – Clients' control account		B4	

1.4 Business cash receipts journal for February 2020

BCRJ2

Collection commission

Date	Details	Fol.	Bank R
16/02	Trust bank account – transfer (1 000 + 280)	B2	2 570
			2 570
28/02	Dr – business bank account (general ledger)		B1

Notes

EXPLANATION 8.2 (continued)

Note – the 1st journal is a debit SA Attorneys and the 2nd journal is a credit to SA Attorneys. The journals have been combined and a net posting of R1 670 has been made to SA Attorneys in the GL.

1.5 Fees journal for February 2020

FJ2

Date	Details	Fol.	Clients R	Fees R
16	SA Attorneys (client) Fees Fees for receiving instructions, issuing summons, and collection commission (350 + 540 + 1 000 + 335 + 280)	C1 N1	2 505	 2 505
	Fees SA Attorneys (client) ⅓ share of fees (630 + 205)	N1 C1	835	 835
			1 670	1 670
28 28	Dr – Clients' control account (2 505 – 835 = 1 670) Cr – Fees account		B3	 N1

1.6 Transfer journal for February 2020

TJ2

Date	Details	Fol.	Dr R	Cr R
16	SA Attorneys (trust creditor) (see NB below) SA Attorneys (client) EFT amount to be transferred to business bank account	TC1 C1	2 570	 2 570
			2 570	2 570
30 30	Dr – Trust creditors' control account Cr – Clients' control account		B3	 B4

* 350 + 540 + 900 + 1 000 – 630 + 335 + 280 – 205 = 2 570 (As shown in the clients' account of SA Attorneys)

NB	*A debit entry in a journal entry is indicated by making it the first entry and then the credit entry will be the second entry as well as the entry being indented.*

2. Ledgers

2.1 General ledger

Dr | **Fees account** | **N1** | **Cr**

			R	2020			R
28/02	Fees journal	FJ2	835	28/02	Fees journal	FJ2	2 505
28/02	Balance	c/d	1 670				
			2 505				2 505
				28/02	Balance	b/d	1 670

EXPLANATION 8.2 (continued)

Dr **Trust creditors' control account** **A10** **Cr**

2020			R	2020			R
28/02	Trust bank	TCPJ2	11 230	28/02	Trust bank	TCRJ2	13 800
28/02	Clients' control	TJ2	2 570				
			13 800				13 800

Dr **Clients' control account** **B4** **Cr**

2020			R	2020			R
28/02	Business bank	BCPJ2	900	28/02	Trust creditors' control	TJ2	2 570
28/02	Fees	FJ2	1 670				
			2 570				2 570

Dr **Trust bank account** **B2** **Cr**

2020			R	2020			R
28/02	Receipts	TCRJ2	13 800	28/02	Payments	TCPJ2	13 800
			13 800				13 800

Dr **Business bank account** **B1** **Cr**

2020			R	2020			R
28/02	Receipts	TCPJ2	2 570	28/02	Payments	BCPJ2	900
				28/02	Balance	c/d	1 670
			2 570				2 570
01/03	Balance	b/d	1 670				

Sheriff costs

2.2 Clients' ledger

Dr **SA Attorneys** **C1** **Cr**

2020			R	2020			R
16/02	Business bank	BCPJ	900	16/02	Fees	FJ2	835
28/02	Fees	FJ	2 505	28/02	SA Attorneys (trust creditor)	TJ2	2 570
			3 405				3 405

EXPLANATION 8.2 (continued)

2.3 Trust creditors' ledger

Dr **SA Attorneys** **TC1** **Cr**

2020			R	2020			R
16/02	Trust bank	TCPJ2	11 230	16/02	Trust bank	TCRJ2	11 000
28/02	SA Attorneys (client)	TJ2	2 570	28/02	Trust bank	TCRJ2	2 800
			13 800				13 800

3. Trial balance

Trial balance of Natal Attorneys at 28 February 2020

	Fol.	Dr R	Cr R
Business bank account	B1	1 670	
Fees account	N1		1 670
		1 670	1 670

Notes

8.8 Recording of the correspondent account statement in the accounting records of the *instructed* attorney (including VAT)

In this section of the learning unit, the steps to be followed by the *instructed* attorney, to account for the transactions entered into by the *instructed* attorney, will be illustrated by Question 8.3. The question deals with the impact of VAT on the accounting transactions.

EXAMPLE 8.3

The accounting entries in the accounting records of the *instructed* attorney as prepared from the account statement.

North Attorneys sent the following account statement to the *instructing* attorneys, Africa Attorneys.

Account statement
North Attorneys

Africa Attorneys PO Box 12124 Tshwane		PO Box 555 Stanger 31 May 2020
	R	**R**
Collection – W West v N Nam		15 000
Sheriff costs	217	
Fee for receiving instruction	430	
Fee for preparation of summons	150	
Correspondence fee	26	
Fee for drafting of admission of guilt	60	
Collection commission	1 000	
Your ⅓ share of fees		555
VAT @ 15% (R1 666 x 15%); (R555 x 15%)	250	83
Electronic fund transfer to yourselves	13 505	
W West v F West – divorce case		
Fee for receiving instruction	300	
Advocate for divorce case	330	
Sheriff costs	21	
Your ⅓ allowance of fees		100
VAT @ 15% (R300 x 15%); (R100 x 15%)	45	15
Amount owing		581
	16 334	16 334

REQUIRED:

Record the information as contained in the corresponding account statement, in the following accounting records of North Attorneys:

1. Subsidiary journals
2. Ledgers
   2.1 General ledger
   2.2 Clients' ledger
   2.3 Trust creditors' ledger
3. Prepare the trial balance

EXPLANATION 8.3

Accounting records of North Attorneys

1. Subsidiary journals

1.1 Trust cash receipts journal for May 2020

TCRJ5

Date	Details	Fol.	Trust creditors R	Bank R
31/05	Africa Attorneys (W West v N Nam)	T5	15 000	15 000
			15 000	15 000
31/05	Dr – Trust bank account			G4
31/05	Cr – Trust creditors' control account		G10	

1.2 Trust cash payments journal for May 2020

TCPJ5

Date	Details	Fol.	Trust creditors R	Bank R
31/05	Africa Attorneys (W West v N Nam)	T5	13 505	13 505
31/05	Business bank account – transfer	C		1 495
			13 505	15 000
31/05	Dr – Trust creditors' control account		G10	
31/05	Cr – Trust bank account			G4

EXPLANATION 8.3 (continued)

1.3 Business cash receipts journal for May 2020

BCRJ5

Date	**Details**	**Fol.**	**Clients R**	**Bank R**
31/05	Trust bank account	C		1 495
				1 495
31/05	Dr – Business bank account			G5

1.4 Business cash payments journal for May 2020

BCPJ5

Date	**Details**	**Fol.**	**Clients R**	**Bank R**
31/05	Africa Attorneys (Sheriff costs – W West: 217 + 21) Africa Attorneys (Advocate – W West)	D9 D9	238 330	238 330
			568	568
31/05	Cr – Business bank account			G5
31/05	Dr – Clients' control account		G11	

1.5 Fees journal for May 2020

FJ5

Date	**Details**	**Fol.**	**Clients R**	**Fees R**
31/05	Africa Attorneys (client)	D9	2 261	
	Fees			1 966
	VAT			295
	Fees for receiving instructions: (430 + 300); issuing of summons: R150; correspondence R26; admission of guilt: R60; collection commission: R1 000			
31/05	Fees		655	
	VAT		98	
	Africa Attorneys (client)	D9		753
	⅓ share of fees			

Combined journal entry:

31/05	Dr – Clients' control account (2 261 – 753)	G11	1 508	
31/05	Cr – Fees account (1 966 – 655)	G14		1 311
31/05	Cr – VAT control account (250 – 83 + 45 – 15)	G17		197

EXPLANATION 8.3 (continued)

1.6 Transfer journal for May 2020

TJ5

Date	Details	Fol.	Dr R	Cr R
31/05	Africa Attorneys (trust creditor)(W West v N Nam)	T5	1 495	
	Africa Attorneys (client)	D9		1 495
	Amount of EFT to be transferred to business bank account			
			1 495	1 495
31/05	Dr – Trust creditors' control account		G10	
31/05	Cr – Clients' control account			G11

2. Ledgers

2.1 General ledger

Dr — Trust bank account — G4 — Cr

2020			R	2020			R
31/05	Receipts	TCRJ5	15 000	31/05	Payments	TCPJ5	15 000
			15 000				15 000

Dr — Business bank account — G5 — Cr

2020			R	2020			R
31/05	Receipts	BCRJ5	1 495	31/05	Payments	BCPJ5	568
				31/05	Balance	c/d	927
			1 495				1 495
01/06	Balance	b/d	927				

Dr — Trust creditors' control account — G10 — Cr

2020			R	2020			R
31/05	Trust bank	TCPJ5	13 505	31/05	Trust bank	TCRJ5	15 000
31/05	Clients' control	TJ5	1 495				
			15 000				15 000

Dr — Clients' control account — G11 — Cr

2020			R	2020			R
31/05	Fees and VAT	FJ5	1 508	31/05	Trust creditors' control	TJ5	1 495
	Business bank	BCPJ5	568	31/05	Balance	c/d	581
			2 076				2 062
01/06	Balance	b/d	581				

EXPLANATION 8.3 (continued)

Dr — Fees account — G14 — Cr

		R	2020			R
			31/05	Fees journal credits	FJ5	1 311

Dr — VAT control account — G17 — Cr

		R	2020			R
			31/05	Journal credits	FJ5	197

2.2 Clients' ledger

Dr — Africa Attorneys — D9 — Cr

2020			R	2020			R
31/05	Business bank	BCPJ5	238	31/05	Fees and VAT	FJ5	753
	Business bank	BCPJ5	330	31/05	Africa Attorneys (trust creditor) (W West v N Nam)	TJ5	1 495
	Fees and VAT	FJ5	2 261	31/05	Balance	c/d	581
			2 829				2 829
01/06	Balance	b/d	581				

2.3 Trust creditors' ledger

Dr — Africa Attorneys (iro W West v N Nam) — T5 — Cr

2020			R	2020			R
31/05	Trust bank	TCPJ5	13 505	31/05	Trust bank	TCRJ5	15 000
31/05	Africa Attorneys (client)	TJ5	1 495				
			15 000				15 000

3. Trial balance

Trial balance of North Attorneys at 31 May 2020

	Dr R	Cr R
Business bank account	927	
Clients control account	581	
Fees account		1 311
VAT control account		197
	1 508	1 508

8.9 Recording of the correspondent account statement in the accounting records of the *instructing* attorney

In this section of the learning unit, the steps to be followed by the *instructing* attorney, to account for the transactions entered into by the instructed attorney, will be discussed.

QUICK NOTE	*In the accounting records of the instructed attorney there will only be transactions recorded in respect of the instructing attorney.* *When the accounting records of the instructing attorney are prepared there will be accounts for BOTH the client and the instructed attorney.*

The discussion refers to the correspondent account statement of SA Attorneys at the start of this learning unit.

EXAMPLE 8.4

For ease of reference the correspondent account statement of SA Attorneys follows:

Correspondent account statement

Accounting statement
SA Attorneys $

Langa Attorneys ×
MBOMBELA

P O Box 1234
MIDRAND
30 April 2020

	R	R
Collection – E North v Z North		7 500
Fees for receiving instruction	330	
Fees for issuing summons – Z North	66	
Tracing fees paid – Z North	450	
Sheriff costs – Z North	600	
Collection commission Ω	750	
Your ⅓ share of fees (allowance) β		382
Electronic fund transfer to yourselves	5 686	
	7 882	7 882

× The instructing attorney
$ The instructed attorney
Ω Collection commission: 7 500 x 10% = 750
β R330 + R66 + R750 = 1 146 x ⅓ = 382

Discussion:

Langa Attorneys (instructing attorney) should apply the following steps to account for the transactions:

STEPS	*Step 1 – Receipt of correspondent account statement and electronic fund transfer*

Where an account statement to which an EFT is attached, is received from an instructed attorney, the most important duty of the instructing attorney (Langa Attorneys) is to immediately issue a **trust** receipt on receipt of the deposit in the trust bank account. It follows that the instructing attorney must credit a trust creditor's account with the amount, namely, SA Attorneys (the instructed attorney).

(T-accounts are used to facilitate the explanation – the journal entries are shown in a separate section).

The following entry is made.

Trust bank

	R	
SA Attorneys (trust creditor)	5 686	

SA Attorneys (trust creditor)

		R
	Trust bank	5 686

STEPS	*Step 2 – Distribution of the original collection*

The next step is to record all the entries appearing on the account statement. Every entry made by the instructed attorney on the account statement is the result of such attorney acting on the instructions of the instructing attorneys, Langa Attorneys (to collect money from Z North on behalf of E North). Each entry must be analysed and recorded in the relevant journal, after distinguishing clearly between business transactions and trust transactions. The following entries are made

- *To transfer the R7 500 to the trust creditors account of E North:*

SA Attorneys (trust creditor)

	R	
E North	7 500	

E North (trust creditor)

		R
	SA Attorneys	7 500

This entry is made in order to transfer the cash collected by SA Attorneys to the trust creditors' account of E North. E North is the client (trust creditor) of Langa Attorneys and is accountable to him.

- *To debit the total expenses incurred and fees levied by SA Attorneys in respect of E North, to the latter's account:*

SA Attorneys (trust creditor)

			R
		E North (330 + 66 + 450 + 600 + 750)	2 196

E North (trust creditor)

	R		
SA Attorneys	2 196		

This entry is made because E North is liable for the expenses incurred by SA Attorneys in respect of the collection.

- *To record the fees earned by Langa Attorneys:*

SA Attorneys (client)

	R		
Fees (1 146 x $^{1}/_{3}$)	382		

Fees

			R
		SA Attorneys	382

The purpose of this entry is to record the one-third of the fees to which Langa Attorneys is entitled. Because this is fees, it amounts to a business transaction and a client account is therefore opened for SA Attorneys. A direct debit entry cannot be made to the trust creditor account of SA Attorneys.

- *When all the entries appearing on the account statement have been recorded, the ledger accounts must be examined to ensure that they reflect the true state of affairs:*

Trust creditors' ledger of Langa Attorneys

SA Attorneys

	R		**R**
E North	7 500	Trust bank E North	5 686 2 196

E North

	R		R
SA Attorneys	2 196	SA Attorneys	7 500

Clients' ledger of Langa Attorneys

SA Attorneys

	R		R
Fees ($^{1}/_{3}$ share of fees)	382		

- *The trust creditor account of SA Attorneys has a credit balance of R382, and the client account has a debit balance of R382. A transfer is made from the trust creditor account to the client account of SA Attorneys via the transfer journal, and an EFT is made to deposit R382 into the business bank account.*

SA Attorneys (trust creditor)

	R		R
SA Attorneys (client)	382		

SA Attorneys (client)

	R		R
		SA Attorneys (trust creditor)	382

Trust bank

	R		R
		Business bank	382

Business bank

	R		
Trust bank	382		

When this entry has been completed, the client account and the trust creditor account of SA Attorneys will be closed off as shown in the next section.

The account of E North has a credit balance of R5 304, which represents the amount owing to him and will be settled via an EFT.

STEPS	*Step 3 – Recording in subsidiary journals*

To gain an overall idea of the accounting process, study the recording of the various transactions in the different subsidiary journals and ledger accounts in the accounting records of Langa Attorneys.

EXPLANATION 8.4

Account numbering used in explanation:

B1	Business bank account
B2	Trust bank account
B3	Trust creditors' control account
B4	Clients' control account
N1	Fees account
TC1	Trust creditor – SA Attorneys
TC2	Trust creditor – E North
C1	Client – SA Attorneys

Accounting records of Langa Attorneys

Subsidiary books

1.1 Trust cash receipts journal for April 2020

TCRJ4

Date	Details	Fol.	Trust creditors R	Bank R
30/04	SA Attorneys (amount received – E North v Z North)	TC1	5 686	5 686
30/04	Dr – Trust bank account (general ledger)	B2		5 686
30/04	Cr – Trust creditors' control account	B3	5 686	

1.2 Trust cash payments journal for April 2020

TCPJ4

Date	Details	Fol.	Bank R
30/04	Business bank account (EFT – transfer to business bank account)	B1	382
30/04	Cr – Trust bank account (general ledger)		B2

1.3 Business cash receipts journal for April 2020

BCRJ4

Date	Details	Fol.	Bank R
30/04	Trust bank account (transfer from trust bank account as per transfer journal)	B2	382
30/04	Dr – Business bank account (general ledger)		B1

EXPLANATION 8.4 (continued)

1.4 General journal for April 2020

GJ4

Date	Details	Fol.	Dr R	Cr R
30/04	SA Attorneys (trust creditor)	TC1	7 500	
	E North (trust creditor)	TC2		7 500
	Amount recovered from Z North			
30/04	E North (trust creditor)	TC2	2 196	
	SA Attorneys (trust creditor)	TC1		2 196
	Expenses incurred by SA Attorneys on behalf of E North			
			9 696	9 696
30/04	Dr – Trust creditors' control account*		B3	
30/04	Cr – Trust creditors' control account*			B3

NB

***In this instance, these two entries happen to have the same totals, but in practice, this need not necessarily be the case.**

Fees of the instructed attorney R330 + R66 + R750 = R1 146 plus tracing fees R450, and Sheriff costs, R600 = R2 196

1.5 Fees journal for April 2020

FJ4

Date	Details	Fol.	Clients R	Fees R
30/04	SA Attorneys (client)	C1	382	
	Fees	N1		382
	⅓ share of fees			
			382	382
30/04	Dr – Clients' control account		B4	
30/04	Cr – Fees account			N1

1.6 Transfer journal for April 2020

TJ14

Date	Details	Fol.	Dr R	Cr R
34	SA Attorneys (trust creditor)	TC1	382	
	SA Attorneys (client)	C1		382
	Amount to be transferred to business bank account			
			382	382
30	Dr – Trust creditors' control account		B3	
30	Cr – Clients' control account			B4

EXPLANATION 8.4 (continued)

General ledger

From general journal.
See folio

Langa Attorneys

Dr **Trust creditors' control account** B3 Cr

2020		Fol.	R	2020		Fol.	R
30/04	Clients' control	TJ4	382	30/04	Trust Bank	TCRJ4	5 686
30/04	Journal debits	GJ4	9 696	30/04	Journal credits	GJ4	9 696
30/04	Balance	c/d	5 304				
			15 382				15 382
				01/05	Balance	b/d	5 304

Dr **Clients' control account** B4 Cr

2020		Fol.	R	2020		Fol.	R
30/04	Journal debits	FJ4	382	30/04	Trust creditors' control	TJ4	382
			382				382

The balance is therefore "NIL"

Dr **Fees account** N1 Cr

				2020		Fol.	R
				30/04	SA Attorneys	FJ4	382

Dr **Business bank account** A4 Cr

2020		Fol.	R				
30/04	Receipts	BCRJ4	382				

Dr **Trust bank account** A5 Cr

2020		Fol.	R	2020		Fol.	R
30/04	Receipts	TCRJ4	5 686	30/04	Payments	TCPJ4	382
				30/04	Balance	c/d	5 304
			5 686				5 686
01/05	Balance	b/d	5 304				

EXPLANATION 8.4 (continued)

Clients' ledger

Langa Attorneys

Dr		SA Attorneys				D1	Cr
2020		**Fol.**	**R**	2020		**Fol.**	**R**
30/04	Fees	FJ4	382	30/04	SA Attorneys (trust creditor)	TJ4	382

Trust creditors' ledger

Langa Attorneys

Dr		SA Attorneys				TC1	Cr
2020		**Fol.**	**R**	2020		**Fol.**	**R**
30/04	E North (trust creditor)	GJ4	7 500	30/04	Trust bank	TCRJ4	5 686
30/04	SA Attorneys (client)	TJ4	382	30/04	E North (trust creditor)	GJ4	2 196
			7 882				7 882

The balance is therefore "NIL"

Dr		E North				TC2	Cr
2020		**Fol.**	**R**	2020		**Fol.**	**R**
30/04	SA Attorneys (trust creditor)	GJ4	2 196	30/04	SA Attorneys (trust creditor)	GJ4	7 500
30/04	Balance	c/d	5 304				
			7 500				7 500
				01/05	Balance	b/d	5 304

Trial balance

Trial balance of Langa Attorneys at 30 April 2020

	Dr R	**Cr R**
Fees		382
Business bank	382	
Trust bank	5 304	
Trust creditors control (E North)		5 304
	5 686	5 686

Langa Attorneys' one-third (⅓) share of the fees, as claimed by SA Attorneys, is not recorded in the account of Langa Attorneys' client (E North), as this is a matter between the two firms of attorneys. When Langa Attorneys (the instructing attorney) therefore send their client (E North) a final statement, mention will be made in it of:

(a) the amount collected; and

(b) the fees and expenses claimed by SA Attorneys (the **instructed** attorneys).

EXAMPLE 8.5

The accounting entries in the accounting records of the *instructing* attorney as prepared from the correspondent account statement

The firm of Nam Attorneys receives the following account statement from its correspondent, Kwa Attorneys:

Account statement **Kwa Attorneys**		
Nam Attorneys 25 Pretoria Avenue Pretville	Instructing attorney	PO Box 10 Bela Bela 16 February 2020

	R	R
Collection – S Africa v C Cape		9 000
Fees for receiving instruction	500	
Fees for issuing summons	440	
Sheriff costs (cash)	390	
Collection commission	900	
Your ⅓ share of fees ((500 + 400 + 900) x ⅓)		600
	2 230	9 600
Claim – A South v W West		7 000
Fees for receiving instruction	800	
Collection commission	700	
Your ⅓ share of fees ((800 + 700) x ⅓)		500
	3 730	17 100
Electronic fund transfer to yourselves	13 370	
	17 100	17 100

REQUIRED:

Record the information as contained in the account statement from Kwa Attorneys in the following accounting records of Nam Attorneys (the instructing attorneys):

1. Subsidiary journals
2. Ledgers
   - 2.1 General ledger
   - 2.2 Clients' ledger
   - 2.3 Trust creditors' ledger
3. Trial balance

Notes

EXPLANATION 8.5

Accounting records of Nam Attorneys

Account numbering used in explanation:

B1 Business bank account
B2 Trust bank account
B3 Trust creditors' control account
B4 Clients' control account
N1 Fees account
TC1 Trust creditor – Kwa Attorneys
TC2 Trust creditor – S Africa
TC3 Trust creditor – A South
C1 Client – Nam Attorneys

1. Subsidiary journals

1.1 Trust cash receipts journal for February 2020

TCRJ2

Date	Details	Fol.	Trust creditors R	Bank R
28/02	Kwa Attorneys (trust creditor)	TC1	13 370	13 370
28/02	Dr – Trust bank account			B2
28/02	Cr – Trust creditors' control account		B3	

1.2 Trust cash payments journal for February 2020

TCPJ2

Date	Details	Fol.	Trust creditors R	Bank R
28/02	Business bank account (transfer) S Africa (9 000 – 500 – 440 – 390 – 900) A South (7 000 – 800 – 700)	B1 TC2 TC3	 6 770 5 500	1 100 6 770 5 500
			12 270	13 370
28/02	Cr – Trust bank account			B2
28/02	Dr – Trust creditors' control account		B3	

Notes

EXPLANATION 8.5 (continued)

1.3 Business cash receipts journal for February 2020

BCRJ2

Date	Details	Fol.	Bank R
28/02	Trust bank account (transfer)	B2	1 100
28/02	Dr – Business bank account		B1

1.4 Transfer journal for February 2020

TJ2

Date	Details	Fol.	Dr R	Cr R
28/02	Kwa Attorneys (trust creditor) Kwa Attorneys (client) *EFT transferred to the business bank*	TC1 C1	1 100	 1 100
			1 100	1 100
28/02	Dr – Trust creditors' control account		B3	
28/02	Cr – Clients' control account			B4

1.5 General journal for February 2020

GJ2

Date	Details	Fol.	Dr R	Cr R
28/02	Kwa Attorneys (trust creditor) S Africa (trust creditor) *Money collected by Kwa Attorneys (S Africa v C Cape)*	TC1 TC2	9 000	 9 000
28/02	S Africa (trust creditor) Kwa Attorneys (trust creditor) *Fees charged and expenses incurred by Kwa Attorneys to collect money from C Cape (500 + 440 + 390 + 900)*	TC2 TC1	2 230	 2 230
28/02	Kwa Attorneys (trust creditor) A South (trust creditor) *Money collected by Kwa Attorneys (A South v W West)*	TC1 TC3	7 000	 7 000
28/02	A South (trust creditor) Kwa Attorneys (trust creditor) *Fees charged and expenses incurred by Kwa Attorneys to collect money from W West (800 + 700)*	TC3 TC1	1 500	 1 500
			12 270	12 270
28/02	Dr – Trust creditors' control account		B3	
28/02	Cr – Trust creditors' control account			B3

EXPLANATION 8.5 (continued)

1.6 Fees journal for February 2020

FJ2

Date	Details	Fol.	Clients R	Fees R
28/02	Kwa Attorneys (client)	C1	1 100	
	Fees	N1		1 100
	⅓ share of fees charged by Kwa Attorneys paid to SA Attorneys. S Africa v C Cape R70; A South v W West R40			
			1 100	1 100
28/02 Dr – Clients' control account			B4	
28/02 Cr – Fees account				N1

2. Ledgers

2.1 General ledger

From the fees journal

Dr **Fees account** **N1** **Cr**

				2020		**Fol.**	**R**
				28/02	Kwa Attorneys (client)	FJ2	1 100

From the general journal. Take note of Folio

Dr **Trust creditors' control account** **B3** **Cr**

2020		**Fol.**	**R**	2020		**Fol.**	**R**
28/02	Client control	TJ2	1 100	28/02	Trust bank	TCRJ2	13 370
28/02	Journal debits	GJ2	12 270	28/02	Journal credits	GJ2	12 270
28/02	Trust bank	TCPJ2	12 270				
			25 640				25 640

Dr **Clients' control account** **B4** **Cr**

2020		**Fol.**	**R**	2020		**Fol.**	**R**
28/02	Journal debits (fees journal)	FJ2	1 100	28/02	Trust creditors' control	TJ2	1 100
			1 100				1 100

Dr **Trust bank account** **B2** **Cr**

2020		**Fol.**	**R**	2020		**Fol.**	**R**
28/02	Receipts	TCRJ2	13 370	28/02	Payments	TCPJ2	13 370
			13 370				13 370

EXPLANATION 8.5 (continued)

Dr **Business bank account** **B1** **Cr**

2020		Fol.	R				
28/02	Receipts	BCRJ2	1 100				

2.2 Clients' ledger

Dr **Kwa Attorneys** **C1** **Cr**

2020		Fol.	R	2020		Fol.	R
28/02	Fees	FJ2	1 100	28/02	Kwa Attorneys (trust creditor)	TJ2	1 100

2.3 Trust creditors' ledger

Dr **Kwa Attorneys** **TC1** **Cr**

2020		Fol.	R	2020		Fol.	R
28/02	S Africa (trust creditor)	GJ2	9 000	28/02	Trust bank	TCRJ2	13 370
28/02	A South (trust creditor)	GJ2	7 000	28/02	S Africa (trust creditor)	GJ2	2 230
28/02	Kwa Attorneys (client)	TJ2	1 100	28/02	A South (trust creditor)	GJ2	1 500
			17 100				17 100

Dr **S Africa** **TC2** **Cr**

2020		Fol.	R	2020		Fol.	R
28/02	Kwa Attorneys (trust creditor)	GJ2	2 230	28/02	Kwa Attorneys (trust creditor)	GJ2	9 000
28/02	Trust bank	TCPJ2	6 770				
			9 000				9 000

Dr **A South** **TC3** **Cr**

2020		Fol.	R	2020		Fol.	R
28/02	Kwa Attorneys (trust creditor)	GJ2	1 500	28/02	Kwa Attorneys (trust creditor)	GJ2	7 000
28/02	Trust bank	TCPJ2	5 500				
			7 000				7 000

EXPLANATION 8.5 (continued)

3. Trial balance

Trial balance of Nam Attorneys at 28 February 2020

	Dr R	Cr R
Business bank account	1 100	
Fees account		1 100
	1 100	1 100

8.10 Recording of the correspondent account statement in the accounting records of the *instructing* attorney (including VAT)

EXAMPLE 8.6

The accounting entries of correspondent transactions in the accounting records of first entry and ledgers of an *instructing* attorney (Including VAT).

The attorneys practice Africa Attorneys received the following account statement from its correspondent, Cape Attorneys:

Account statement **Cape Attorneys**		PO Box 555 Stanger 31 May 2020
Africa Attorneys PO Box 12124 Pretoria		
	R	**R**
Collection – C Natal v D Western		15 000
Sheriff costs	217	
Fee for receiving instruction	430	
Fee for preparation of summons	150	
Fee for drafting letter of intent	160	
Collection commission	1 000	
Your ⅓ share of fees		580
VAT @ 15%	261	87
Collection – C Natal v D Natal (Maintenance)		8 500
Fee for receiving instruction	290	
Advocate for court case	330	
Sheriff costs	187	
Collection commission	850	
Your ⅓ share of fees		380
VAT @ 15%	171	57
Electronic fund transfer to yourselves	20 558	
	24 604	24 604

Additional information

1. Africa Attorneys paid C Natal the amount collected.
2. Africa Attorneys do not have permission to settle the accounts of the different matters against each other.

Proof of calculation of VAT:

Fee income for matter: C Natal v D Western

430 + 150 + 160 + 1 000	=	1 740
	=	1 740 x 15%
VAT	=	261

Fee income for matter: C Natal v D Natal

290 + 850	=	1 140
	=	1 140 x 15%
VAT	=	171

REQUIRED:

Record the information as contained in the correspondent account statement from Cape Attorneys in the following accounting records of Africa Attorneys (the instructing attorney):

1. Subsidiary journals
2. Ledgers
   2.1 General ledger
   2.2 Clients ledger
   2.3 Trust creditors ledger
3. Trial balance

(Round off all amounts to the nearest R1.)

EXPLANATION 8.6

Accounting records of Africa Attorneys *(instructing)*

Account numbering used in explanation:

B1	Business bank account
B2	Trust bank account
B3	Trust creditors' control account
B4	Clients' control account
B5	VAT control account
N1	Fees account
TC1	Trust creditor – Cape Attorneys
TC2	Trust creditor – C Natal (v D Western)
TC3	Trust creditor – C Natal (v D Natal)
C1	Client – Cape Attorneys
C2	Client – C Natal (v D Western)

EXPLANATION 8.6 (continued)

1. Subsidiary journals

1.1 Trust cash receipts journal for May 2020

TCRJ5

Date	Details	Fol.	Trust creditors R	Bank R
31/05	Cape Attorneys (trust creditor)	TC1	20 558	20 558
31/05	Dr – Trust bank account			B2
31/05	Cr – Trust creditors' control account		B3	

1.2 Trust cash payments journal for May 2020

TCPJ5

Date	Details	Fol.	Trust creditors R	Bank R
31/05	C Natal (trust creditor matter: C Natal v D Western)	TC2	12 782	12 782
	Business bank account – transfer (C Natal v D Western)	B1		667
	C Natal (trust creditor matter: C Natal v D Natal)	TC3	6 672	6 672
	Business bank account – transfer (C Natal v D Natal)	B1		437
			19 454	20 558
31/05	Cr – Trust bank account			B2
31/05	Dr – Trust creditors' control account		B3	

1.3 Business cash receipts journal for May 2020

BCRJ5

Date	Details	Fol.	Clients R	Bank R
31/05	Trust bank account – transfer (C Natal v D Western)	B2	–	667
31/05	Trust bank account – transfer (C Natal v D Natal)	B2	–	437
			–	1 104
31/05	Dr – Business bank account			B1

Notes

EXPLANATION 8.6 (continued)

1.4 Transfer journal for May 2020

TJ5

Date	Details	Fol.	Dr R	Cr R
31/05	Cape Attorneys (trust creditor) (C Natal v D Western)	TC2	667	
	Cape Attorneys (trust creditor) (C Natal v D Natal)	TC3	437	
	Cape Attorneys (client)	C1		1 104
	Transfer to business bank account (C Natal v D Western 667 + C Natal v D Natal 437)			
			1 104	1 104
31/05	Dr – Trust creditors' control account		B3	
31/05	Cr – Clients' control account			B4

1.5 General journal for May 2020

GJ5

Date	Details	Fol.	Dr R	Cr R
31/05	Cape Attorneys (trust creditor)	TC1	15 000	
	C Natal (trust creditor C Natal v D Western)	TC2		15 000
	Money collected by Cape Attorneys (C Natal v D Western)			
31/05	C Natal (trust creditor C Natal v D Western)	TC2	2 218	
	Cape Attorneys (trust creditor)	TC1		2 218
	Fees charged and expenses incurred by Cape Attorneys to regarding matter C Natal v D Western: Fees R1 740 (430 + 150 + 160 + 1 000), Sheriff costs R217 and VAT R261.			
31/05	Cape Attorneys (trust creditor)	TC1	8 500	
	C Natal (trust creditor C Natal v D Natal)	TC3		8 500
	Money collected by Cape Attorneys (C Natal v D Natal)			
31/05	C Natal (trust creditor C Natal v D Natal)	TC3	1 828	
	Cape Attorneys (trust creditor)	TC1		1 828
	Fees charged and expenses incurred by Cape Attorneys regarding maintenance case C Natal v D Natal: Fees R1 140 (R290 + 850), Advocate fee R330, Sheriff costs R187 and VAT R171.			
			19 454	19 454
31/05	Dr – Trust creditors' control account		B3	
31/05	Cr – Trust creditors' control account			B3

EXPLANATION 8.6 (continued)

1.6 Fees journal for May 2020

FJ5

Date	Detail	Fol.	Clients R	Fees R
31/05	Cape Attorneys (client)	C1	667	
	Fees	N1		580
	VAT	B5		87
	⅓ share of fees (including VAT) charged by Cape Attorneys (C Natal v D Western)			
	Cape Attorneys (client)	C1	437	
	Fees	N1		380
	VAT	B5		57
	⅓ share of fees (including VAT) charged by Cape Attorneys (C Natal v D Natal)			
31/05	Dr – Clients' control account	B4	1 104	1 104

2. Ledgers

2.1 General ledger

Dr Trust bank account B2 Cr

2020			R	2020			R
31/05	Receipts	TCRJ5	20 558	31/05	Payments	TCPJ5	20 558
			20 558				20 558

Dr Business bank account B1 Cr

2020			R				
31/05	Receipts	BCRJ5	1 104				

Dr Trust creditors' control account B3 Cr

2020			R	2020			R
31/05	Trust bank	TCPJ5	19 454	31/05	Trust bank	TCRJ5	20 558
31/05	Clients' control	TJ5	1 104	31/05	Journal credits	GJ5	19 454
31/05	Journal debits	GJ5	19 454				
			40 012				40 012

EXPLANATION 8.6 (continued)

Dr — Clients' control account — B4 — Cr

2020			R	2020			R
31/05	Journal debits	FJ5	1 104	31/05	Trust creditors' control	TJ5	1 104
			1 104				1 104

Dr — Fees account — N1 — Cr

				2020			R
				31/05	Cape Attorneys (client)	FJ5	580
				31/05	Cape Attorneys (client)	FJ5	380
							960

Dr — VAT control account — B5 — Cr

				2020			R
				31/05	Cape Attorneys (client)	FJ5	87
				31/05	Cape Attorneys (client)	FJ5	57
							144

2.2 Clients' ledger

Dr — Cape Attorneys — C1 — Cr

2020			R	2020			R
31/05	Fees & VAT (580 + 87)	FJ5	667	31/05	Cape Attorneys (trust creditor)	TJ5	1 104
31/05	Fees & VAT (380 + 57)	FJ5	437				
			1 104				1 104

2.3 Trust creditors' ledger

Dr — Cape Attorneys — TC1 — Cr

2020			R	2020			R
31/05	Cape Attorneys (client)	TJ5	1 104	31/05	Trust bank	TCRJ5	20 558
31/05	C Natal (trust creditor)	GJ5	15 000	31/05	C Natal (trust creditor)	GJ5	2 218
31/05	C Natal (trust creditor)	GJ5	8 500	31/05	C Natal (trust creditor)	GJ5	1 828
			24 604				24 604

EXPLANATION 8.6 (continued)

Dr C Natal (in respect of C Natal v D Western) TC2 Cr

2020			R	2020			R
31/05	Trust bank	TCPJ5	12 782	31/05	Cape Attorneys (trust creditor)	GJ5	15 000
31/05	Cape Attorneys (trust creditor)	GJ5	2 218				
			15 000				15 000

Dr C Natal (in respect of C Natal v D Natal) TC3 Cr

2020			R	2020			R
31/05	Trust bank	TCPJ5	6 672	31/05	Cape Attorneys (trust creditor)	GJ5	8 500
31/05	Cape Attorneys (trust creditor)	GJ5	1 828				
			8 500				8 500

3. Trial balance

Trial balance of Africa Attorneys at 31 May 2020

	Dr R	Cr R
Business bank account	1 104	
Fees account		960
VAT control account		144
	1 104	1 104

Notes

8.11 Self-assessment questions

Questions	Answers
What is the legal definition of correspondents?	
Distinguish between the instructing and instructed attorney.	
Which attorney compiles the correspondent account statement?	
Explain the first accounting step of an instructing attorney if a statement is received from a correspondent.	
Name the account in the general ledger that will indicate the amount which must be available in the trust bank account.	
Explain why an instructing attorney always has more than one trust creditor.	
The money collected by an instructed attorney from a third party constitutes business money. TRUE/FALSE	
The expenses incurred by an instructed attorney are paid out of the business bank account. TRUE/FALSE	
List the type of fees that can be charged by the instructed attorney.	

Questions	Answers
What is a correspondent allowance?	
Calculate the correspondent allowance if the professional and collection fees charged by the instructed attorney amount to R9 000. The instructed attorney is **<u>not</u>** a VAT vendor.	
Calculate the correspondent allowance if the professional and collection fees charged by the instructed attorney amount to R9 000. The instructed attorney is a VAT vendor.	
What is a collection cost?	
What is a collection commission?	
Calculate collection commission if the attorney was instructed to collect debt of R34 000.	
Calculate collection commission if the attorney was instructed to collect a total debt of R33 000. The debt will be collected in 3 payments.	

Questions	**Answers**
Provide detail of the parties involved in a correspondent transaction.	
List the accounts that will be opened in the accounting records of the <u>instructed</u> attorney if the matter involves trust monies and the following parties: Instructing attorney – SA Attorneys Client of instructing attorney – S Africa Instructed attorney – South Attorneys	
List the accounts that will be opened in the accounting records of the <u>instructing</u> attorney if the matter involves trust monies and the following parties: Instructing attorney – West Attorneys Client of instructing attorney – N North Instructed attorney – Mpuma Attorneys	

If you are able to adequately answer all of the above assessment criteria, you have completed Learning unit 8. If you were unable to do so or were uncertain of the answers to any of the questions, please revise the sections in the learning unit and ensure you have a thorough knowledge of this learning unit and a clear understanding of the explained concepts.