COMMERCIAL TRANSACTIONS

A transaction. This is any dealing between two parties involving exchange of goods for money (price or consideration). Hence there are always two parts of a transaction i.e.

(i) the transfer of goods or services by the seller,

(ii) the payment for them by the buyer.

A commercial transaction. This is one where one or both of the parties involved are traders.

TYPES OF TRANSACTIONS

1. **A cash transaction.** This is one where payment for goods is made as soon as the goods are handed over to the buyer.

Or; this is where transfer of goods or services and payment are executed simultaneously. Here, payment is either made using cash or bank cheque. All cash transactions are supported by a document called cash sale slip.

A cash sale slip. This is a document issued by the seller to the buyer when goods have been sold for cash.

Example of a cash sale slip

GYADI ENTERPRISES LIMITED
P.O. Box 423, Iganga (U)
email:gyadient@yahoo.com

"Suppliers of text books and stationery"

Mobile: 0774-509017
0704-509017

TO: Kiira College Butiki
P.O. Box 1181, Jinja (U)

S/No.	Description	Quantity	Unit	Amount

CASH SALE

Date	7/8/2012
No.	154

TOTTTTTTTTTTTTTT

2. Credit transaction. This is where payment is made some time after the transfer of goods or services.

Or; this is any business dealing between two people where payment for goods or services is made at a future date.

Here, the buyer obtains the goods or services and promises to pay at a later date.

STEPS AND DOCUMENTS INVOLVED IN CREDIT TRANSACTIONS

A credit transaction goes through a number of steps and each step raises a document that shows details of a transaction. Each document has its own content and it is prepared in a special format. The following illustration will enable us understand these steps properly. The following transaction took place between ARISTOC BOOKLEX LTD, retailers in books stationery and GYADI ENTERPRISES LTD, suppliers of text books and stationery.

1. **Birth of an idea (creating awareness).** This involves making the public aware of the existence of a business goods or services.

Before any transaction takes place, the seller must first make the public aware of the existence of his/her goods or services. This can be done in various ways which may include:

i) The sellers may place regular advertisements in local newspapers or magazines, through radio or television.

ii) They may arrange exhibitions.

iii) They may attend international book festivals.

iv) They may send circulars or leaflets to retailers about books published and stocked by them.

v) They may employ travelling salesmen to visit various retailers in the country.

2. **Making inquiries.** This involves contacting a number of suppliers inquiring about the goods offered by them, their terms, services, methods of payment, etc.

An inquiry may be made orally or by writing a letter. Orally, Aristoc Booklex may either ring up the Sales Manager of Gyadi Enterprises Ltd and ask for necessary details or visit their offices personally. Alternatively, they may write an inquiry letter.

Letter of Inquiry (Inquiry note). This is a document sent by the buyer to the supplier inquiring about various types of goods and services, their prices, terms and conditions of payment, mode of delivery, discounts if any, etc.

TYPES OF LETTER OF INQUIRY

i) A general letter of inquiry. This asks for general information i.e. information concerning various types of goods and services, their prices, terms and conditions of payment, mode of delivery, discounts if any, etc.

ii) A specific letter of inquiry. This looks at a particular product, its price, terms and conditions of payment, discounts if any, etc. It clearly specifies the area of particular interest.

iii) Replying of the inquiry. This involves answering an inquiry letter and it can be done by sending a price list, a price current, a catalogue or a quotation

3. Price list. This is a list of items offered by the supplier together with their respective prices.

A price list does not carry a lot of information and it is commonly used when the commodities listed are well known or are popular brands.

Price current. This is a price list made where there are no standard prices i.e. where the prices are ever fluctuating.

In this case, a supplier sends a list known as a price current to show the prevailing prices at that time.

Or; **Catalogue**. This is a booklet that briefly describes each item offered for sale and its price. It is more illustrative, attractive and more informative than a price list.

Or; **Quotation.** This is a document sent by the supplier to the buyer after receiving the letter of inquiry.

In the quotation, the potential supplier states prices for his/her products, the terms and conditions for payment and delivery, the lead time, specifications of his/her products, warranty and discounts to the buyers if any.

It is sent by the seller to the buyer according to the specifications given by the buyer.

4. **Placing an order.** Having received all the necessary information from the supplier, the retailer (buyer) may decide to place an order requesting for the supply of a particular item(s).

An order can be made verbally, by writing an order letter or by filling a pre-printed order form.

However, it is not wise for a businessman to place orders verbally as problems may arise due to misunderstanding of instructions, lack of proof of order, etc.

If, however, there is an urgent need for the goods and there is no time to go through the formalities of writing an order, verbal orders may given but these should be followed by written orders as soon as practicable.

Local Purchase Order (purchase order/order form). This is a document sent by the retailer (buyer) to the potential supplier requesting to be supplied with the goods or services at the quoted prices.

It indicates the description of items needed by the buyer, the purchase price, address of the buyer, etc. Order forms are usually pre-printed.

5. **Deciding on the method of payment.** At this stage, the seller decides whether or not to extend credit facilities.

Most transactions between wholesalers and retailers are credit transactions and most transactions between retailers and consumers are cash transactions.

If the seller decides to refuse credit, or if the buyer himself prefers to pay cash, the following alternatives are available.

i) **Cash with order (C.W.O).** Here, the buyer sends money along with the order.

ii) **Cash on delivery (C.O.D).** Here, the seller collects money when he delivers the goods. This term is also applicable when goods are sent through the post, with post offices being instructed to deliver the parcel against a stated payment.

iii) Spot cash. Here, the buyer pays for the goods as he collects them from the sellers premises. When the buyer pays in cash for the goods, he is issued with a document called a cash sale slip that evidences the receipt of money by the seller.

6. Credit status inquiry. At this stage, the seller ascertains the creditworthiness of the buyer who is asking to be extended credit.

This inquiry is necessary especially if it is the first transaction between them. The seller may get confidential report on the creditworthiness of the prospective customer from different sources through writing credit status inquiry letter to them.

These include:

i) **Bankers to the buyer.** Here, the supplier may ask one of the bankers where the prospective customer has an account.

ii) Other suppliers. The buyer may be required to mention another supplier from whom information about his paying habits may be obtained.

iii) Other customers. Here, the supplier may ask one of his regular clients who may happen to know his prospective customer, about his creditworthiness.

iv) Trade Association. If the prospective buyer happens to be a member of a trade association e.g. Chamber of Commerce, the supplier may approach the associations office for a confidential report on him.

7. **Deciding on the credit terms.** After Gyadi Enterprises Ltd have received a favorable reply to their credit status inquiry letter, they may now consider granting credit to Aristoc Booklex Ltd and decide about the length of the credit period. A credit period usually ranges from seven days to one month for normal orders, and from one to three months for larger orders.

A seven days or less length of credit period is often referred to as **prompt cash.** Wholesalers usually offer discounts to their customers to encourage them to settle their accounts quickly and also to encourage large quantity purchases. (This is discussed in detail at the end of this chapter).

8. **Packing the goods.** At this stage, the order received from the prospective buyer is now passed by the suppliers sales department to the warehouses packing section.

The goods are then packed in appropriate cases or packets, and the contents of each packet are noted on a document/sheet called package sheet.

Package sheets are usually written in quadruplicate, i.e. in four copies. The original copy is placed inside the packet/case, one copy is sent to the buyer by post or together with the delivery note, one copy is sent to the accounts department and the last copy is retained by the warehouse for its own records.

9. **Delivering of goods ordered for**. This involves the physical transfer of goods from the seller to the buyer.

At this stage, a delivery note is prepared by the seller and it is signed by the buyer to evidence the delivery of goods.

Goods ordered for may be delivered by the seller, collected by the buyer in his own vehicle or transported through a public carrier. However, the supplier may send the buyer a dispatch note before delivering the goods.

A dispatch note/ advice note. This is a document sent by the potential supplier to the buyer informing him/her that the goods have been dispatched (sent) and are on the way. A dispatch note enables the buyer to make arrangements for sale of the old stock as well as preparing his/her store in advance. It is sent separately to reach the purchaser before the arrival of the goods.

Note. A dispatch one takes the same format like that of a delivery note.

Delivery note (Goods delivery note). This is a document showing details of goods that have been delivered to the buyer.

It accompanies goods that have been supplied to the buyer and it indicates the goods supplied, type, quantity, date of delivery, mode of transport, etc. a delivery note may be sent with or without a package sheet.

It is usually sent together with the package sheet when the quantity of goods being sent is large and several package sheets are prepared.

10. **Invoicing.** This is where the seller informs the buyer of the amount due from him. The seller does this by preparing a document called an invoice.

An invoice . This is a document sent by the supplier to buyer indicating the amount of money due from the buyer.

It clearly shows the quantity of items sent to the buyer, the unit price and the total price (amount) due from the buyer.

Note 1. An invoice is sent only if the goods are sold on credit and it serves two major purposes i.e. it notifies the buyer of the amount due from him and it also serves as evidence or proof of the debt due to the seller, who uses it for accounting purposes.

Note 2. An invoice is at times referred to as a bill. A bill is usually issued when the payment is asked for “services rendered”.

Hence an invoice implies that payment is being asked for “goods sold”. It is normally issued by doctors, lawyers, technicians, and other professional people to their clients.

An invoice shows the following details:

i. Name and address of the seller

ii. The invoice number

iii. Date of invoice

iv. Name and address of the buyer

v. A brief description of the goods sold

vi. Quantity supplied

vii. The unit price of goods sold

viii. The total cost of the goods sold

ix. Discounts if any allowed

x. Order number of the buyer

xi. Delivery note number

xii. E &O.E i.e. Errors and Omissions Excepted. This expression means that the seller deserves the right to correct any mistake which may appear on the invoice.

It informs the buyer that such errors which may appear on the invoice are not intended and will be subjected to correction.

11. **Receiving goods and services bought/purchased.** This refers to the process of receiving goods and services that have been bought or ordered by a business and delivered by the supplier.

On receiving the goods purchased or ordered, the buyer performs the following activities/steps;

Inspect the goods to see that they are not damaged.

i) Make a record in his stores record books of the description and quantity of the goods received.

ii) Verify the goods received with the copy of order placed and delivery note or package sheets received.

Note. If no delivery note is received from the seller, the buyer may himself issue a goods received note that shows the details of goods received to the seller.

12. **Receiving of an invoice.** This refers to the process of receiving a document from the supplier indicating the amount of money due from the buyer.

On receiving an invoice, the buyer performs the following activities/steps:

i. Verifying the invoice with a copy of the order placed to ensure that he has been invoiced for the goods actually he ordered.

ii. Verifying the invoice against the package sheet, delivery note or goods received note to ensure that the goods invoiced have actually been received.

iii. Checking the prices and trade discounts allowed if any, to ensure that no overcharge has been made and that due discount has been allowed.

iv. Checking the calculations and arithmetical accuracy of the invoice against totals, multiplications, calculation of trade discount if any, percentages, etc.

v. Passing on the invoice to the accounts department to prepare a cheque, if the invoice is found accurate in all the above aspects. If, however, the invoice is received from a regular supplier, the accounts department keeps it in a pending file till the end of the month, when all invoices received from a particular supplier are paid by means of a single cheque.

13. **Correcting discrepancies in an invoice.** If an invoice, upon checking, is found incorrect, the buyer takes appropriate steps to ensure that he pays only the correct amount. An incorrect invoice may lead to either an over-charge or an under-charge.

An over-charge in an invoice may result from;

i) Incorrect pricing

ii) An error in trade discount calculation

iii) In totaling or

iv) Inclusion of wrong items.

Incase of an over-charge, the seller should be informed of the error and will issue a credit note to rectify/correct the invoice.

Credit note. This is a document issued by the seller to the buyer to correct an over-charge in the invoice.

It informs the buyer that he has "credited" by the seller the amount of over-charge in the invoice.

Note. A credit note is usually printed in red to distinguish it from the invoice.

14. **Returning of goods.** If a buyer on receipt of goods from the seller finds some or all of them defective or unsatisfactory, he may return such goods and claim a "credit" for their cost.

When returning such goods, the buyer prepares a goods returned note. A copy of the goods returned note is sent to the seller; another copy to the accounts department and one is retained by the warehouse/store for its own record purposes.

On receipt of goods returned by the buyer, a seller issues a credit note to acknowledge the receipt of such goods and agreeing to relieve the buyer from the responsibility to pay for them.

Therefore, a credit note may also be issued if any goods are returned by the buyer to the seller as unsatisfactory.

An under-charge in an invoice may result from:

i) Incorrect pricing

ii) An error in trade discount calculation

iii) In totaling or

iv) Omission of an item.

To correct an under-charge in an invoice, the seller prepares a document called a debit note.

Debit note. This a document sent by the seller to the buyer to correct an under-charge in an invoice.

It is the opposite of a credit note and is usually drawn in the same way except for the colour i.e. a debit note is usually printed in blue or black unlike a credit note which is usually printed in red.

A debit note debits the buyer i.e. it performs the same function as an invoice. Hence most firms do not keep separate debit note forms but issue an additional invoice to correct an under-charge in a previously issued invoice.

15. **Preparing a statement of account.** In case of big transactions between the buyer and the seller, the seller may provide additional services of preparing and sending monthly statements of account.

Statement of Account. This is a document sent by the seller to the buyer at periodical intervals normally every month showing the transactions which have taken place during a given period of time.

It is sent to the buyer at the end of the month demanding for payment. The statement of account normally starts with an opening balance at the beginning of a given period.

The statement of account indicates the following information:

i)The amount due from the buyer at the beginning of the month.

ii) List of invoices issued during the month.

iii) Total value of credit notes issued during the month.

iv) Total value of debit notes if any issued to the buyer during the month,

v) Total remittances (payments) received during the month.

vi) Amount due at the end of the month and

vii) The corresponding dates

The statement of account has four columns i.e.

i) Date. This records the date of the transaction.

ii) Details. It gives a brief description of the transaction that took place.

iii) Debit. It records the opening balance and list of invoices issued during the month.

iv) Credit. This shows the total value of credit notes issued and total payments received during the month.

Note. The difference between the debit and credit columns is called a “balance” and this gives the amount due to the buyer at the end of the month.

16. **Receiving a statement of account.** On receiving of a monthly statement of account, a buyer takes the following steps:

i) Checks it against previous statement to ensure that the opening balance is correct.

ii) Verifies it with invoices received during the month.

iii) Verifies it with credit notes received during the month.

iv) Verifies any payment made during the month.

v) Prepares a cheque for payment.

17. **Paying for the goods.** After receiving a statement of account, the buyer verifies/proves the statement of account and prepares to settle his/her account/debt either by cash or by cheque.

When the buyer pays for the goods, he/she is issued with a receipt. However, it is not necessary to issue a receipt if payment is made by cheque.

This is because a cheque is evidence of payment in itself.

Receipt. This is a document that acknowledges settlement of a debt.

It is given by the supplier to the buyer when the buyer settles his/her debt for the goods that were once taken on credit. A receipt acts as evidence of payment and marks the end of a credit transaction. It acknowledges receipt of amount of money due from the buyer.

DISCOUNTS

A discount. This is a reduction in the original price of a good or commodity.

Or; this is a reduction in the price charged by the seller to the customer hence an allowance given to traders on goods purchased.

TYPES OF DISCOUNTS

1. Trade discount

This is an allowance made if goods are sold by one businessman (usually a manufacturer) to another businessman (retailer) on goods whose price is either fixed or controlled or is generally known.

For instance sugar, soap, cigarettes, books, etc.

2. **Quantity discount**

A trade discount is a reduction in the price paid for goods bought in large quantities. It is an allowance given to a customer for buying goods in large quantities.

A quantity discount is given as an addition to a trade discount. For example, a wholesaler in books may allow say, 25% trade discount on all books sold by him to bookshops whatever the quantity involved, and an additional 5% quantity discount if at least 100 copies are bought of each title ordered.

Note. It is important to note that if a retailer allows a price reduction due to the size of an order from a consumer, such reduction is not a trade discount, but a quantity discount.

Both the trade and quantity discounts are expressed as percentage of the gross value of the goods sold.

Example

If Kadoma bought 10 crates of Soda at Shs 150,000 and he was given a trade discount of 15%. Calculate;

(a)Trade discount that was earned by Kadoma.

(b)The amount that he actually paid.

(a) Trade discount = Percentage discount x the cost price

$$= \frac{15}{100} \times 150{,}000$$

Trade discount = **Shs. 22,500**

(b) Amount actually paid = Cost price - trade discount

= 150,000 - 22,500

= **Shs. 127,500**

Or;

Amount actually paid = $\frac{(100-15)}{100} \times \text{cost price}$

$$= \frac{85}{100} \times 150{,}000$$

= **Shs. 127,500**

Cash Discounts

A cash discount. This is a reduction in price allowed to customers to encourage them to pay their debts promptly/quickly or in time.

Or; this is an allowance a seller gives to a customer when payment is made within a specified period of time.

A cash discount is calculated as a percentage of the total amount due and is usually between 1 and 2 ½ per cent.

TYPES OF CASH DISCOUNTS

i) Discount allowed

This is an allowance given by the business to its customers on goods sold to them on credit in order to encourage them to pay promptly. Discount allowed is a loss to the business.

Example

A firm sold goods on credit worth Shs 12,000 to Ochan and was to allow him a cash discount of 2 ½ % if he pays in time. If the Ochan paid in time,

i) Calculate the amount of cash discount.

ii) How much Ochan paid.

Solution

i) Cash discount = Percentage discount x cost price

$= \frac{2.5}{100} \times 12{,}000$

= **Shs. 300**

Amount paid = $\frac{(100-2.5)}{100}$ x cost price

$= \frac{97.5}{100} \times 12{,}000$

= **Shs. 11,700**

Or; Amount paid = Cost price — Cash discount

= 12,000 - 300

= **Shs. 11,700**

ii) Discount received

This is an allowance received by the business from its suppliers for paying its debts in time. Discount received is regarded as an income to the business.

2. **Cash and Trade Discounts Combined**

At times, a customer may be given a trade discount on buying goods and at the same time he may be allowed a cash discount so as to settle his debt in time.

Example

Alex bought 50 boxes of water at Shs 8,000 each. The supplier allowed him a 25% discount because of buying in large quantities and a 5% cash discount if he pays within one month. If Alex paid within the stated period, calculate;

i) Trade discount

ii) Cash discount

iii) Amount he actually paid

Solution

Trade discount = Percentage discount x cost price

But cost price = Quantity bought x Unit price

= 50 x 8,000

= Shs. 400,000

(i) Trade discount $= \frac{25}{100} \times 400{,}000$

= **Shs. 100,000**

(ii) Cash discount = Percentage discount x price after trade discount

$= \frac{5}{100} \times (400{,}000 - 100{,}000)$

= **Shs. 15,000**

(iii) Amount actually paid $= \frac{(100-25)}{100} \text{ cost price} \times \frac{(100-5)}{100}$

$= \frac{75}{100} \times 400{,}000 \times \frac{95}{100}$

= **Shs. 285,000**

Or;

Amount actually paid = Cost price — (trade discount + cash discount)

= 400,000 — (100,000 + 15,000)

= **Shs. 285,000**

Or;

Amount actually paid = Price after trade discount — cash discount

= 300,000 — 15,000

= **Shs. 285,000**

REVISION QUESTIONS FOR SENIOR TWO

1. (a) List the contents of the following documents

    i. An Order form

    ii. A reply to the order

    iii. An invoice

    iv. Statement of account

   (b) What are the procedures taken on receipt of an invoice by any customer?

2. (a) Briefly explain the importance of business documents to a trader

   (b) Explain the most important documents that are required in a commercial transaction