



### WORKSHEET 18

School: Ba Sangam College

Year: 1201

Name \_\_\_\_\_

Subject: Accounting

Strand -6	System for Implementing the accounting process
Sub Strand -6.1	Accounting for credit transactions
Content Learning Outcome 6.1.1	Examine the basic internal control procedures over credit transactions.

#### Importance of Internal Control

Every business must follow proper internal control procedures in order to:

- Avoid fraud and error.
- Safeguard business assets and other resources.
- Promote operational efficiency.
- Adhere to prescribed management policies.

#### Principles of internal control

- Separation or segregation of duties
- Reliable personnel
- Authorization
- Sound accounting practices
- Responsibility
- Rotation of duties
- Physical control
- Verification
- Serialization of documents

**Internal check** is checking of day to day transactions whereby the work of one employee is checked by the other member of the staff. In other words the work of each individual employee is independently checked. The main purpose of internal check is to detect fraud and error. **6.1**

#### ACCOUNTING FOR CREDIT TRANSACTIONS

Most businesses buy and sell on credit in order to expand their services to all sorts of customers and suppliers.

#### **Reasons why firms offer credit facilities to Customers**

- To maximize sales volume and profits.
- To enable the customer to buy the product in case they do not have sufficient cash.
- Allows the customers to enjoy the same goods and services as of the people with money.
- To avoid the goods from becoming obsolete.

#### **Internal Control over Credit Sales**

It is important for firms to have a good control over credit sales in order to avoid losses, fraud, error and misuse of inventory and theft.

Sales orders received must be checked with the manager, or the credit control department about the credit worthiness of a customer before it is processed.

Inquiries must be made with the stock officer for the supply of goods.

A tax invoice must be written out for every sale before goods are delivered to the customer. Serially numbered tax invoice is prepared and the original copy must be given to the customer. One copy goes to the accounting department while another copy becomes the delivery slip. Correct order number for the customer must be recorded on the invoice. The tax invoice must be signed by the customer as a proof for purchasing goods. A separate staff must be assigned to check the prices and calculations. Sales Returns and allowances – a strict procedure for all returns inwards and allowances, must be in place. All credit notes to be checked by a responsible officer in order to prevent employees from issuing credit notes to cover cash frauds. Only authorized staff members should be allowed to accept return of goods.

### **Internal Control over Accounts Receivable**

All credit sales should be approved by an authorized person.  
The credit worthiness of the customer should be looked at before the credit sale is made.

**Credit worthiness** is the ability of the customer to pay the amount owing by him or her to the business.

### **The following needs to be considered:**

- Income and financial commitments.
- Employment security.
- Residence and contact.
- Ability to pay and credit ratings.

The credit control department in large businesses plays an important role. Number of days given to pay, discounts allowed and interest charged needs to be considered.

The employee who handles accounts receivable records should not be receiving cash. A Statement of Account must be sent to each debtor in a form of a reminder to pay the sum owed.

**Cycle Billing** – in large businesses cycle billing can be used whereby customers are grouped alphabetically and statements are sent in cycles during the month. For example, Debtors whose name begins with A – E, their statements will be sent on the first day of every month, F - J on the 10th of the month and so on. This assists in separation of duties amongst employees.

All customers should be given a time period to pay the accounts and interest to be charged on overdue accounts.

**Aging Schedule or Age Analysis** of debtors account should be prepared every month to follow with the overdue accounts. It reflects that an aged debtor is more likely to be declared as bad debt.

### **Internal Control Over Credit Purchases**

Three quotes must be taken before buying goods.  
All purchases should be made on an order form, properly signed and sanctioned by an authorized employee.  
Necessary checks must be made on goods received in terms of quality of goods, prices, terms of payments and discounts offered. Comparison must be done with the purchase order, delivery docket and the invoice received from the supplier.  
Authorisation of payment is made by an employee other than the person who ordered the goods.

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Credit notes to be checked properly when goods are returned to the suppliers and necessary deductions done before payments.

### **Internal Control Over Accounts Payable**

Employees who handle accounts payable records should not handle payment of cash.

Procedures should be employed which ensures that payments are made on time to take advantage of any discount.

Proper authorisation should be obtained before payment is made to suppliers.

Use of control accounts and subsidiary ledgers allow greater control through separation and rotation of duties.

**Sectionalising the Ledger: -** Means dividing the ledger into different groups, Example: General ledger and Subsidiary ledger.

**General Ledger** - It contains all the information of the debtors and creditors control accounts, and other impersonal accounts.

**Subsidiary Ledger** It provides detailed information and records of each individual accounts receivable and accounts payable.

### **Advantages of Control Accounts**

A trial balance can be prepared from the general ledger without referring to subsidiary ledger. Errors can be detected through the use of control accounts.

Enables further division of labour and responsibility. Incorporating rotation of duties through distribution of ledgers to different employees will assist in detecting errors and fraud.

### ***Format of an Accounts Receivable Control Account***

**Accounts Receivable Control Account (T Form)**

	\$		\$
Opening balance	X	Cash	X
Sales	X	Discount Allowed	X
Interest	X	Sales returns	X
Cash refund	X	Transfer–Creditors ledger (contra)	X
Dishonoured Cheques	X	Closing Balance	X
	<b>XXX</b>		<b>XXX</b>

**Accounts Receivable Control Account (3 Column Form)**

	Debit \$	Credit \$	Balance \$
Opening Balance			XX Dr
Sales	X		XX Dr
Cash		X	XX Dr
Discount Allowed		X	XX Dr
Cash Refund	X		XX Dr
Dishonoured Cheques	X		XX Dr
Sales Returns		X	XX Dr
Interest	X		XX Dr
Bad Debts		X	XX Dr
Freight	X		XX Dr
Transfer – Creditors Ledger		X	XX Dr

Closing Balance

### ***Format of an Accounts Payable Control Account***

**Accounts Payable Control Account**

	\$		\$
Cash	X	Opening balance	X
Discount received	X	Purchases	X
Purchase returns	X	Interest	X
Transfer – debtors ledger (contra)	X	Cash refund	X
Closing balance	X		
	<b>XXX</b>		<b>XXX</b>

**Accounts Payable Control Account – 3 Column Form**

	Debit \$	Credit \$	Balance \$
Opening Balance			XX Cr
Purchases		X	XX Cr
Cash	X		XX Cr
Discount Received	X		XX Cr
Interest		X	XX Cr
Cash Refund		X	XX Cr
Purchase Returns	X		XX Cr
Transfer – Debtors Ledger (Contra)	X		XX Cr

Closing Balance

### **Contra Account**

Businesses may buy and sell to the same firm. Hence the debtor also represents the creditor for the firm. In such cases rather than paying each other, the transfer between debtors and creditors ledger is done to offset the amounts owed.

### **Schedule of Balances**

consists of the list of closing balance of each individual debtor and creditor. This should equal to the closing balance of accounts receivable and accounts payable control account.

#### **Note:**

Bad debts are an actual financial loss arising from a debtor not paying his or her account.

Doubtful debts are those debts which a business is unlikely to be able to collect from accounts receivables.

Bad Debts Recovered is a debt which was previously written off but recovered later.

**Note: Students are to go over the examples on pages 166 - 169**

### **Activity Question**

Ashwini's Minimart maintains its subsidiary ledger and other accounts. The following information relates to the accounts receivables and accounts payables ledger balances for the year ending 31<sup>st</sup> July 2018.

<b><u>Summary Information</u></b>	<b><u>Amount (\$)</u></b>
Total of Tax Invoices Issued	15 230
Cash Sales	32 000
Accounts Receivables balance 01/08/17	10 750
Accounts Payables balance 01/08/17	20 200
Sale Returns and Allowances	2 760
Discount Received	1 000
Discount Allowed	895
Cash paid to Creditors	11 573
Interest charged to Debtors	785
Cash refund to Accounts Receivables	390
Bad debts	1 440
Cash received from Accounts Receivables	9 300
Contra entry from Debtors to Creditors ledger	450
Accounts Payables balance 31/07/18	40 800
Purchases Returns	665

#### **Required**

Select the relevant information and prepare the Accounts Receivables Control Account of Ashwini's Minimart as at 31<sup>st</sup> July 2018 to find out the closing balance of the Accounts Receivables. **(5 marks)**

**Accounts Receivables Control Account**

<b><u>Date</u></b>	<b><u>Particulars</u></b>	<b><u>\$</u></b>	<b><u>Date</u></b>	<b><u>Particulars</u></b>	<b><u>\$</u></b>

**THE END**