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Accounting

Harold Randall • David Hopkins

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Cambridge International AS and A Level Accounting

**Harold Randall
David Hopkins**

CAMBRIDGE UNIVERSITY PRESS

Cambridge, New York, Melbourne, Madrid, Cape Town,
Singapore, São Paulo, Delhi, Tokyo, Mexico City

Cambridge University Press
4381/4 Ansari Road, Daryaganj, Delhi 110002, India

www.cambridge.org

Information on this title: www.cambridge.org/9781107690622

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Printed in India at

A catalogue for this publication is available from the British Library

ISBN 978-1-107-69062-2 Paperback

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Preface

There have been a number of changes in the world of accounting since the first publication of this textbook, most notably the introduction of the **International Accounting Standards (IAS)**. These changes have resulted in the need for a re-write of the original work. The book is still aimed at AS and A level accounting students studying the CIE syllabus, who still face the problems by asking ‘How do I do this?’

This textbook covers the entire Cambridge AS and A Level Accounting syllabus. Ideally, students should already have taken O level or IGCSE accounting before starting on AS Level or A level studies. Many do not have such a background and this text has such students in mind in the early chapters. The essentials of double-entry bookkeeping are covered in sufficient detail to equip students to progress to more advanced work. It must be emphasised, however, that thorough mastery of the basics is absolutely necessary if real progress is to be made with the subsequent chapters.

The text follows the order of the Cambridge AS and A Level Accounting syllabus but allows for some flexibility in the sequence in which the topics are studied. Whichever the order in which the chapters are taken, it is of paramount importance that the whole of the syllabus is covered before the examination. Every topic is likely to find its place in at least one of the papers each session. It is

invariably the case that too many candidates enter the examinations inadequately prepared — with inevitably disappointing results. A grid is provided to show how the chapters cover the AS level and A level syllabuses. However, as the syllabus changes from time to time, both tutors and students need to assess the topics and their teaching and learning strategy in light of any changes.

I have been an examiner and lecturer for a number of years and also trained abroad on behalf of CIE. These experiences have given me a valuable insight into the challenges face by students and tutors overseas. In re-writing the text I hope that I have kept to the style which Harold Randall used so effectively.

New topics have been added and old ones deleted. Answers to exercises within chapters and answers to multiple-choice questions are provided at the end of the textbook. I have also retained and, in some cases expanded the section on ‘Examination hints’. Despite numerous re-reads and re-working of questions any mistakes are solely down to me!

The study of accountancy can be extremely rewarding. I have been involved in it now for more years than I care to admit to and am still learning! To all my readers, both old and new, I send my best wishes for success.

David Hopkins

Topics grid

The grid below shows how the chapters of this text cover the topics in the syllabuses for AS level and A level accounting. The syllabuses do not present the topics or their contents in the order in which they should be taught, and the order in which the chapters are shown in the grid is intended only to show how the syllabuses are covered. Teachers will decide their own order to suit their particular teaching plans, which will usually follow, more or less, the chapters in sequence.

Some topics are either wholly or partly outside the AS level syllabus but none of the topics is outside the A level syllabus.

Syllabus	Chapter	AS level	A level
THE ACCOUNTING SYSTEM			
A. Recording Financial Information	1	All	All
	2	All	All
	3	All	All
	4	All	All
	5	All	All
	10	All	All
	11	All	All
B. Accounting Principles	12	All	All
	9	All	All
C. Control Systems	6	All	All
	13	All	All
	14	All	All
	15	All	All
FINANCIAL ACCOUNTING			
D. Preparation of Financial Statements	7	All	All
	8	All	All

	16	All	All
	17	All	All
	18	All	All
	19	All	All
	20	All	All
	21	All	All
	22	All	All
	23	All	All
	24	N/A	All
E. Capital	25	§§25.1–25.5	All
F. Business Purchase	26	N/A	All
G. Published Company Accounts	27	N/A	All
FINANCIAL REPORTING AND INTERPRETATION			
H. Interpretation and Analysis	28	§§ 28.1–28.6, 28.8, 28.9, 28.10	All
I. Company Financing	29	N/A	All
ELEMENTS OF MANAGERIAL ACCOUNTING			
J. Costing Principles and Systems	30	All	All
	31	All	All
	32	N/A	All
	33	All	All
K. Budgeting	34	N/A	All
L. Standard Costing	35	N/A	All
M. Investment Appraisal	36	N/A	All

International Standards Terminology

Given below is the list of international standards terminology used in CIE accounting syllabuses. Centres should use the new terminology in their teaching and learning materials so that candidates are familiar with the terms. Candidates will not lose marks for using different terms.

International Usage	Current/UK usage
Balance sheet (statement of financial position)	<i>Balance sheet</i>
Bank (and other) loans/Interest bearing loans and borrowing	<i>Loans repayable after 12 months</i>
Bank overdrafts and loans/Interest bearing loans and borrowing	<i>Loans repayable within 12 months</i>
Capital or equity/shareholders' equity	<i>Capital</i>
Cash (and cash equivalents)	<i>Bank and cash</i>
Cost of sales	<i>Cost of goods sold</i>
Current assets	<i>Current assets</i>
Current liabilities	<i>Current liabilities/ Creditors: amounts due within 12 months</i>
Finance costs	<i>Interest payable</i>
Finance income/investment revenues	<i>Interest receivable</i>
Financial statements	<i>Final accounts</i>
Gross profit	<i>Gross profit</i>
Income statement (statement of comprehensive income)	<i>Trading and profit and loss account</i>
Intangible assets	<i>Goodwill etc.</i>
Inventory/inventories (of raw materials and finished goods)	<i>Stock</i>
Investment property	<i>Investments</i>
Non-current assets	<i>Fixed assets</i>
Non-current liabilities	<i>Long term liabilities/ Creditors: amounts falling due after more than one year</i>
Other operating expenses	<i>Sundry expenses (administration and distribution)</i>
Other operating income	<i>Sundry income</i>
Other payables	<i>Accruals</i>
Other receivables	<i>Prepayments</i>
Plant and equipment	<i>Plant and equipment</i>
Profit (before tax) for the year	<i>Net profit</i>
Property	<i>Land and buildings</i>
Raw materials Ordinary goods purchased	<i>Purchases</i>
Revenue	<i>Sales</i>
Share capital	<i>Share capital</i>
Trade payables	<i>Creditors</i>
Trade receivables	<i>Debtors</i>
Work in progress	<i>Work in progress</i>

Part I

The accounting system

1

Double-entry bookkeeping: cash transactions

In this chapter you will learn:

- that every transaction has two aspects
- that double-entry bookkeeping records both aspects of a transaction
- what ledger accounts are
- the meanings of the terms 'debit' and 'credit'
- how to record cash transactions in ledger accounts.

1.1 What is double-entry bookkeeping?

Double-entry bookkeeping is a system of recording transactions that recognises that there are two sides (or aspects) to every transaction. For example, you give your friend \$10 in exchange for his watch. This involves you giving him \$10 (one aspect) and your friend receiving \$10 (the other aspect). The transfer of the watch involves him giving you the watch (one aspect) and you receiving his watch (the other aspect). Every transaction involves giving and receiving. It is important that you *recognise* and *record* both aspects of every transaction in your bookkeeping.

1.2 Ledger accounts

Transactions are recorded in **ledger accounts**. An account is a history of all transactions of a similar nature. A ledger is a book that contains accounts. An account separates what is received from what is given. For example, a Cash account records cash received and cash paid, as shown:

Cash			
Debit		Credit	
	\$		\$
Mar 1	Cash received from customers	Mar 2	Cash paid to suppliers
	240		80
Mar 4	Cash received from customers	Mar 3	Wages paid
	118		116

The left-hand side of the account is called the debit side and is used to record cash received (that is, coming into the account). The right-hand side of the account is the credit side and shows cash paid (that is, going out of the account). All accounts have a debit side on the left to record what is received, and a credit side on the right to record what is given. In practice, the words 'debit' and 'credit' are not shown because bookkeepers do not need to be reminded of them.

1.3 How to record cash transactions

Bookkeeping treats businesses as 'persons' with separate identities from their owners. For example, if Abdul is a trader, all his business transactions are recorded as those of the business and not as Abdul's own transactions.

In the example that follows, some transactions are recorded in ledger accounts. Make sure you understand the bookkeeping entries, and observe the wording carefully. This is important as you must be able to record transactions in ledger accounts correctly.

Example

(Here all transactions are recorded from the point of view of Abdul's business, not from the point of view of the people with whom the business deals.)

Transaction 1 April 1. Abdul starts business as a trader by paying \$10 000 into a Bank account which

4 The accounting system

he opens for the business. Abdul gives, and the business receives, \$10 000. An account for Abdul will be opened (his Capital account) and credited with his 'capital'. The business Bank account will be debited.

Bank	
\$	\$
Apr 1 Abdul – Capital 10 000	

Abdul – Capital	
\$	\$
	Apr 1 Bank 10 000

Note. Each entry is dated and shows the name of the other account in which the double entry is completed. Make sure you show these details for every entry you make in a ledger account.

Entries in ledger accounts are known as **postings**, and bookkeepers are said to 'post' transactions to the accounts.

Transaction 2 April 2. Abdul buys a motor vehicle for the business and pays \$2000 from the business Bank account. A Motor Vehicles account must be opened.

Bank	
\$	\$
Apr 1 Abdul – Capital 10 000	Apr 2 Motor Vehicles 2000

Motor Vehicles	
\$	\$
Apr 2 Bank 2000	

Transaction 3 April 3. Abdul buys goods which he will re-sell in the normal course of trade for \$3000 and pays by cheque.

Bank	
\$	\$
Apr 1 Abdul – Capital 10 000	Apr 2 Motor Vehicles 2000
	Apr 3 Purchases 3000

Purchases	
\$	\$
Apr 3 Bank 3000	

Transaction 4 April 4. Abdul sells a quantity of the goods for \$800 and pays the money into the bank.

Bank	
\$	\$
Apr 1 Abdul – Capital 10 000	Apr 2 Motor Vehicles 2000
Apr 4 Sales 800	Apr 3 Purchases 3000

Sales	
\$	\$
	Apr 4 Bank 800

Transaction 5 April 7. A customer returns some goods and receives a refund of \$40.

Bank	
\$	\$
Apr 1 Abdul – Capital 10 000	Apr 2 Motor Vehicles 2000
Apr 4 Sales 800	Apr 3 Purchases 3000
	Apr 7 Sales Returns 40

Sales Returns	
\$	\$
Apr 7 Bank 40	

Note. Goods returned are not debited to Sales account but to Sales Returns account. This account is also known as Goods Inwards or Returns Inwards account.

Transaction 6 April 8. Abdul returns some goods costing \$100 to a supplier and receives a refund.

Bank	
\$	\$
Apr 1 Abdul – Capital 10 000	Apr 2 Motor Vehicles 2000
Apr 4 Sales 800	Apr 3 Purchases 3000
Apr 8 Purchases Returns 100	Apr 7 Sales Returns 40

Purchases Returns			
\$		\$	
	Apr 8	Bank	100

Note. Goods returned to a supplier are credited to Purchases Returns account. This account is also known as Goods Outwards account.

Transaction 7 April 10. Abdul buys another motor vehicle for the business and pays \$4000 by cheque.

Bank			
\$		\$	
Apr 1	Abdul – Capital	10 000	
Apr 4	Sales	800	
Apr 8	Purchases Returns	100	
Apr 2	Motor Vehicles	2000	
Apr 3	Purchases	3000	
Apr 7	Sales Returns	40	
Apr 10	Motor Vehicles	4000	

Motor Vehicles			
\$		\$	
Apr 2	Bank	2000	
Apr 10	Bank	4000	

Note. As explained in §1.2, an account is a history of all transactions of a similar nature. Therefore, it is not necessary to open another account for the second motor vehicle. Similarly, all purchases of office equipment are posted to Office Equipment account, and all purchases of office furniture are posted to Office Furniture account. You will encounter other examples such as plant and machinery, and fixtures and fittings.

Transaction 8 April 11. Tania lends the business \$5000. Abdul pays the money into the business bank account.

Bank			
\$		\$	
Apr 1	Abdul – Capital	10 000	
Apr 4	Sales	800	
Apr 8	Purchases Returns	100	
Apr 11	Tania – Loan	5 000	
Apr 2	Motor Vehicles	2000	
Apr 3	Purchases	3000	
Apr 7	Sales Returns	40	
Apr 10	Motor Vehicles	4000	

Tania – Loan			
\$		\$	
	Apr 11	Bank	5000

Transaction 9 April 12. Abdul pays rent on a warehouse by cheque, \$1000.

Bank			
\$		\$	
Apr 1	Abdul – Capital	10 000	
Apr 4	Sales	800	
Apr 8	Purchases Returns	100	
Apr 11	Tania – Loan	5 000	
Apr 2	Motor Vehicles	2000	
Apr 3	Purchases	3000	
Apr 7	Sales Returns	40	
Apr 10	Motor Vehicles	4000	
Apr 12	Rent Payable	1000	

Rent Payable			
\$		\$	
Apr 12	Bank	1 000	

Transaction 10 April 14. Abdul sublets part of the warehouse and receives a cheque for \$300 for the rent. This is paid into the bank.

Bank			
\$		\$	
Apr 1	Abdul – Capital	10 000	
Apr 4	Sales	800	
Apr 8	Purchases Returns	100	
Apr 11	Tania – Loan	5 000	
Apr 14	Rent Receivable	300	
Apr 2	Motor Vehicles	2000	
Apr 3	Purchases	3000	
Apr 7	Sales Returns	40	
Apr 10	Motor Vehicles	4000	
Apr 12	Rent Payable	1000	

Rent Receivable			
\$		\$	
	Apr 14	Bank	300

Note. Rent receivable is not posted to the Rent Payable account. It is important to keep income and expenditure in separate accounts.

Transaction 11 April 15. Abdul pays wages by cheque, \$1200.

Bank			
\$		\$	
Apr 1	Abdul – Capital	10 000	
Apr 4	Sales	800	
Apr 8	Purchases Returns	100	
Apr 11	Tania – Loan	5 000	
Apr 14	Rent Receivable	300	
Apr 2	Motor Vehicles	2000	
Apr 3	Purchases	3000	
Apr 7	Sales Returns	40	
Apr 10	Motor Vehicles	4000	
Apr 12	Rent Payable	1000	
Apr 15	Wages	1200	

Wages			
\$		\$	
Apr 15	Bank	1 200	

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Transaction 12 April 16. Abdul withdraws \$600 from the business Bank account for personal use.

Bank			
	\$		\$
Apr 1 Abdul – Capital	10 000	Apr 2 Motor Vehicles	2000
Apr 4 Sales	800	Apr 3 Purchases	3000
Apr 8 Purchases Returns	100	Apr 7 Sales Returns	40
Apr 11 Tania – Loan	5 000	Apr 10 Motor Vehicles	4000
Apr 14 Rent Receivable	300	Apr 12 Rent Payable	1000
		Apr 15 Wages	1200
		Apr 16 Drawings	600

Drawings		
	\$	\$
Apr 16 Bank	600	

Note. Money drawn out of a business by the owner for personal use is debited to a Drawings account, not to the owner's Capital account.

EXERCISE 1

Open the necessary ledger accounts and post the following transactions to them. All transactions took place in the bank account.

- May 1** Martine started business as a florist by paying \$300 into a business Bank account.
- 2** Charline lent the business \$1000.
Martine then had the following transactions.
- 3** Paid rent, \$100.
- 4** Purchased shop fittings, \$400.
Purchased flowers \$300, paying by cheque.
- 5** Received refund of \$20 for flowers returned to supplier.
- 6** Sold some flowers and received \$40.
- 7** Paid wages, \$60.
- 8** Withdrew \$100 for personal use.

EXERCISE 2

Complete the entries for the following table. The first item has been done for you.

	Debit account	Credit account
1. Noel pays a cheque into his business Bank account as capital	Bank	Noel – Capital
2. Purchases some goods for resale and pays by cheque		
3. Sells some goods and banks the takings		
4. Pays rent by cheque		
5. Purchases shop fittings and pays by cheque		
6. Cashes cheque for personal expenses		
7. Pays wages by cheque		
8. Returns goods to supplier and banks refund		
9. Receives rent from tenant and banks cheque		
10. Refunds money to customer by cheque for goods returned		
11. Motor vehicle purchased and paid for by cheque		
12. Pays for petrol for motor vehicle and pays by cheque		

HINTS

- All transactions are recorded from the point of view of the business, not from those of its customers and suppliers.
- When recording transactions, think very carefully about which account 'gives' and which account 'receives'. Credit the account that 'gives' and debit the account that 'receives'.
- Make sure you complete the double entry for every transaction before starting to record the next one.
- Date every entry and enter the name of the other account in which the double entry is completed in the details column.
- If you make a mistake in an exercise, study the answer given at the end of the book and make sure you understand what you should have done *and why*.
- The golden rule is that for every debit entry there must be an equal credit entry.

MULTIPLE-CHOICE QUESTIONS

1. Joel occupies part of Natasha's business premises. Which entries in Natasha's books record the rent Joel pays her by cheque?

Debit account	Credit account
A. Bank	Rent Payable
B. Bank	Rent Receivable
C. Rent Payable	Bank
D. Rent Receivable	Bank

2. Yasmina purchased some office equipment for use in her business. The equipment was faulty and she returned it to the supplier who refunded the cost to Yasmina. Which entries in Yasmina's books record the return of the equipment?

Debit account	Credit account
A. Bank	Purchases Returns
B. Bank	Office Equipment
C. Purchase Returns	Bank
D. Office Equipment	Bank

3. A trader withdraws money from his business Bank account for personal expenses. Which entries record this in his books?

Debit account	Credit account
A. Bank	Capital
B. Bank	Drawings
C. Capital	Bank
D. Drawings	Bank

4. A trader returns goods to the supplier and receives a refund. Which entries record the refund in the trader's books?

Debit account	Credit account
A. Bank	Purchases
B. Bank	Purchases Returns
C. Purchases	Bank
D. Purchases Returns	Bank

ADDITIONAL EXERCISES

1. Open the necessary ledger accounts and post the following transactions to them.

June 1 Farook commenced business by paying \$15 000 into his business Bank account.
Amna lent the business \$5000.

Farook then had the following business transactions.

- 2 Purchased premises and paid \$8000.
- 3 Bought office furniture for \$2000 and paid by cheque.
- 4 Paid \$5000 by cheque for goods for re-sale.
- 5 Sold some goods for \$1500 and banked the proceeds.
- 6 Paid insurance premium by cheque, \$600.
- 7 Bought motor van and paid \$3000 by cheque.
- 8 Drew cheque for \$50 to pay for petrol for motor van.
- 9 Bought some goods costing \$2000 for re-sale and paid by cheque.
- 10 Sold goods for \$2400 and banked the proceeds. Drew cheque for wages, \$400.
- 11 Repaid \$1200 by cheque to customers for goods returned.
- 12 Received a refund of \$900 from suppliers for goods returned.
- 13 Received a refund of insurance of \$100.
Withdrew \$200 from business Bank account for personal expenses.
- 14 Returned some office furniture that was damaged and received a refund of \$800.
- 15 Repaid \$1000 of the loan from Amna.

2. Complete the entries for the following table with information taken from the accounts of a trader.

	Debit account	Credit account
1. Local taxes paid by cheque		
2. Bank pays interest to trader		
3. Sundry expenses paid by cheque		
4. Postage and stationery paid by cheque		
5. Telephone bill paid by cheque		
6. Carriage inwards* paid by cheque		
7. Carriage outwards** paid by cheque		
8. Interest paid by cheque to brother in respect of a loan received from him		
9. Interest paid to bank		

* Carriage inwards is the delivery cost of bringing the goods from the supplier to the buyer.

** Carriage outwards is the cost of delivering goods to a customer.

2

Double-entry bookkeeping: credit transactions

In this chapter you will learn:

- how to record transactions which do not involve immediate cash payments in ledger accounts
- the difference between trade and cash discounts and how to treat them.

2.1 What are credit transactions?

Many transactions take place without any money being paid or received at the time. For example, Lai sells goods to Chin for \$500 on 31 May and gives Chin until 30 June to pay. The transaction is ‘on credit’. The sale has taken place on 31 May and must be recorded in the books of both Lai and Chin at that date. No entries to record payment are made in their books until Chin pays Lai.

2.2 How to record credit transactions

In a seller’s books A sale on credit is credited to Sales account and debited to an account opened in the name of the customer. When the customer pays, his or her account is credited, and the Bank account debited.

In a customer’s books A purchase on credit is debited to Purchases account and credited to an account opened in the name of the supplier. When the supplier is paid, his or her account is debited, and the Bank account credited.

Example

Lai sells goods to Chin for \$500 on 31 May and gives Chin until 30 June to pay.

In Lai’s books Credit the sale to Sales account and debit it to an account for Chin.

Sales			
	\$		\$
		May 31 Chin	500
Chin			
	\$		\$
May 31 Sales	500		

The debit entry in Chin’s account shows that he is a **debtor** in Lai’s books; that is, Chin owes Lai \$500 until he pays for the goods.

In Chin’s books Debit the purchase to Purchases account and credit it to an account for Lai.

Purchases			
	\$		\$
May 31 Lai	500		

Lai			
	\$		\$
		May 31 Purchases	500

The credit entry in Lai’s account shows that he is a **creditor** in Chin’s books.

Goods returned

On 4 June Chin returns some of the goods costing \$100 to Lai because they are damaged.

In Lai’s books Credit Chin’s account and debit Sales Returns account.

Chin			
	\$		\$
May 31 Sales	500	Jun 4 Sales Returns	100
Sales Returns			
	\$		\$
Jun 4 Chin	100		

In Chin's books Debit Lai's account and credit Purchases Returns account.

Lai			
	\$		\$
Jun 31 Purchases Returns	500	May 31 Purchases	500
Purchases Returns			
	\$		\$
		Jun 4 Lai	100

2.3 How to record payments for goods bought or sold on credit

Trade discount

Trade discount is an allowance made by one trader to another. In the above example, the goods which Lai sold to Chin may have been sold normally for \$625. Lai knows that Chin, also a trader, must make a profit on the goods when he sells them. He has allowed Chin a **trade discount** of \$125 (20% of \$625) so that if Chin sell the goods for \$625 he will make a profit of \$125.

Note. Although the normal price of the goods was \$625, the transaction was for \$500 only, and only \$500 is entered into the books of both Lai and Chin. Trade discount is *never* recorded in ledger accounts.

Cash (or settlement) discount

Lai has given Chin one month to pay for the goods. To encourage Chin to pay by 30 June, Lai may allow Chin to pay less than the amount due. This allowance is a cash (or settlement) discount. (Notice the difference between cash discount and trade discount: trade discount is not dependent on payment being made promptly, or even at all.)

Note. Cash discounts are *always* recorded in ledger accounts.

Suppose Lai has allowed Chin a cash discount of 5% provided Chin pays by 30 June, and Chin pays Lai on 28 June. Chin owes Lai \$400 (\$500 – \$100), 5% of \$400 = \$20. He will, therefore, pay only \$380.

In Lai's books Debit the discount to Discounts Allowed account.

Chin			
	\$		\$
May 31 Sales	500	Jun 4 Sales Returns	100
		Jun 28 Bank	380
		Jun 28 Discounts Allowed	20
Bank			
	\$		\$
Jun 28 Chin	380		
Discounts Allowed			
	\$		\$
Jun 28 Chin	20		

In Chin's books Credit the discount to Discounts Received account

Lai			
	\$		\$
Jun 4 Purchases Returns	100	May 31 Purchases	500
Jun 28 Bank	380		
Jun 28 Discounts Received	20		
Bank			
	\$		\$
		Jun 28 Lai	380
Discounts Received			
	\$		\$
		Jun 28 Lai	20

Example

Andrew had the following transactions in May.

- May 1** Purchased goods from David. The goods cost \$1000 less 10% trade discount.
- 2** Purchased goods from Rodney for \$1600 less 15% trade discount.
- 3** Purchased a computer for the office on credit from Bernard for \$2000.

- 4 Sold goods to Mario for \$800.
- 5 Returned goods which had cost \$100 after trade discount to David.
- 6 Purchased goods from Ludovic for \$700 less trade discount at 20%.
- 7 Sold goods to Ravin for \$500.
- 8 Mario returned goods which had been sold to him for \$40.
- 9 Received cheque from Ravin for amount owing, less cash discount of 5%.
- 10 Paid amount owing to David, less cash discount of 5%.
- 11 Paid amount owing to Rodney, less cash discount of 5%. Paid Bernard for computer.
- 12 Received cheque from Mario for amount owing, less 5% cash discount.
Paid amount owing to Ludovic, less 5% cash discount.

These transactions are recorded as follows:

David			
	\$		\$
May 5 Purchases Returns	100	May 1 Purchases	900
May 10 Bank	760		
May 10 Discounts Received	40		

Rodney			
	\$		\$
May 11 Bank	1292	May 2 Purchases	1360
May 11 Discounts Received	68		

Bernard			
	\$		\$
May 11 Bank	2000	May 3 Office Computer	2000

Ludovic			
	\$		\$
May 12 Bank	532	May 6 Purchases	560
May 12 Discounts Received	28		

Mario			
	\$		\$
May 4 Sales	800	May 8 Sales Returns	40
		May 12 Bank	722
		May 12 Discounts Allowed	38

Ravin			
	\$		\$
May 7 Sales	500	May 9 Bank	475
		May 9 Discounts Allowed	25

Purchases			
	\$		\$
May 1 David	900		
May 2 Rodney	1360		
May 6 Ludovic	560		

Purchases Returns			
	\$		\$
		May 5 David	100

Sales			
	\$		\$
		May 4 Mario	800
		May 7 Ravin	500

Sales Returns			
	\$		\$
May 8 Mario	40		

Discounts Allowed			
	\$		\$
May 9 Ravin	25		
May 12 Mario	38		

Discount Received			
	\$		\$
		May 10 David	40
		May 11 Rodney	68
		May 12 Ludovic	28

Office Computer			
	\$		\$
May 3 Bernard	2000		

Bank			
	\$		\$
May 9 Ravin	475	May 10 David	760
May 12 Mario	722	May 11 Rodney	1292
		May 11 Bernard	2000
		May 12 Ludovic	532

Calculations

Purchases:	Amount before trade discount	Trade discount	Cost to Andrew
	\$	\$	\$
From: David	1000	(10%) 100	900
Rodney	1600	(15%) 240	1360
Ludovic	700	(20%) 140	560
Cash settlements:	Amount before cash discount	Cash discount (5%)	Amount paid
	\$	\$	\$
By: Ravin	500	25	475
Mario	760	38	722

EXERCISE 1

Post the following transactions in the books of Geraud.

- June 1** Purchased goods from Khor which cost \$3000 less trade discount of 10%.
5 Sold goods to Lai for \$600.
10 Returned goods which had cost Geraud \$200 to Khor.
15 Purchased goods from Lim which cost \$2800 before trade discount of 10%.
20 Sold goods to Chin for \$1300.
25 Lai returned goods which had cost him \$200.
30 Geraud paid Khor and Lim the amounts due to them after deducting 5% cash discount.
 Lai and Chin paid Geraud the amounts they owed him after deducting 5% cash discount.

HINTS

- Remember to record all transactions from the point of view of the business, not from those of its customers and suppliers.
- Where trade discounts are given, record all amounts net of trade discount.
- Note carefully whether cash discount is to be deducted from settlements.
- Remember to complete the entries for cash discounts to the correct Discount accounts.
- Be accurate in all your calculations.

MULTIPLE-CHOICE QUESTIONS

1. Davina bought goods on credit from Sharon for \$600 less trade discount of \$120. Which entries record this transaction in Davina's books?

Account to be debited	Account to be credited
A. Purchases \$480	Sharon \$480
B. Purchases \$480	Sharon \$600
	Discounts Allowed \$120

Account to be debited	Account to be credited
C. Purchases \$600	Sharon \$600
D. Purchases \$600	Sharon \$480
	Discounts Received \$120

2. Kristal bought goods on credit from Prisca. The goods had a list price of \$1000 but Prisca allowed

Kristal trade discount of 10% and cash discount of 4%.

How much did Kristal have to pay Prisca?

A. \$860 B. \$864 C. \$900 D. \$960

3. Shirley bought goods from Corrine. The goods had a list price of \$800. Corrine allowed Shirley trade discount of 20% and cash discount of 5%. In Corrine's books, which entries record the cheque she received from Shirley?

Account to be debited

- A. Bank \$608
Discounts Allowed \$32
- B. Bank \$608
Discounts Received \$32
- C. Bank \$608
Discounts Allowed \$152
- D. Bank \$608
Discounts Received \$152

Account to be credited

- Shirley \$640
- Shirley \$640
- Shirley \$760
- Shirley \$760

ADDITIONAL EXERCISES

1. Fleming had the following transactions.

- July** 1 Purchased goods from Adams for \$5000 less trade discount of 15%. Adams allowed Fleming 4% cash discount.
- 4 Purchased goods from Bond for \$2500 less trade discount of 10%. Bond allowed Fleming 4% cash discount.
- 5 Returned goods which had cost \$600 to Adams.
- 7 Purchased goods from Astle for \$7000 less trade discount of 20%. Astle allowed Fleming 5% cash discount.
- 9 Returned goods which had cost \$800 to Astle.
- 10 Purchased goods from Cairns for \$4200 less 10% trade discount. Cairns allowed Fleming 5% cash discount.
- 14 Fleming settled all accounts owing to his suppliers by cheque, taking advantage of the cash discount in each case.

Required

Post the transactions listed above in Fleming's books in good form.

2. Streak had the following transactions in March.

- Mar** 1 Sold goods to Blignaut for \$2500 less trade discount of 10%, and allowed him cash discount of 4%.
- 4 Sold goods to Ebrahim for \$4000 less trade discount of 15%, and allowed him cash discount of 5%.
- 6 Ebrahim returned goods which had cost him \$200.
- 8 Sold goods to Friend for \$3200 less trade discount of 20%, and allowed him cash discount of 5%.
- 12 Sold goods to Flower for \$2000 less trade discount of 10%, and allowed him cash discount of 4%.
- 14 Flower returned goods which had cost him \$350.
- 15 Blignaut, Ebrahim, Friend and Flower settled their accounts by cheque, each taking advantage of cash discount.

Required

Post the transactions listed above in Streak's books in good form.

3

Books of prime (or original) entry

In this chapter you will learn:

- the purpose of books of prime entry
- how to enter transactions in books of prime entry
- how to post transactions from the books of prime entry to ledger accounts.

3.1 What is a book of prime entry?

A **book of prime entry** is used to list all transactions of a similar kind *before* they are posted to ledger accounts. They are sometimes known as books of first (or original) entry but for convenience they will be referred to as books of prime entry in this text. Because they list transactions before they are posted to ledger accounts they are *outside* the double-entry model. *It is important to remember that they are not part of double-entry bookkeeping.* There is, however, one exception to this rule, and that is the cash book, as explained later in §3.4.

The names of the books of prime entry and their uses are:

Book of prime entry	Use
Sales journal (or sales day book)	To record all sales made on credit. The entries are made from copies of invoices sent to customers.
Sales returns book (or sales returns journal, or returns inwards journal)	To record all goods returned from customers. When customers return goods that were bought on credit they are sent credit notes showing the amount credited to their account for the returns. The sales returns book is prepared from the copies of credit notes sent to customers.
Purchases journal (or purchases day book)	To record all purchases of stock in trade (goods for resale) made on credit. These are entered in the purchases journal from suppliers' invoices.
Purchases returns journal (or purchases	To record all goods returned to suppliers. The purchases returns journal is

Book of prime entry	Use
returns book, or returns outwards journal)	prepared from credit notes received from suppliers.
Cash book	To record all cash and bank transactions. (But see §3.4)
Journal (or general journal)	To record all transactions for which there is no other book of prime entry. (Also see HINTS.)

3.2 How to write up books of prime entry

Example

Jayasuriya has sent and received the following invoices and credit notes.

Invoices sent to customers	Amount of invoice
	\$
May 1 Atapattu	2350
May 4 de Silva	1746
May 6 Arnold	520
Credit notes sent to customers	Amount of credit note
	\$
May 3 Atapattu	350
May 5 de Silva	146
May 7 Arnold	60
Invoices received from suppliers	Amount of invoice
	\$
May 2 Vaas	5000
May 5 Fernando	3600
May 7 Mubarak	2200
Credit notes received from suppliers	Amount of credit note
	\$
May 6 Vaas	1000
May 7 Fernando	600

The transactions will be entered in the books of prime entry as follows:

Sales journal		\$	Sales Returns journal		\$
May 1	Atapattu	2350	May 3	Atapattu	350
May 4	de Silva	1746	May 5	de Silva	146
May 6	Arnold	<u>520</u>	May 7	Arnold	<u>60</u>
		<u>4616</u>			<u>556</u>

Purchases journal		\$	Purchases returns journal		\$
May 2	Vaas	5 000	May 6	Vaas	1000
May 5	Fernando	3 600	May 7	Fernando	<u>600</u>
May 7	Mubarak	<u>2 200</u>			<u>1600</u>
		<u>10 800</u>			

3.3 How to post from books of prime entry to ledger accounts

Example

Use the information in the books of prime entry in §3.2.

Step 1. Post each item in the books of prime entry to the supplier's or customer's account in the ledger following the procedure already learned in chapter 2, but do *not* post the individual items to the Purchases, Purchases Returns, Sales or Sales Returns accounts.

Atapattu					
		\$			\$
May 1	Sales	2350	May 3	Sales Returns	350

de Silva					
		\$			\$
May 4	Sales	1746	May 5	Sales Returns	146

Arnold					
		\$			\$
May 6	Sales	520	May 7	Sales Returns	60

Vaas					
		\$			\$
May 6	Purchases	Returns	1000	May 2	Purchases
					5000

Fernando						
			\$			\$
May 7	Purchases	Returns	600	May 5	Purchases	3600

Mubarak			
	\$		\$
May 7	Purchases		2200

Step 2. Post the *total* of each book of prime entry to the Sales, Sales Returns, Purchases or Purchases Returns accounts, as appropriate.

Sales			
	\$		\$
May 7	Sales journal total		4616

Sales Returns			
	\$		\$
May 7	Sales returns journal total	556	

Purchases			
	\$		\$
May 7	Purchases journal total	10 800	

Purchases Returns			
	\$		\$
May 7	Purchases returns journal total		1600

3.4 The cash book

A **cash book** is the book of prime entry for all cash and bank transactions; but we have already seen in chapter 1 that it is also an account. It is the only book of prime entry that is also part of the double-entry model.

The cash book is also used as the book of prime entry for cash discounts. A column is provided on the debit side of the Bank account to record discounts allowed, and a column on the credit side to record discounts received.

Bank					
	Discounts (allowed)	Bank		Discounts (received)	Bank
	\$	\$		\$	\$

The words 'allowed' and 'received' are sometimes omitted because bookkeepers know which is which.

3.5 How to enter discounts in the cash book

When a payment is received from a customer who has deducted cash discount, enter the amount of the discount in the discounts allowed column next to the amount received in the bank column.

Enter discounts received from suppliers in the discounts received column next to the amount paid in the bank column.

Example

All payments due from customers and all payments to suppliers in §3.2 were settled on 7 May. In each case, cash discount of 5% was allowed or received.

Bank					
	Discounts (allowed)	Bank		Discounts (received)	Bank
	\$	\$		\$	\$
May 7 Attapattu	100	1900	May 7 Vaas	200	3800
May 7 de Silva	80	1520	May 7 Fernando	150	2850
May 7 Arnold	<u>23</u>	437	May 7 Mubarak	<u>110</u>	2090
	<u>203</u>			<u>460</u>	

Atapattu					
	\$			\$	
May 1 Sales	2350	May 3 Sales Returns		350	
		May 7 Bank		1900	
		May 7 Discounts Allowed		100	

de Silva					
	\$			\$	
May 4 Sales	1746	May 5 Sales Returns		146	
		May 7 Bank		1520	
		May 7 Discounts Allowed		80	

Arnold					
	\$			\$	
May 6 Sales	520	May 7 Sales Returns		60	
		May 7 Bank		437	
		May 7 Discounts Allowed		23	

Vaas					
	\$			\$	
May 6 Purchases		May 2 Purchases		5000	
Returns	1000				
May 7 Bank	3800				
May 7 Discounts Received	200				

Fernando					
	\$			\$	
May 7 Purchases		May 5 Purchases		3600	
Returns	600				
May 7 Bank	2850				
May 7 Discounts Received	150				

Mubarak					
	\$			\$	
May 7 Bank	2090	May 7 Purchases		2200	
May 7 Discounts Received	110				

3.6 How to post discounts from the cash book to the Discounts Allowed and Discounts Received accounts

The periodic totals of the discount allowed column in the cash book are posted to the **debit** of the Discounts Allowed account; the periodic totals of the discounts received column are posted to the **credit** of the Discounts Received account. The discount columns in the cash book are not part of the double-entry model.

Discounts Allowed			
	\$		\$
May 7 Cash book total	203		

Discounts Received			
	\$		\$
May 7 Cash book total		460	

Exercise 1

Murgatroyd had the following transactions, all on credit, in March.

- March**
- 1 Purchased goods from Tikolo for \$10 000 less trade discount of 20%. Tikolo allowed him 5% cash discount.
 - 4 Sold goods to Snyman for \$1200 less trade discount of 10%. He allowed Snyman 4% cash discount.
 - 6 Purchased goods from Walters for \$8000 less trade discount of 10%. Walters allowed Murgatroyd 5% cash discount.
 - 10 Sold goods to Karg for \$2500 less trade discount of 10%. He allowed Karg 4% cash discount.
 - 11 Snyman returned goods which had cost him \$200.
 - 12 Returned goods which had cost \$400 to Tikolo.
 - 13 Purchased goods from Burger for \$7000 less trade discount of 25%. Burger allowed him cash discount of 4%.
 - 17 Sold goods to Kotze for \$3000 less trade discount of 10%. He allowed Kotze 5% cash discount.
 - 18 Purchased goods from Tikolo for \$6000 less trade discount of 20%. Tikolo allowed him 5% cash discount.
 - 20 Karg returned goods which had cost him \$300.
 - 22 Returned to Burger goods which had cost \$1000.
 - 25 Sold goods to Snyman for \$1800 less trade discount of 10%. Murgatroyd allowed Snyman 5% cash discount.
 - 31 Received cheques from Snyman, Karg and Kotze respectively in full settlement of their accounts, and sent cheques in full settlement of their accounts to Tikolo, Walters and Burger.

Required

Enter the transactions for March in Murgatroyd's books of prime entry and post them in good form to the proper accounts.

3.7 Three-column cash book

Most businesses receive cash that they do not bank and pay some of their expenses out of the unbanked cash. An account for this cash is kept in the cash book. It is usually found convenient to have columns for cash next to those for the Bank account for cash receipts and payments. The account is then a combined Bank and Cash account.

Bank and Cash							
	Disc \$	Cash \$	Bank \$		Disc \$	Cash \$	Bank \$

3.8 How to write up a three-column cash book

The cash columns are entered in exactly the same way as the bank columns, cash received being debited, and cash payments credited, in the cash columns. When cash is banked, the cash column must be credited and the bank column debited with the amount. When cash is drawn from the bank, the bank column must be credited and the cash column must be debited.

Example

On 1 May Cassius received \$700 in cash from a customer. On 3 May he paid sundry expenses of \$40 out of cash. On 4 May his takings were \$2000. On 5 May he banked \$1500 cash.

On 7 May he paid cash, \$70, on sundry items. On May 8 he withdrew \$500 from the bank to pay wages.

Bank and Cash							
	Disc \$	Cash \$	Bank \$		Disc \$	Cash \$	Bank \$
May 1 Sales		700		May 3 Sundry exps.		40	
May 4 Sales		2000		May 5 Bank ϕ		1500	
May 5 Cash ϕ			1500	May 7 Sundry exps.		70	
May 8 Bank ϕ		500		May 8 Cash ϕ			500
				May 8 Wages		500	

Note. ϕ is an abbreviation for 'contra', indicating that the double entry is completed on the opposite sides of the Bank and Cash accounts.

Exercise 2

Enter the following transactions in Joshua's three-column cash book.

- March**
- 1 Received takings from cash sales, \$1100.
 - 2 Paid electricity in cash, \$130.
 - 3 Received takings from cash sales, \$900.
 - 4 Banked cash, \$1700.
 - 5 Paid sundry expenses in cash, \$25.
 - 6 Drew \$800 from bank for the office cash float.
 - 7 Paid for stock by cash, \$750.

3.9 The journal

All transactions should be recorded in one of the books of prime entry before being posted to ledger accounts. The journal is the book of prime entry for transactions for which there is no other book of prime entry. Items which will require entries in the journal are

- corrections of posting errors
- adjustments to accounts (which are dealt with later)
- transfers between accounts
- purchase and sale of items other than stock-in-trade (e.g. machinery, delivery vans, etc. used in the business) on credit
- opening entries in a new set of ledgers (e.g. when there is no more room in the existing ledgers and the balances on the accounts are transferred to new ledgers or to make the opening entries at the start of a new accounting period).

Each journal entry shows the account to be debited, and the account to be credited. It follows that the debits should always equal the credits. The journal is ruled as follows:

Date	Accounts	Dr*	Cr*

*Dr is short for debit and Cr is short for credit.

3.10 How to make journal entries

Always state the account to be debited before the one to be credited. Every entry should have a brief but informative explanation of the reason for the entry; this is called the **narrative**.

Example

- Jonah discovered that he had credited \$100 that he had received from A. Burger on 1 April to an account for L. Burger in error. The journal entry to correct the error will be:

Date	Accounts	Dr	Cr
April 1	L. Burger A. Burger	\$ 100	\$ 100

Correction of an error. A remittance from A. Burger on this date was posted incorrectly to L. Burger's account.

- On 4 May Jonah bought office furniture from A. Whale on credit for \$400.

Date	Accounts	Dr	Cr
May 4	Office Furniture A. Whale	\$ 400	\$ 400

Purchase of office furniture from A. Whale. See A. Whale's invoice no. 123 dated 4 May.

Note. The narrative gives Jonah the information he needs to enable him to check on the details later if needs be.

- On 13 May Jonah bought a delivery van for \$3000 and paid by cheque.
(The book of prime entry for this cash transaction is the cash book but, by also entering the purchase in the journal, Jonah will be able to see more detail about this important item than if he had entered it in the cash book only.)

Date	Accounts	Dr	Cr
May 13	Delivery Van account Bank	\$ 3000	\$ 3000

Purchase of delivery van, registration no. G1234PYD. See Wheeler's invoice no. 6789 dated 13 May.

Exercise 3

Prepare journal entries in proper form to correct the following.

- Credit note no. 964, for \$120, received from A & Co., a supplier, has been posted to A. Cotter's account in error.
- Invoice no. 104, for \$400, received from Hussain, a supplier, has not been entered in the purchases journal.
- Invoice no. 6789, for \$150, sent to Maya, a customer, has been entered in the sales journal as \$105.
- The purchase of a machine for use in the business, and costing \$2300, has been debited to Purchases account in error.
- Credit note no. 23, for \$68, sent to Hanife, a customer, has been omitted from the sales returns journal.

HINTS

- Remember that books of prime entry, *except the cash book*, are not part of the double-entry model.
- Recognise the correct book of prime entry for every transaction you record in ledger accounts.
- Enter invoices *net of trade discount* in the books of prime entry.
- Post the periodic totals of the sales journal, sales returns journal, purchases journal and purchases returns journal to the Sales, Sales Returns, Purchases and Purchases Returns accounts respectively.
- Remember that the discount columns in the cash book are memorandum columns only and not part of the double-entry model.
- Prepare cash books in columnar form if possible. (See §3.8.)
- Show the debit entry before the credit entry in the journal.
- Add a suitable narrative with proper detail to every entry in the journal.
- Prepare journal entries only to ledger accounts, *never to other books of prime entry*.

MULTIPLE-CHOICE QUESTIONS

1. Tania purchased goods for \$1000 less 25% trade discount. She was allowed cash discount of 10%. Which amount should she enter in her purchases journal?

A. \$650 B. \$675 C. \$750 D. \$1000

2. Lara purchased goods costing \$1800 less trade discount of 30%. He was allowed cash discount of 5%.

How much should Lara have to pay for the goods?

A. \$1080 B. \$1197 C. \$1260 D. \$1800

3. Cora sent an invoice to Maria for \$2000 less 20% trade discount. Cora has omitted to enter the invoice in her sales journal.

What effect will this have on her accounts?

Maria's account		Sales account	
Debit	Credit	Debit	Credit
A	understated \$1600	understated \$1600	

Debit	Credit	Debit	Credit
B understated \$1600			understated \$1600
C	understated \$2000	understated \$2000	
D understated \$2000			understated \$2000

4. Cheung has received a cheque for \$1540 from Raju in full settlement of a debt of \$1700.

How should this be recorded in Cheung's books of account?

	Debit	\$	Credit	\$
A	Bank	1540	Raju	1540
B	Bank	1700	Raju	1700
C	Bank	1540	Raju	1700
	Discounts Allowed	160		
D	Bank	2000	Raju	1540
			Discounts Received	160

ADDITIONAL EXERCISES

1. Adeel's transactions for the month of April were as follows:

- April**
- 1 Bought goods from Bilal for \$3000 less 20% trade discount. Bilal allowed Adeel 5% cash discount.
 - 2 Sold goods to Imran for \$800 less 10% trade discount. He allowed Imran 5% cash discount.
 - 3 Bought goods from Asad for \$1300 less 20% trade discount. Asad allowed Adeel 5% cash discount.
 - 5 Purchased a delivery van on credit from Syed for \$6000. The invoice for the van was no. 324.
 - 8 Returned goods which had cost \$100 to Bilal.
 - 10 Sold goods to Raza for \$1100 less 20% trade discount. He allowed Raza 5% cash discount.
 - 13 Imran returned goods which had cost him \$60.
 - 15 Purchased goods from Asma for \$4000 less 25% trade discount. Asma allowed Adeel 5% cash discount.
 - 16 Sold goods to Amna for \$1500 less 20% trade discount. He allowed Amna 5% cash discount.
 - 17 Sold goods to Raza for \$1600 less 20% trade discount. He allowed Raza 5% cash discount.
 - 21 Returned goods which had cost him \$600 to Asma.
 - 24 Amna returned goods which had cost her \$300.
 - 26 Purchased goods from Bilal for \$4000 less 20% trade discount. Bilal allowed Adeel 5% cash discount.
 - 30 Adeel settled all accounts he owed by cheque, and received cheques for all amounts owing by his customers. All discounts were taken.

Required

- (a) Enter all the transactions for April into the books of prime entry.
 - (b) Post the books of prime entry to the ledger accounts.
2. Prepare journal entries with suitable narratives to record the following:
- (a) Received from Mumtaz invoice no. 506 dated 3 March for \$10 000. This was in respect of the purchase of a machine on credit.
 - (b) Invoice no. 495 dated 6 March for \$675 for goods sold to Wayne. The invoice has been entered twice in the sales journal.
 - (c) Invoice no. 998 dated 7 March for \$4250 in respect of a delivery van purchased from Younas and paid for by cheque.
 - (d) Credit note no. 103 dated 10 March for \$190 sent to Browne but omitted from the sales returns journal.
 - (e) Invoice no. 854 dated 15 March for \$1300 for goods purchased from Sandra. The invoice has been posted to Geeta's account in error.

4

Balancing accounts

In this chapter you will learn:

- how to find and record a balance on a ledger account
- what debit balances and credit balances mean.

4.1 Why accounts need to be balanced

The cash book must be balanced periodically to find how much money is left in the bank account or how much cash the business has left. Similarly, the ledger accounts are balanced to find how much the business owes other people, how much it is owed, and how much has been received from, or spent on, the various activities.

4.2 How to balance an account

Add each side of the account to find which has the lesser total. Insert on that side the amount needed to make both sides equal, or, in other words, balance. Insert the total on each side of the account and carry the balance down to the other side of the account on the next day.

Example 1

Bank			
	\$		\$
Apr 1 Abdul – Capital	10 000	Apr 2 Motor Vehicles	2 000
Apr 4 Sales	800	Apr 13 Purchases	3 000
Apr 8 Purchases Returns	100	Apr 7 Sales Returns	40
Apr 11 Tania – Loan	5 000	Apr 10 Motor Vehicles	4 000
Apr 14 Rent Receivable	300	Apr 12 Rent Payable	1 000
		Apr 15 Wages	1 200
		Apr 16 Drawings	600
		Apr 10 Balance carried down	4 360
	<u>16 200</u>		<u>16 200</u>
Apr 11 Balance brought down	4 360		

Notes

- The account has been balanced at 10 April.
- The balance was entered on the credit side to make it balance with the debit side, and carried down to the debit side on the next day.
- The account has a *debit balance* showing how much money is left in the Bank account on 10 April.
- The totals are placed level with each other although there are more items on the credit side than on the debit side.

Example 2

Charley is a customer whose account has been balanced and is as follows:

Charley				
	\$			\$
Jun 4 Sales	1040	Jun 6 Sales Returns		400
Jun 10 Sales	3105	Jun 14 Bank		600
Jun 19 Sales	900	Jun 14 Discount		40
		Jun 30 Balance c/d		<u>4005</u>
	<u>5045</u>			<u>5045</u>
Jul 1 Balance b/d	4005			

Notes

- Charley's account has a debit balance which shows that he owes the business \$4005; he is a 'debtor' of the business.
- c/d is short for 'carried down' and b/d is short for 'brought down'. These abbreviations are quite acceptable in accounting.
- The credit entry on 14 June is described simply as 'discount' because it is understood that it is discount allowed.

Example 3

Sara (who supplies goods to the business)					
	\$			\$	
May 8 Purchases	1000	May 1 Balance	b/d	1940	
May 29 Bank	2005	May 12 Purchases		7330	
May 29 Discount	125				
May 31 Balance	c/d				
	<u>6140</u>				
	<u>9270</u>				<u>9270</u>
		June 1 Balance	b/d	6140	

Notes

- The credit balance shows that Sara is owed \$6140; she is a creditor of the business.
- When Sara's account was balanced on the previous 30 April, a balance of \$1940 was carried down and appears as an opening credit balance on her account at 1 May.

If an account has only one entry on each side and they are of equal amount, the account is simply ruled off.

Gerald			
	\$		\$
Mar 4 Sales	<u>1000</u>	Mar 23 Bank	<u>1000</u>

An account with an entry on one side only is balanced without the insertion of totals.

Paula			
	\$		\$
Mar 31 Balance	c/d	Mar 22 Purchases	<u>1500</u>
	<u>1500</u>	Apr 1 Balance	b/d 1500

A three-column cash book is balanced as follows:

Bank and Cash									
		Disc	Cash	Bank			Disc	Cash	Bank
		\$	\$	\$			\$	\$	\$
May 1	Sales		700		May 3	Sundry exps.		40	
May 4	Sales		2000		May 5	Bank	¢	1500	
May 5	A & Co.	100		2080	May 6	Z & Sons	50		600
May 5	Cash	¢		1500	May 7	Sundry exps.		70	
May 7	P Ltd	80		450	May 8	Q Bros.	40		160
May 8	Bank	¢	500		May 8	Cash	¢		500
					May 8	Wages		500	
					May 8	Balance	c/d		
		<u>180</u>	<u>3200</u>	<u>4030</u>			<u>90</u>	<u>1090</u>	<u>2770</u>
								<u>3200</u>	<u>4030</u>
May 9									
Balances	b/d		1090	2770					

Note. The discount columns are not balanced. The totals are carried to the Discounts Allowed and Discounts Received accounts respectively.

4.3 When are accounts balanced?

The cash book will usually be balanced at frequent intervals because it is always important to know how much money is in the Bank account. It will be balanced at weekly intervals in small businesses, daily in large ones.

Accounts for customers and suppliers are balanced monthly because of the practice of sending and

receiving statements of account. The statements are copies of the accounts of customers in the sellers' books and are sent to customers so that they can reconcile their ledger accounts with those of their suppliers. Any differences can be enquired into and agreement reached between supplier and customer. The statements also remind customers that payment of outstanding balances is due.

The other accounts are usually balanced as and when required; this will always be when a trial balance is being prepared. Trial balances are explained in chapter 6.

HINTS

- Remember that balances carried down on accounts should always be shown as brought down on the accounts on the next day. Marks may be lost in an examination if this is not done.

5

The classification of accounts and division of the ledger

In this chapter you will learn:

- that accounts are classified as either personal or impersonal
- about the division of impersonal accounts into real accounts and nominal accounts.

5.1 The classification of accounts

All accounts fall into one of two classes: **personal** or **impersonal**. Each of these classes can be further divided into subgroups.

Personal accounts are those for persons (including sole traders, partnerships and companies). The subgroups are as follows:

- **Accounts for debtors**, persons who owe the business money. They are usually the customers of the business, and their accounts have debit balances. These accounts are collectively known as current assets. (Other current assets include cash in hand, cash at bank and stock, as explained below under Impersonal accounts.)
- **Accounts for creditors**, persons to whom the business owes money. They are usually those who supply goods or services to the business, and their accounts have credit balances. This group includes Loan accounts. Creditors who have to be paid within one year are **current liabilities**. Creditors who do not have to be paid within one year (e.g. for a long-term loan) are **long-term liabilities**.
- The owner's **Capital and Drawings accounts**.

Impersonal accounts are all accounts other than personal accounts. The subgroups are as follows:

- **Accounts with debit balances**. These are further divided into asset accounts (real accounts) and expenses accounts (nominal accounts).

- **Asset accounts** (real accounts) are things that the business owns. This group may be further subdivided into
 - **fixed or non-current assets**, which are things acquired for use in the business and not for re-sale, such as premises, plant and machinery, vehicles, office furniture and equipment. These assets are intended to be used in the business for a number of years. Expenditure on fixed assets is **capital expenditure**.
 - **current assets**, in addition to the debtors referred to above, are those that arise in the course of trading, such as stock-in-trade, stocks of stationery, stocks of fuel, cash at bank and in hand.
- **Expenses accounts** (nominal accounts) include rent payable, wages, salaries, heating and lighting, postage and stationery, etc. This type of expenditure is **revenue expenditure**.
- **Accounts with credit balances**. These accounts record **revenue** (sales) and **other income** (rent receivable, discounts received and interest receivable). These are also nominal accounts.

The distinction between the types of accounts is very important. Care must always be taken to ensure that capital expenditure is not confused with revenue expenditure. The cost of purchasing a motor vehicle is capital expenditure and must be debited to the Motor Vehicles account. The cost of running the vehicle is revenue expenditure and must be debited to Motor Vehicles Running Expenses account.

As a result, you will always find capital expenditure on the balance sheet (statement of financial position) of a business (see chapter 8). Revenue expenditure, on the other hand is always found in the Profit and Loss Account (Income Statement) for a business (see chapter 7).

Exercise 1

Copy and complete this table, ticking the boxes which correctly describe the given accounts in the books of a bakery.

Account	Personal	Fixed asset	Current asset	Revenue or other income	Expense
Capital					
Sales Returns					
Delivery Vans					
Purchases					
Rent Payable					
Debtors					
Stock-in-trade					
Discounts Allowed					
Drawings					
Bank					
Rent Receivable					
Creditors					
Computer					
Wages					
Discounts Received					

5.2 Division of the ledger

Except in very small businesses there are too many accounts to be kept in a single ledger. It is usual to divide the accounts among several ledgers as follows:

- sales ledger for the accounts of customers
- purchase ledger for the accounts of suppliers
- general (or nominal) ledger for the impersonal accounts for assets, revenue, other income, and expenses
- private ledger for accounts of a confidential nature—the owner's Capital and Drawings accounts and Loan accounts; also the Trading and Profit and Loss Accounts (Income

Statements) and Balance Sheets (Statements of Financial Position) (see chapters 7 and 8).

- cash book containing the Bank and Cash accounts.

The division of the ledger as above is essential in a business which employs several bookkeepers; the work may be divided between them so that they do not all need to be working on the same ledger at the same time. It helps to detect and prevent errors occurring in the books of account. It may also help to detect and prevent fraud by the accounts staff. This is known as internal control.

6

The trial balance

In this chapter you will learn:

- the purpose of trial balances
- how to prepare a trial balance
- the limitations of trial balances
- six types of error which do not affect the agreement of the two sides of a trial balance.

6.1 What is a trial balance?

A **trial balance** is a list of all the balances extracted from the ledgers at a particular date. Its purpose is to check that the total of the debit balances equals the total of the credit balances. The principle of double entry ensures that the two totals should agree. If the totals do not agree there must be an error somewhere in the bookkeeping.

6.2 How to prepare a trial balance

First balance all the ledger accounts including the cash book. Then list the balances with the debit balances and credit balances in separate columns. The total of the debit balances should equal the total of the credit balances. If the totals are equal, the trial balance agrees.

Example

The following trial balance has been extracted from the books of Zabine at 31 March 2010.

	Debit balances	Credit balances
Account	\$	\$
Premises	70 000	
Machinery	10 000	
Office Furniture	5 000	
Sales		100 000
Sales Returns	700	
Purchases	6 900	
Purchases Returns		1 000
Trade receivables*	1 100	
Trade payables*		1 575

Account	\$	\$
Rent Payable	1 600	
Wages and Salaries	4 080	
Heating and Lighting	960	
Sundry Expenses	1 430	
Cash	500	
Bank	12 600	
Loan from Ludmilla		2 000
Capital – Zabine		13 000
Drawings	2 705	
	<u>117 575</u>	<u>117 575</u>

* The balances on the accounts in the sales ledger are listed and totalled separately; the total is entered in the trial balance as trade receivables.

** The balances on the accounts in the purchase ledger are listed and totalled separately; the total is entered in the trial balance as trade payables.

Exercise 1

Prepare a trial balance from the following balances that have been extracted from the books of Achilles, a grocer, at 31 December.

Account	\$
Premises	50 000
Motor Vans	8 000
Office Furniture	2 000
Computer	3 000
Sales	60 000
Sales Returns	700
Purchases	4 000
Purchases Returns	500
Motor Vehicle Running Expenses	4 200
Wages	1 800
Rent	2 000
Bank	1 650
Capital	20 000
Drawings	3 150

6.3 Limitations of a trial balance

As stated above, if a trial balance does not agree, there must be a mistake somewhere in the bookkeeping. Unfortunately, even if a trial balance agrees, it does not mean that there are no errors because there are six types of error that do not affect the agreement of the trial balance. They are as follows:

1. **Errors of omission.** A transaction omitted completely from the books results in there being neither debit nor credit entry for the transaction. This could happen if a transaction is not entered in a book of prime entry.
2. **Errors of commission.** A transaction is posted to the wrong account, but the account is of the same class as the account to which the posting should have been made. Example: the payment of a telephone bill is posted in error to Heating and Lighting account. Telephone account and Heating and Lighting account are both expense accounts.
3. **Errors of principle.** A transaction is posted to a wrong account which is not of the same type as the correct account. Example: revenue expenditure treated as capital expenditure. For instance, payment for petrol for a vehicle has been debited to Motor Vehicles account (a fixed asset account) instead of to Motor Vehicles Running Expenses account (an expense account).
4. **Errors of original entry.** A wrong amount is entered in a book of prime entry for a transaction. Example: a sales invoice for \$200 is

entered in the sales journal as \$20.

5. **Complete reversal of entries.** An account which should have been debited has been credited, and the account which should have been credited has been debited. Example: a payment received from Hussain is debited to Hussain's account and credited to Bank account.
6. **Compensating errors.** Two or more errors cancel each other out. Example: an invoice for \$1100 in the sales journal is posted to the customer's account as \$1000. At the same time, the sales journal total is understated by \$100. The debit balance on the customer's account and the credit balance on Sales account will both be understated by \$100.

Exercise 2

State which type of error each of the following represents.

- (a) Payment of rent has been debited to the Bank account and credited to the Rent Payable account.
- (b) The purchase of a computer has been debited to the Office Expenses account.
- (c) A supplier's invoice has been omitted from the purchases journal.
- (d) The total of Wages account has been overstated by \$1000 and rent received of \$1000 has been posted twice to the Rent Received account.
- (e) Discount allowed to Amna has been credited to Asma's account.
- (f) A purchase of goods for \$960 has been entered in the purchases journal as \$690.

HINTS

- Learn the six types of error which do not affect the trial balance.
- Look for the cause of a difference on a trial balance by carrying out the following simple checks before spending a lot of time checking all your postings:
 - check the additions of the trial balance
 - if the difference is divisible by 2, look for a balance equal to half the difference which may have been entered on the wrong side.
 - if the difference is divisible by 9, two figures may have been transposed in a balance; for example \$269 may have been copied as \$296.

MULTIPLE-CHOICE QUESTIONS

1. Which of the following accounts normally has a credit balance?
 - A. Discounts Allowed
 - B. Discounts Received
 - C. Purchases
 - D. Sales Returns.
2. After which error will a trial balance still balance?
 - A. An invoice for \$400 in the sales journal not posted to the customer's account in the sales ledger.
 - B. A purchase of goods from Ratna for \$1000 credited to Ravin's account in the purchases ledger.
 - C. Payment of \$60 to Josan entered correctly in the Bank account and credited to Josan's account.
 - D. Rent paid \$660 entered correctly in the cash book but posted to Rent Payable account as \$600.

3. A business has paid rent of \$800. The payment has been entered in the books as follows:

Account debited	Account credited
Bank \$800	Rent \$800

Which type of error is this?

- A. Commission
 - B. Compensating
 - C. Complete reversal
 - D. Principle.
4. Discounts allowed of \$160 for one month have been posted to the credit of the Discounts Received account. What effect has this had on the trial balance?
 - A. \$160 too much credit
 - B. \$160 too little debit
 - C. \$160 too little debit and \$160 too much credit
 - D. \$320 too much credit

ADDITIONAL EXERCISES

1. The following balances at 31 December 2010 have been extracted from Hassan's books.

	\$
Sales	160 000
Sales Returns	2 600
Purchases	84 000
Purchases Returns	3 400
Wages	26 000
Heating and Lighting	3 160
Rent Payable	5 000
Rent Receivable	1 000
Advertising	2 900
Postage and Telephone	2 740
Discount Allowed	6 100
Discounts Received	5 900
Plant and Machinery	50 000
Delivery Van	9 000
Bank	2 300
Trade Receivables	7 400
Trade Payables	3 700
Drawings	8 800
Capital	?

Required

Prepare a trial balance at 31 December 2010 from the balances extracted from Hassan's books and calculate the balance on his Capital account.

2. An inexperienced bookkeeper has extracted a trial balance at 31 December 2010 from Andrea's books. It contains some errors and does not balance.

	\$	\$
Premises	70 000	
Plant and Machinery	30 000	
Office Equipment	5 000	
Wages	7 600	
Rent Payable		4 000
Heating and Lighting	1 500	
Sundry Expenses	1 720	
Sales		133 000
Purchases	57 000	
Discounts Allowed		2 450
Discounts Received	1 070	
Bank	2 910	
Trade Receivables	14 000	
Trade Payables		10 140
Purchases Returns	2 400	
Sales Returns		3 150
Rent Receivable	1 200	
Capital		80 000
Drawings		28 480
	<u>194 400</u>	<u>261 220</u>

Required

Re-write the trial balance and correct the errors so that it balances.

Part II

Financial accounting