
Accounting (Basics) - Lecture 8

CHARACTERISTIC OF CLEARING RELATIONS.
ACCOUNTING PROCEDURES CONCERNING
RECEIVABLES AND LIABILITIES (PAYABLES)
FROM BUSINESS RELATIONSHIPS.

Content

- Characteristic of clearing relations
- Accounting procedures concerning receivables and liabilities (payables) from business relationships

Debtors and Creditors

- Debtors and creditors mean the **liabilities (payables)** and **receivables** of the entity towards other entities.
- Debtors and creditors include trade payables and liabilities, accounting with employees, partners, institutions and financial bodies, accounting of short-term loans and credits and accounting on temporary accounts of assets and liabilities.

Debtors and Creditors

- Debtors and creditors include:
- **Receivables** (short-term and long-term). Here, mostly the receivables from clients, advanced paid to suppliers, complaints towards suppliers and bills for collection submitted to the bank are accounted.
- **Liabilities** (short-term). In this group short-term liabilities (payables) to suppliers, accepted short-term advances from clients, liabilities from complaints and notes payable are accounted.

Debtors and Creditors

- **Accounting with employees and institutions.** Here the liabilities from labour relations including health insurance and social security, other payables to employees, receivables from employees from advances paid for travel expenses and compensation claimed by employees are accounted.

Debtors and Creditors

- **Accounting for taxes and subsidies.** In this group advances paid for income tax during the year and withholding income tax for income taxed with a special tax rate in cases where, under the income tax law, withheld tax may be accounted as the total tax liability are covered.
- As of the balance sheet day, the liability of the entity is accounted from the tax due for the tax period based on the tax return.
- Also, withheld income tax to be paid by the entity as the payer of taxes collected from tax payers.
- Value added tax, other taxes and fees are also included in this group.

Debtors and Creditors

- **Receivables from partners, cooperative members and group entities.** Here short-term loans to entities of the consolidation unit, receivables from shareholders, partners, cooperative members, etc are covered.
- **Payables to partners, cooperative members and group entities.** Here, e.g. short-term liabilities to entities within the consolidation unit, payables to shareholders, partners, cooperative members, etc. are accounted.

Debtors and Creditors

- **Other receivables and liabilities.** In this group receivables and liabilities from sale of the business, receivables and payables from fixed term deposits, receivables and payables upon issue and purchase of short-term bonds, etc. are accounted.

Debtors and Creditors

- **Temporary accounts of assets and liabilities.** In this group transitional accounts of assets and liabilities, accrued expenses and revenues, income and expenditures are accounted.
- **Adjusting entry to debtors and creditors and internal settlement.** Here is where adjusting entries to receivables, the reduction and/or cancellation thereof, are accounted.

Mutual compensation

- **Receivables and liabilities** in accounting and financial statements **must not be mutually compensated** (calculated against each other or set off), with the exception of:
 - Additionally assessed tax and refunds for income taxes, indirect taxes and fees (under conditions agreed upon in advance), compensation of credit notes and refunds.
 - Receivables from and liabilities to the same individual person or corporate entity may be compensated if accounted in the same currency and mature within one year.

Allowances, adjusting entries and asset amortization

- Businesses are allowed to include into financial statements only profit actually reached and must take into account all foreseeable risks and possible losses relating to their assets and liabilities that they are aware of at the moment of preparing the financial statements, including all asset depreciations.
- To this end, allowances, adjusting entries and asset amortization are used.

Valuation of Receivables and Liabilities

- **Receivables** are valued:
 - upon emergence of receivables through nominal value,
 - upon acquisition against payment or by means of deposit through purchase price,
 - as of the balance sheet day transitional reductions of receivables are expressed through an adjusting entry.

Valuation of Receivables and Liabilities

- **Liabilities** are valued:
 - upon emergence through nominal (face) value,
 - upon takeover through purchase price,
 - if discovered during inventory that the value of liabilities is higher (and/or lower) than the value thereof named in accounting, the liabilities are accounted in the books and financial statements in this valuation, as discovered.

Valuation of Receivables and Liabilities

- Receivables and liabilities reported upon emergence **in a foreign currency** are converted to the reference currency (in the Czech Rep. it is the Czech crown) by the foreign exchange rate.
- When collecting receivables or paying liabilities, exchange rate differences are investigated and posted to profit and loss (as exchange rate profit and/or loss).

Accounting Receivables

- A **receivable** can be characterised as the right of an individual person or legal entity (creditor) to require the other party (debtor) to deliver a certain amount of currency based on a certain liability.

Accounting Receivables

■ Trade receivables

- This account is where **receivables from clients** are accounted for.
- Receivables from clients are credited to the supplier upon delivery under the respective contractual provisions in the contract.

Accounting Receivables - example

- Accounting operations:
 - Issued invoice – value of delivery (goods supply, service)
 - Accounting of VAT
 - Current account statement, collection of receivables

Accounting Receivables - example

- Accounting operations - solution:
 - Issued invoice – value of delivery (goods supply, service): **Trade receivables / Revenues**
 - Accounting of VAT: **Trade receivables / VAT**
 - Current account statement, collection of receivables: **Bank accounts / Trade receivables**

Complaints from supplies

- If the client **complains** about a supply, one of the accounting methods is to account on the other side of accounts on which it was originally accounted.

Complaints from supplies - example

- For the invoice issued in the amount of the 120 client files a complaint in the amount of 20. The entity (not registered for VAT) acknowledged the complaint. The client will pay a lower amount.

Operati on	Text	Amount	Debit	Credit
1	Invoice issued for services	120	Trade receivables	Revenues from services
2	Defects identified complaint	20	Revenues from services	Trade receivables

Bill of exchange

- A trade receivable may be paid by a **bill of exchange**.
- The bill of exchange is a security.
- If the bill of exchange fulfils the function of a security, it is viewed in accounting as a bill receivable, **bill for collection**.
- Bills for collection are valued by the purchase price resulting from the price of the **receivable and interest**.

Bill of exchange

- Bills of exchange may be:
 - paid during their maturity periods,
 - submitted to the bank for discount (the discount of a bill of exchange means the purchase or sale of the bill prior to maturity date, with corresponding interest deduction (discount)).

Bill of exchange - example

- The receivable from example worth 120 was paid by a bill of exchange with a 10-percent interest. The bill of exchange was discounted at the bank with a 5-percent discount. The debtor paid the bill of exchange within the maturity period.

Bill of exchange - example

Operation	Text	Amount	Debit	Credit
1	Starting state of receivable	120	Trade receivables	
2a	Payment of receivable from client by bill of exchange	120	Bills for collection	Trade receivables
2b	Interest	12	Bills for collection	Interest
3	Discount of bill of exchange	132	Receivables from discounted securities	Bills for collection
4a	Provision of discounted loan – credit to account	125	Bank accounts	Discount loans
4b	– discount	7	Interest	Discount loans
5	Advice note of bank on payment of bill of exchange	132	Discount loans	Receivables from discounted securities

Bill of exchange

- If the debtor **fails to pay** the bill of exchange, the bank returns the bill of exchange to the original owner who must pay the discount loan.

Payment of operating advances - example

- The client provided to the supplier an advance payment of 50 for goods. Later on, the client received the goods ordered, including invoice for the amount 120.

Payment of operating advances - example

Operation	Text	Amount	Debit	Credit
1	Account statement – operating advance paid by an entity not registered for VAT	50	Payment of operating advances	Bank accounts
2	Invoice from supplier for goods	120	Purchase of goods	Trade payables
3	Accounting of operating advance paid	50	Trade payables	Payment of operating advances
4	Account statement – payment of invoice to supplier	70	Trade payables	Bank accounts

Other receivables

- In this account **other trade receivables** are accounted, e.g. complaints at goods takeover from a supplier.

Other receivables - example

- After receiving an invoice, the client files a complaint for the amount of 15 which was acknowledged by the supplier.

Other receivables - example

Operation	Text	Amount	Debit	Credit
1	Invoice for material received from supplier	95	Purchase of material	Trade payables
2	Identification of defects, filing of complaint	15	Other receivables	Purchase of material
3	Acknowledgement of complaint by supplier	15	Trade payables	Other receivables

Liabilities

- A **liability** can be characterised as the duty of the individual person or legal entity to pay (deliver) to the other person (creditor) for goods, services, loans, damages, etc.

Trade payables

- In this account **short-term liabilities** to suppliers emerging upon delivery of assets or services are accounted.

Trade payables - example

- An entity received an invoice from a supplier for services for 200 excl. VAT with a 21-percent VAT rate. It paid this liability from its current account.
 - A) the entity is registered for VAT
 - B) the entity is not registered for VAT

Trade payables – example – A) registered for VAT

Operati on	Text	Amount	Debit	Credit
1	Invoice received from supplier for services – price excl. VAT – VAT Total	200 42 242	Other services VAT	Trade payables
2	Account statement – payment of liability	242	Trade payables	Bank accounts

Trade payables – example – B) not registered for VAT

Operation	Text	Amount	Debit	Credit
1	Invoice received from supplier for services – price excl. VAT	242	Other services	Trade payables
2	Account statement – payment of liability	242	Trade payables	Bank accounts

Notes payable

- The liability to a supplier may be paid by a **bill of exchange**.
- The bill of exchange is a security, but becomes a bill payable, note payable, when the trade liability is paid.
- Notes payable are valued by their purchase price created from the price of the liability and interest.

Notes payable - example

- An accounting entity registered for VAT received an invoice for services from a supplier for 200 excl. VAT with a 21-percent VAT rate. It paid the liability by a bill of exchange with a 10-percent interest. The entity paid the bill of exchange from its bank account within the maturity period.

Notes payable - example

Operation	Text	Amount	Debit	Credit
1	Invoice received from supplier for services – price excl. VAT – VAT Total	200 42 242	Other services VAT	Trade payables
2a	Payment of liability	242	Trade payables	Notes payable
2b	Interest	24	Interest	Notes payable
3	Current account statement – payment of bill of exchange	266	Notes payable	Bank accounts

Operating advances received

- In this account **advances paid by the consumer** which are a liability for the entity are tracked.

Operating advances received - example

Oper ation	Text	Amount	Debit	Credit
1	Account statement – operating advance received, entity not registered for VAT	50	Bank accounts	Operating advances received
2	Invoice issued for sale of goods	120	Trade receivables	Revenues from sales of goods
3	Accounting of received operating advance	50	Operating advances received	Trade receivables
4	Current account statement – collection of receivable	70	Bank accounts	Trade receivables

Other liabilities

- In this account **other trade payables** are recorded, such as complaints filed by consumers.

Other liabilities - example

Operation	Text	Amount	Debit	Credit
1	Invoice issued for sale of goods	180	Trade receivables	Revenues from sale of goods
2	Identification of defects, filing of complaint	30	Revenues from sale of goods	Other liabilities
3	Acknowledgement of complaint	30	Other liabilities	Trade receivables