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PEARSON EDEXCEL INTERNATIONAL AS / A LEVEL

ACCOUNTING

STUDENT BOOK 1

JOHN BELLWOOD
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PEARSON EDEXCEL
INTERNATIONAL AS/A LEVEL

ACCOUNTING

Student Book 1

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UNIT 1

ABOUT THIS BOOK

This book is for students following the Edexcel International Advanced Subsidiary (IAS) Accounting course.

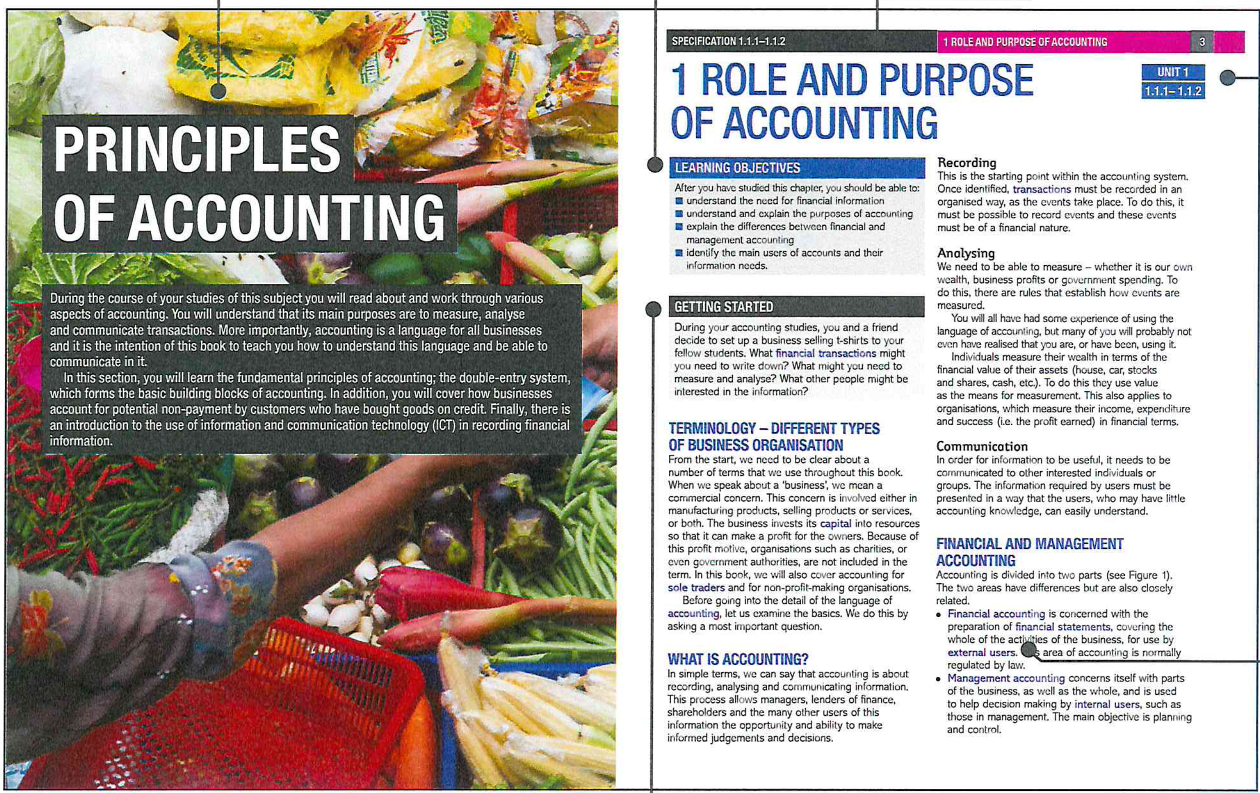
The course has been structured so that teaching and learning can take place in any order, both in the classroom and in any independent learning. The book contains full coverage of the IAS unit. The six topic areas within this unit match the titles and order of those in the specification.

Each topic area is divided into chapters to break the content down into manageable chunks. Each chapter features a mix of learning and activities. Global case studies are embedded throughout to show a range of examples within the context of the chapter. Checkpoint questions at the end of each chapter help you to assess understanding of the key learning points. There are exam-style questions at the end of each chapter (except Chapter 1, which is introductory) to provide opportunities for exam practice. Answers are provided in the online eBook version of this textbook.

Topic openers
Introduce each of the key topics in the specification.

Learning objectives
Each chapter starts with a list of key assessment objectives.

Specification reference
The specification reference is given at the start of each chapter and in the running header.

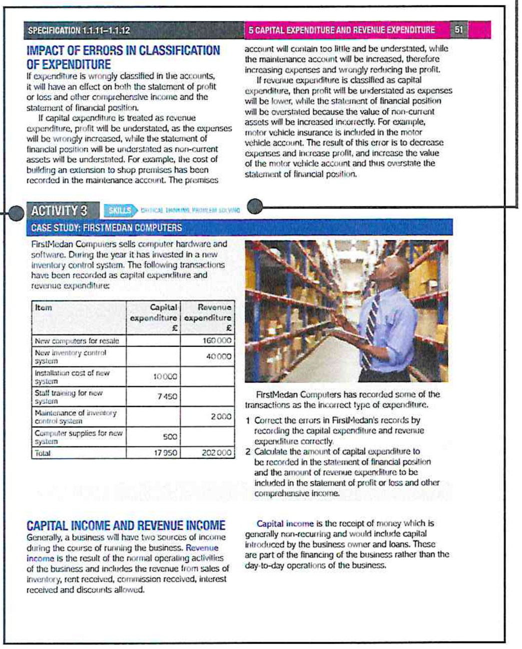


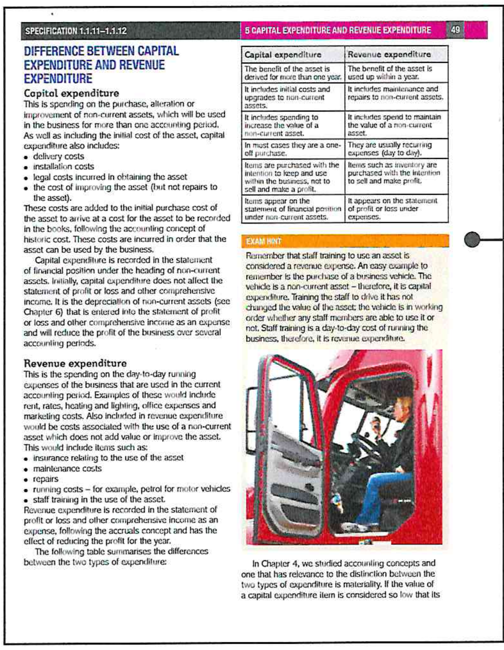
Key subject terms are colour coded within the text.

Getting started
An activity to introduce the key concepts in each chapter. Questions are designed to stimulate discussion and use of prior knowledge. These can be tackled as individuals, pairs, groups or the whole class.

Activity
Each chapter includes activities to embed understanding through case studies and questions.

Skills
Relevant exam questions have been assigned key skills, allowing for a strong focus on particular academic qualities. These transferable skills are highly valued in further study and the workplace.



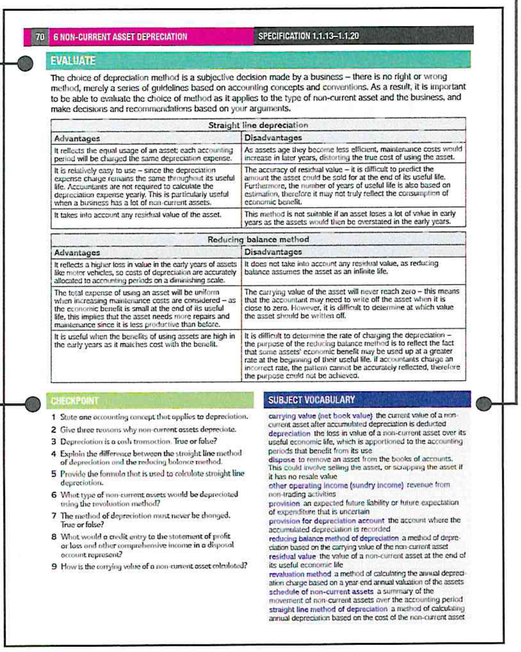


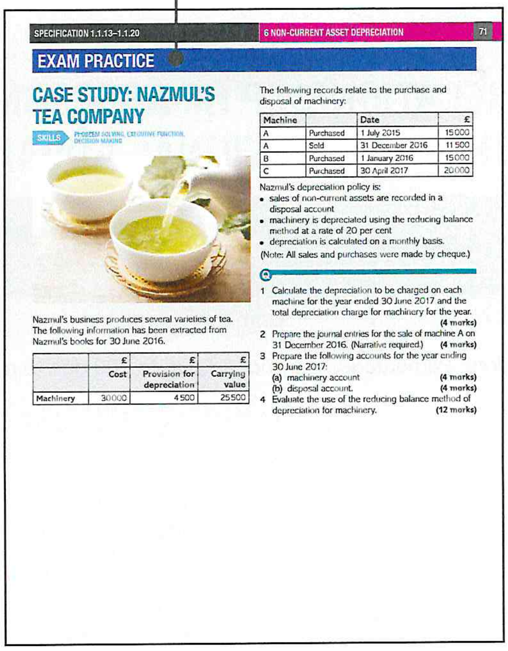
Exam hint
Tips give practical advice and guidance for exam preparation.

Exam practice
Exam-style questions are found at the end of each chapter (except Chapter 1). They are tailored to the Pearson Edexcel specification to allow for practice and development of exam writing technique. They also allow for practice responding to the command words used in the exams.

Subject vocabulary
An alphabetical list of all the subject terms in each chapter with clear definitions for EAL learners. Please note: A collated glossary is available at the back of the book.

Evaluate
See page ix.





Checkpoint
Questions to check understanding of the key learning points in each chapter. These are NOT exam-style questions.

ASSESSMENT OVERVIEW

The following tables give an overview of the assessment for this course. You should study this information closely to help ensure that you are fully prepared for this course and know exactly what to expect in each part of the assessment.

PAPER 1	PERCENTAGE OF IAS	PERCENTAGE OF IAL	MARKS	TIME	AVAILABILITY
THE ACCOUNTING SYSTEM AND COSTING Written exam paper Paper code WAC11 Externally set and marked by Pearson Edexcel Single tier of entry	100%	50%	200	3 hours	January, June & November First assessment: June 2016

ASSESSMENT OBJECTIVES AND WEIGHTINGS

ASSESSMENT OBJECTIVE	DESCRIPTION	% IN IAS	% IN IA2	% IN IAL
A01	Demonstrate knowledge of accounting procedures and techniques and an understanding of the principles and concepts upon which they are based	30	24–25	27–28
A02	Select and apply knowledge and understanding of accounting procedures, techniques, concepts and principles to a variety of accounting situations. Present accounting information in an appropriate format	43–44	41–42	42–43
A03	Analyse financial information, interpret financial data and information and communicate reasoning, showing understanding	17	23–24	20–21
A04	Evaluate financial and non-financial evidence and make informed recommendations and decisions	9–10	10–11	10

Note: Percentages may not add up to 100 due to rounding.

RELATIONSHIP OF ASSESSMENT OBJECTIVES TO UNITS FOR THE INTERNATIONAL ADVANCED SUBSIDIARY QUALIFICATION

UNIT NUMBER	ASSESSMENT OBJECTIVE			
	A01	**A02**	**A03**	**A04**
Unit 1	30%	43–44%	17%	9–10%

Note: Percentages may not add up to 100 due to rounding.

ASSESSMENT SUMMARY

PAPER 1	DESCRIPTION	MARKS	ASSESSMENT OBJECTIVES
THE ACCOUNTING SYSTEM AND COSTING Paper code WAC11	**Structure** Paper 1 assesses 100 per cent of the total IAS Accounting qualification and 50 per cent of the IAL Accounting qualification There will be two sections, A and B. Students must answer all questions in Section A and select from a choice of questions in Section B Section A: two compulsory multi-part questions (110 marks); Section B: three multi-part questions from a choice of four (90 marks) **Assessment** This is a single-tier exam paper The assessment duration is 3 hours Calculators may be used in the examinations	The total number of marks available is 200	Questions will test the following assessment objectives: AO1 – 14% AO2 – 20% AO3 – 7% AO4 – 9%

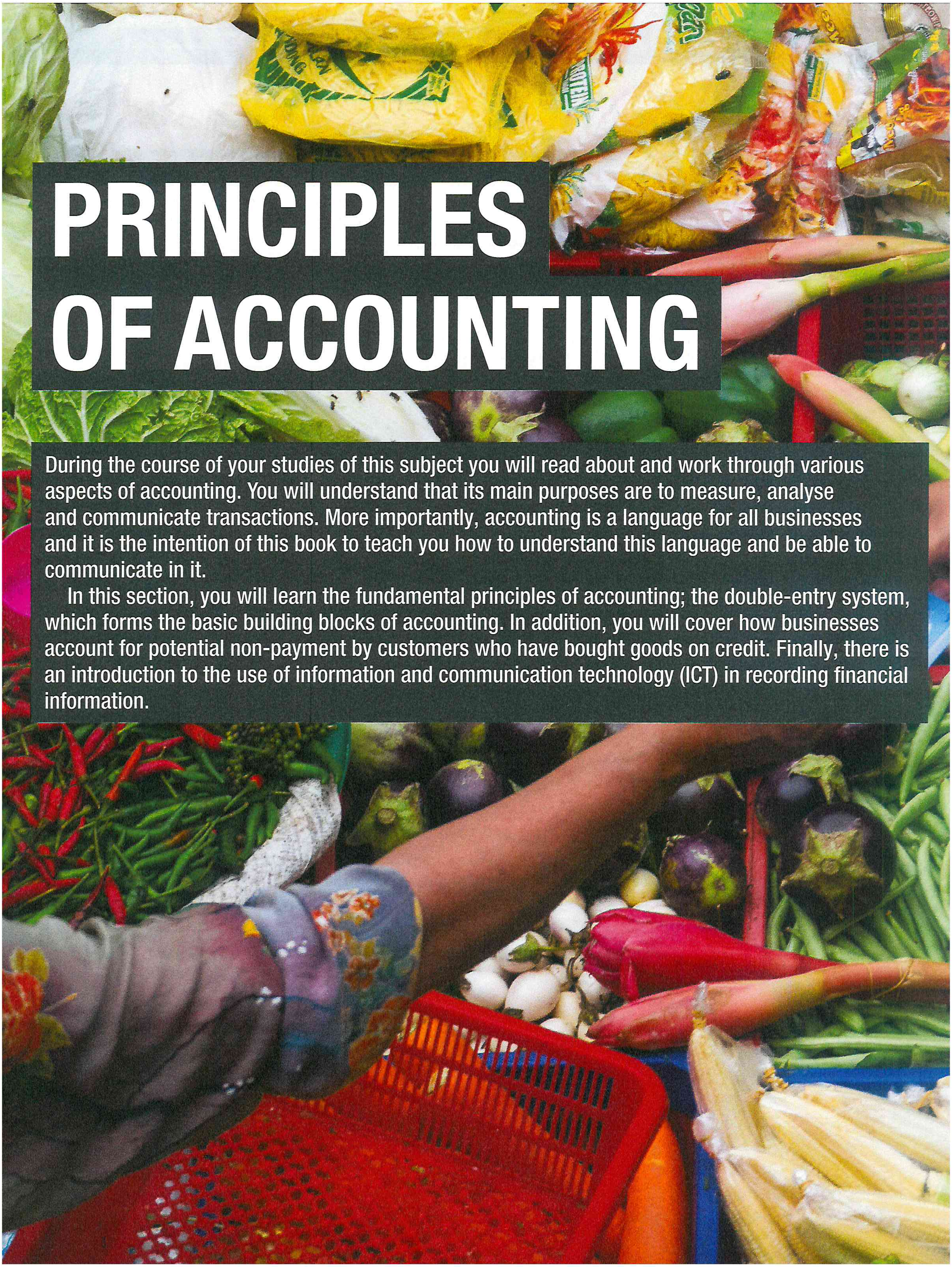
EVALUATE QUESTIONS

In the exam you will see questions that ask you to 'Evaluate'. In your answer, you will need to compare two methods or ways of working and state which one you think is the most suitable for the scenario given and why. In this book there are 'Evaluate' sections. They give examples of possible methods you might be asked to evaluate, as well as a table showing arguments for and against the method. You could use these tables to help you plan an essay answer on the topic.

Remember in the exam to always develop your points; the examiner will not award full marks if you only write bullet points. To achieve the highest marks, you will need to write a conclusion in which you decide which method is best. You need to justify your decision with reasons and you will also be expected to show a chain of reasoning – how your points have helped you to come to your conclusion.

CURRENCY

All of the examples in this textbook use GBP £ because all the examination papers also use GBP £ only. However, you might want to challenge yourself by creating examples using the currency from your own country or other major currencies, such as USD $.



PRINCIPLES OF ACCOUNTING

During the course of your studies of this subject you will read about and work through various aspects of accounting. You will understand that its main purposes are to measure, analyse and communicate transactions. More importantly, accounting is a language for all businesses and it is the intention of this book to teach you how to understand this language and be able to communicate in it.

In this section, you will learn the fundamental principles of accounting; the double-entry system, which forms the basic building blocks of accounting. In addition, you will cover how businesses account for potential non-payment by customers who have bought goods on credit. Finally, there is an introduction to the use of information and communication technology (ICT) in recording financial information.

1 ROLE AND PURPOSE OF ACCOUNTING

UNIT 1
1.1.1– 1.1.2

LEARNING OBJECTIVES

After you have studied this chapter, you should be able to:
- understand the need for financial information
- understand and explain the purposes of accounting
- explain the differences between financial and management accounting
- identify the main users of accounts and their information needs.

GETTING STARTED

During your accounting studies, you and a friend decide to set up a business selling t-shirts to your fellow students. What **financial transactions** might you need to write down? What might you need to measure and analyse? What other people might be interested in the information?

TERMINOLOGY – DIFFERENT TYPES OF BUSINESS ORGANISATION

From the start, we need to be clear about a number of terms that we use throughout this book. When we speak about a 'business', we mean a commercial concern. This concern is involved either in manufacturing products, selling products or services, or both. The business invests its **capital** into resources so that it can make a profit for the owners. Because of this profit motive, organisations such as charities, or even government authorities, are not included in the term. In this book, we will also cover accounting for **sole traders** and for non-profit-making organisations.

Before going into the detail of the language of **accounting**, let us examine the basics. We do this by asking a most important question.

WHAT IS ACCOUNTING?

In simple terms, we can say that accounting is about recording, analysing and communicating information. This process allows managers, lenders of finance, shareholders and the many other users of this information the opportunity and ability to make informed judgements and decisions.

Recording

This is the starting point within the accounting system. Once identified, **transactions** must be recorded in an organised way, as the events take place. To do this, it must be possible to record events and these events must be of a financial nature.

Analysing

We need to be able to measure – whether it is our own wealth, business profits or government spending. To do this, there are rules that establish how events are measured.

You will all have had some experience of using the language of accounting, but many of you will probably not even have realised that you are, or have been, using it.

Individuals measure their wealth in terms of the financial value of their assets (house, car, stocks and shares, cash, etc.). To do this they use value as the means for measurement. This also applies to organisations, which measure their income, expenditure and success (i.e. the profit earned) in financial terms.

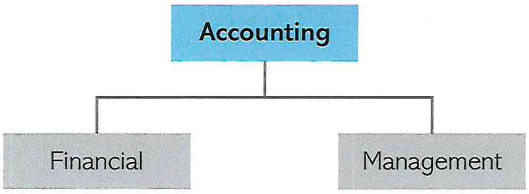
Communication

In order for information to be useful, it needs to be communicated to other interested individuals or groups. The information required by users must be presented in a way that the users, who may have little accounting knowledge, can easily understand.

FINANCIAL AND MANAGEMENT ACCOUNTING

Accounting is divided into two parts (see Figure 1). The two areas have differences but are also closely related.

- **Financial accounting** is concerned with the preparation of **financial statements**, covering the whole of the activities of the business, for use by **external users**. This area of accounting is normally regulated by law.
- **Management accounting** concerns itself with parts of the business, as well as the whole, and is used to help decision making by **internal users**, such as those in management. The main objective is planning and control.



▲ Figure 1 The areas of accounting

These distinctions do not mean that the basic data is different. The sources are the same, but they are analysed and reported in different ways in order to be useful for different purposes.

We will now examine the two areas in more detail.

Financial accounting

As financial accounts are required by law, the following applies.

- The disclosure of information must conform to legal requirements and some businesses may show only the minimum requirements.
- Reports should contain financial information which is useful to users.
- The information provided is designed for external users.
- The results are based on past activities.
- All of the information presented is based on accounting concepts and conventions.
- The results are shown in a set of accounts, which are published annually in a standard, summarised format.
- For any event to be shown, it must be measurable in monetary terms.

Management accounting

Management accounts provide specific information to managers for a very definite purpose. It may be for the introduction of a new product or the purchase of a new machine. It could include the preparation of quotations and the costing of specific jobs. The prepared accounts will assist with planning, control, monitoring, decision making and investment.

All of the above can only be possible because management accounting information has certain standards. These can be summarised as follows.

- The information is detailed and up to date. Reports could be weekly, monthly, etc.
- The statements are usually forward looking (although some may look back). Examples of management accounting reports include budgets and cost reports.
- Accounts are confidential and for internal use only.
- There is no standard format and the accounts are not subject to external regulation.
- The information is both financial and non-financial (quantitative and qualitative).

People often ask if two systems are necessary within an organisation because of these differences. As we see from the above, each gives different information, so we can say that both are needed, but they can be done through a good integrated system which is linked to one database. The larger the company, the greater the need for good strategic management information, but the more information given, the greater the cost. Therefore, we must consider the costs and the benefits of preparing management accounts.

THE NEED FOR FINANCIAL ACCOUNTING

Having reviewed the definition, let us now examine the need for financial accounting. Accounts are prepared for a variety of reasons:

- to assess the trading activities of a business
- to enable external owners to see how managers are performing
- to control the activities of the business
- to plan future activities
- to assist in raising finance
- to report on the activities of the business to interested parties.

USERS OF FINANCIAL ACCOUNTS

The efficiency and sustainability of a business is very important to many groups of people. These groups will have a different level of understanding of accounts. Nevertheless, attempts must be made to ensure effective communication to a broad range of users.

At this stage, it is essential that we identify the main users of financial accounting. However, not all of the users listed below can study the financial statements of a business, since some businesses (such as a sole trader business) are not required by law to publish their accounts publicly.

Owners

The owners of a business and the existing and potential shareholders of a company will want to know how effectively the directors and managers are performing their stewardship function; that is, how they control and organise the company. This is important in all businesses where the owners and shareholders are not involved in the day-to-day running, so they can rely on the financial statements to communicate the results. They will use the financial statements as the basis for their decisions – to sell some, or all, of their shares or perhaps to buy some additional shares. In addition, they will also use the financial statements to decide how profits are to be shared out and allocated.

Small-business owners also use financial statements to assess **profitability**. They may need to adjust their expenses if the profit target cannot be met. They may also look for extra finance by looking at the ratio between assets and liabilities.

Trade creditors

These include the various businesses that supply goods and services to the reporting business – they are usually called 'suppliers'. Suppliers usually study the amount of debts that are due in the short term, as they need to obtain payment from businesses within one to three months. They would want to know if they are able to provide credit to a business and, if so, whether they will be paid on the due date. A supplier would also consider whether to provide credit in the future in order to continue a business relationship.

Long-term creditors

The second type of creditors are those who provide finance to a business. These advances (loans) are usually repaid over an extended (long) period of time. Long-term creditors will look at the assets and liabilities, particularly the non-current liabilities (liabilities that need to be repaid over a long period of time). Lenders look at assets to see whether they could be sold for cash if one day the business cannot repay the debt. Lenders look at non-current liabilities to assess whether the business already has too many debts to repay.

The loan creditors will want to ensure that interest payments will be made promptly and that capital repayments on loans will be made as agreed.

Employees

This group includes existing, potential and past employees, as well as trade unions whose members are employees. Past employees will be mainly concerned with ensuring that any pensions paid by the business are maintained. Present employees will be interested in ensuring that the business is able to keep on operating – and therefore maintaining their jobs and paying them acceptable wages – and that any pension contributions are paid. In addition, they may want to ensure that the business is being fair to them, so that they get a reasonable share of the profits made by the business as a result of their efforts. Trade unions will protect the interests of their members and will, possibly, use the financial statements in wage and pension negotiations.

Potential employees will also be interested in assessing whether or not it would be worth seeking employment with that particular business.

Bankers

Where a bank has not given a loan or an overdraft, there will be no great need to see the financial statements. However, where money is owed to the bank, they will want to ensure that the payment of interest will be made when it is due, and that the business will be able to repay the loan or overdraft on the due date.

Bankers are also interested in profit so that they can see whether a business can pay the interest on a loan on time. Furthermore, they will also look at the amount of assets and liabilities. Bankers require some form of security from a business when it takes out a loan or applies for an overdraft, and so the quality and amount of a business's assets will affect the final amount of loan available.

Customers

Customers want to know whether or not a business is a secure supply source of goods and services. If customers buy warranty services for products such as electronic goods, they may also want to know whether the business will provide after-sales service.

Competitors
Business rivals will use the information to assess their own position, compared with that of the rival business. The information will serve as a benchmark for them to use. Potential takeover bidders will also want to assess the desirability of any such move.

The analyst and/or adviser group
Financial journalists need information for their readers, while stockbrokers need it to advise current and potential investors. Credit agencies want the information in order to advise present and possible suppliers of goods and services to the business as to its ability to get credit.

Governments
Governments will need to know the financial position to assess the tax payable by the business. Large businesses are required to publish annual financial details, including annual revenue, annual salaries, expenses and profit details. Governments may also use the information to decide their future policies.

Other official agencies
Various organisations that are concerned with the supervision of industry and commerce may want financial statements for their specific purposes. These organisations vary from country to country.

Management
In addition to the internally produced management accounts, management are also concerned with any financial statements. This is because the financial statements give an overall view of the financial situation of the business. This allows them to evaluate the performance of the business. Management would then consider the effect of such financial statements on the local community and the world at large.

The public
This section of users consists of groups such as taxpayers, political parties, pressure groups and consumers. The needs of these parties will vary accordingly. It should be noted that in a local community the businesses can be very important to the local economy.

ACTIVITY 1
SKILLS CRITICAL THINKING

CASE STUDY: PRINCIPLES OF ACCOUNTING
This book shows you how accounts are prepared. It also shows how the information provided is used.

1 List the six reasons for preparing accounts.
2 There are many users of accounts and the information that they provide. Identify six such users.

ACTIVITY 2
SKILLS CRITICAL THINKING, REASONING

CASE STUDY: DEFINING ACCOUNTING
Accounting is defined differently by many organisations, but it is agreed that there are three key words that are associated with accounting.

1 What are the three key words associated with accounting?
2 In your own words, state how you would describe accounting.

ACTIVITY 3
SKILLS CRITICAL THINKING, REASONING

CASE STUDY: FINANCIAL AND MANAGEMENT ACCOUNTING
1 Draw a table to show the differences between financial accounting and management accounting.
2 While thinking about the differences that exist, write down a list of the things they have in common.

CHECKPOINT
1 What is accounting?
2 Explain the difference between financial accounting and management accounting.
3 Accounting information is used to control the activities of a business. True or false?
4 Accounting information is used to report on the activities of a business. True or false?
5 Competitors are not interested in the accounting information for a business. True or false?
6 Identify two internal and two external business users of accounting information.
7 Explain the difference between financial recording and financial accounting.

SUBJECT VOCABULARY

accounting the process of recording, classifying, analysing and communicating financial information

accounting concepts guidelines for the treatment of accounting transactions

capital investment (cash, resources or other assets) provided by the owner of the business

external user a person outside the business organisation

financial accounting the recording and presentation of past financial information to external users for their decision making

financial statements (final accounts) produced by the business to provide a summary of the performance of the business (the statement of profit or loss and other comprehensive income) and the financial position of the business (the statement of financial position)

financial transaction a business event or action that has a monetary impact on the business

internal user a person inside the business organisation

management accounting the preparation of past and future, financial and non-financial information for internal users

profitability the ability of a business to generate profit

quotation a document prepared in response to an enquiry from a customer detailing the price that will be charged for the product or service requested

sole trader a business owned by a single person

transaction a business event, such as the sale of inventory, which can be measured in monetary terms and which must be recorded in the books of accounts

2 DOUBLE-ENTRY SYSTEM 1

UNIT 1
1.1.3

LEARNING OBJECTIVE

After you have studied this chapter, you should be able to:
- record transactions in the books of account.

GETTING STARTED

You buy a new computer with some cash you have saved. Write down two things that have happened. You sell some computer games to a friend who promises to pay you next month. Again, write down two things that have happened. Can you think of other business transactions that take place and the two effects these have?

CLASSIFICATION OF ACCOUNTS

Accountants classify transactions (i.e. events that can be measured in monetary terms) into six elements.

- Capital is the amount of owner's interest in the business, it represents the owner's investment in the business.
- **Liabilities** are amounts due by the business; in other words, debts that must be paid. For example, these can be amounts due to suppliers for goods or services or rent and telephone. Any amount owing and to be paid within one year is a short-term liability (also called **current liability**). Any amount to be paid for a time period of greater than one year is called a **non-current liability**.
- **Expenses** – when running a business all firms will have to make payments for expenses, which include, for example, wages, electricity and motor expenses. All these costs are recorded in separate **ledger accounts** so that the business can see the total of each expense.
- **Assets** are items of value that a business possesses. This could be the building it occupies, its delivery vehicles, or the computers and other office equipment (termed **non-current assets**). In addition, the business also has its **inventory**, **trade receivables** (people that owe it money for goods or services) and cash in the bank or on hand (all of which are termed **current assets**).
- **Revenue (or income)** is usually derived from the receipt of money for goods or services provided by the business. If, for example, the business is a dress shop, then the sale of dresses to its customers would generate revenue to the business. Other forms of revenue could be any interest received from investment accounts, rent received from letting out premises owned by the business, and even commission received for arranging the sale of a product for someone else.
- **Drawings** – the owner of a business takes money from the business for his/her private needs which is called drawings. This also includes the withdrawal from the business of goods as well as cash. As these withdrawals are of a private nature they are not classed as an expense of the business.

EXAM HINT

You will notice that the first letters of each word above – Capital, Liabilities, Expenses, Assets, Revenue, Drawings – spell out 'CLEARD'. You can use this to help you remember the terms in your exam.

ACTIVITY 1

SKILLS CRITICAL THINKING

CASE STUDY: ASSETS OR LIABILITIES?

You should now be able to fill in the tables below:

Identify the following:	Asset	Liability
1 Delivery vehicle		
2 Bank loan		
3 Inventory		
4 Cash on hand		
5 Trade payables		
6 Trade receivables		
7 Office equipment		
8 Cash at bank		

Identify the following:	Expense	Revenue
1 Rent received		
2 Telephone charges		
3 Sales of goods or services		
4 Wages and salaries		
5 Commission paid		
6 Advertising costs		
7 Rent payable		
8 Purchases		

DOUBLE-ENTRY SYSTEM

Accounting is based on transactions. There are two effects for every transaction, as can be seen from the example below. Accountants use the following accounting equation:

Assets = Capital – Drawings + Liabilities

This accounting equation then evolved into the double-entry system:

	Assets, expenses, drawings	Liabilities, capital & revenue
Balance	Dr	Cr
Increase	Dr	Cr
Decrease	Cr	Dr

We have an existing business which has £1 000 in the bank and an inventory of goods purchased for £200. We now buy an additional £300 of goods, for cash.

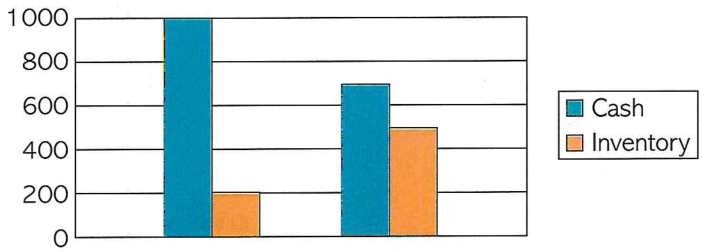
Account	Element	Increase/decrease	Dr or Cr
Cash	Asset	Decrease	Cr
Inventory	Asset	Increase	Dr

From Figure 1, we can see that the original amount of cash and inventory is reflected in the first section of the graph. You then see the increase in the **purchases** and the relevant decrease in the cash balance.

You can see that at least two accounts are affected when a transaction occurs. It is this dual effect (duality) that lies behind the double-entry system. We can say, therefore, that double entry is the system by which the books of account reflect the fact that every transaction has two sides:

- receiving a benefit by one or more accounts
- giving a benefit.

This means that each transaction made in the books of account is made twice (that's the reason for the term 'duality'), a debit and a credit.



▲ Figure 1 Movement of cash and inventory

BASIC RULES FOR DOUBLE-ENTRY TRANSACTIONS

It is vital that accounting transactions are recorded correctly in the books. **Debit entries** are always recorded on the left-hand side of the ledger and the **credit entry** on the right-hand side, as shown below:

Debit side (Dr) **Credit side (Cr)**

Account name

Date	Details	£	Date	Details	£

If we now take each of the six types of account, we can see how the transactions are recorded.

Capital

Debit side (Dr) **Credit side (Cr)**

Capital

Date	Details	£	Date	Details	£
Decreases on the debit side			Increases on the credit side		

Liabilities

Debit side (Dr) **Credit side (Cr)**

Liability account

Date	Details	£	Date	Details	£
Decreases on the debit side			Increases on the credit side		

Expenses

Debit side (Dr) **Credit side (Cr)**

Expense account

Date	Details	£	Date	Details	£
Increases on the debit side			Decreases on the credit side		

Assets

Debit side (Dr) **Credit side (Cr)**

Asset account

Date	Details	£	Date	Details	£
Increases on the debit side			Decreases on the credit side		

Revenue

Debit side (Dr) **Credit side (Cr)**

Revenue account

Date	Details	£	Date	Details	£
Decreases on the debit side			Increases on the credit side		

Drawings

Debit side (Dr) **Credit side (Cr)**

Drawings

Date	Details	£	Date	Details	£
Increases on the debit side			Decreases on the credit side		

ACTIVITY 2

SKILLS CRITICAL THINKING

CASE STUDY: DEBITS AND CREDITS

Answer the following questions on debits and credits.

Does a debit item:	Yes	No
1 decrease capital?		
2 decrease income?		
3 decrease liabilities?		
4 decrease assets?		
5 decrease expenses?		

Does a credit item:	Yes	No
1 increase capital?		
2 increase income?		
3 increase liabilities?		
4 increase assets?		
5 increase expenses?		

SOURCE OF TRANSACTIONS

A transaction is the act which involves a transfer of money or value from one person or business to another. It is this which is recorded in the books of account for the business. The accounts of a business are contained in a book, or a number of books, called ledger(s) (covered in more detail later in this chapter).

In order to record the transaction, we need to have some record or proof of it having taken place, otherwise we cannot simply record a transaction. This proof can come from one of two sources:

- external – from another person or business, e.g. an invoice for purchases
- internal – from documents prepared by the business to record transactions, e.g. petty cash vouchers, cheque counterfoils, etc.

ACCOUNTING FOR INVENTORY

Inventory refers to the goods or stock that a business buys with the intention of selling at a later time and for a profit. While inventory is an asset, the purchase and sale are not recorded as inventory. When inventory is bought it is recorded as a purchase and when it is sold it is recorded as a sale. This is a very important concept that you must remember.

Purchase of inventory

A business buys inventory to the value of £500, paying in cash. The effect would be:

Account	Element	Increase/ decrease	Dr/Cr	£
Purchases	Asset	Increase	Dr	500
Cash	Asset	Decrease	Cr	500

If the purchases were paid by means of a bank transaction (a cheque or credit transfer) then the 'cash' entry would change to 'bank' to reflect that the funds for the purchase were taken from the bank account. If the purchases were made on credit, when payment for the goods will be made after the transaction has taken place, then the following would be recorded:

Account	Element	Increase/ decrease	Dr/Cr	£
Purchases	Asset	Increase	Dr	500
Trade payables	Liability	Increase	Cr	500

As the business has not paid for the asset, it now owes the supplier £500 and so a liability increases.

Sales of inventory

The business now sells all of the inventory for £900. Let us assume it receives the money immediately, so either the bank or cash increases:

Account	Element	Increase/ decrease	Dr/Cr	£
Cash or bank	Asset	Increase	Dr	900
Sales	Revenue	Increase	Cr	900

If the business does not receive the money immediately, then a trade receivable is created as an asset of the business:

Account	Element	Increase/ decrease	Dr/Cr	£
Trade receivables	Asset	Increase	Dr	900
Sales	Revenue	Increase	Cr	900

Make sure you fully understand double entry, its duality, and debit and credit entries. Let's get started and look at some basic transactions.

WORKED EXAMPLE

You are given the following list of transactions:

1 The business buys a car for cash, paying £3 600.
2 The business sells goods on credit to Mr Brown, for £320.
3 The business pays £68 cash for an advertisement in the local newspaper.
4 The business pays, in cash, the weekly wages of £190.
5 The business buys £197 worth of goods on credit from Mr Green, for resale.

Remember that every transaction must be posted to a ledger account and all these accounts have a heading (or name). Each transaction will have two effects. Given the above information, we will identify the accounts for the above transactions as follows:

1 The business buys a car for cash, paying £3 600:

Account	Element	Increase/ decrease	Dr/Cr	£
Motor car	Asset	Increase	Dr	3 600
Cash	Asset	Decrease	Cr	3 600

2 The business sells goods on credit to Mr Brown, for £320:

Account	Element	Increase/ decrease	Dr/Cr	£
Mr Brown	Asset	Increase	Dr	320
Sales	Income	Increase	Cr	320

Mr Brown is a trade receivable account for the business.

3 The business pays £68 cash for an advertisement in the local newspaper:

Account	Element	Increase/ decrease	Dr/Cr	£
Advertising	Expense	Increase	Dr	68
Cash	Asset	Decrease	Cr	68

4 The business pays, in cash, the weekly wages of £190:

Account	Element	Increase/ decrease	Dr/Cr	£
Wages	Expense	Increase	Dr	190
Cash	Asset	Decrease	Cr	190

5 The business buys £197 worth of goods on credit from Mr Green, for resale:

Account	Element	Increase/ decrease	Dr/Cr	£
Purchases	Expense	Increase	Dr	197
Mr Green	Liability	Increase	Cr	197

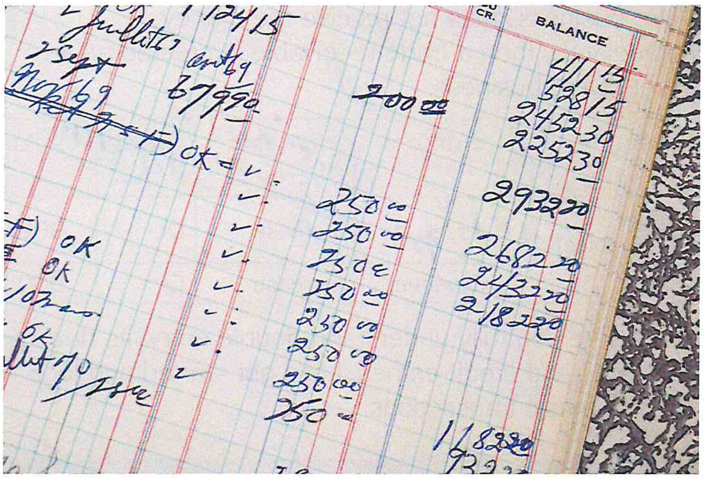
Mr Green is a trade payable account.

You will see from the above that each account has its own name, e.g. motor car, purchases, wages, etc. We do not mix the transactions into a single account. However, all transactions for one account are shown in that account, e.g. the cash account will have three entries in the example above.

THE LEDGER

From the above examples, you can see that all the transactions of a business are posted into a ledger or ledgers. The ledger can be described as a collection of accounts of a business (in simple terms, it is a book with one page for each account or, if the accounts are computerised, they be will part of the software package), and it is in the principal book of account where all financial transactions are recorded. We commonly talk about 'keeping the books' or 'writing up the books'. In this instance, the word 'books' means the ledger (or ledgers).

An account is the place where all the information relating to one type of asset, liability, income or expense is to be found. It reflects a detailed record of all transactions as they relate to a particular expense, receipt, asset or liability.



▲ An old-fashioned paper ledger

A LEDGER ACCOUNT

Each ledger account has its own name, e.g. motor expenses, advertising, trade receivables, and all are similar in appearance.

A typical ledger account that we would expect to see in a business is illustrated in Figure 2. The name of the account is placed at the top of the account. This describes the nature of the transaction contained in the account. From its title, we can work out if it is an expense or income account, an asset or a liability.

The page is divided into two halves by a central vertical line. The left-hand side is the debit side (Dr) and the right-hand side is the credit side (Cr). Each side is ruled in exactly the same way, with a number of vertical columns.

The first column is for the date of the transaction. The next column gives the details of that transaction. The third column is the folio column. A folio number (that is, a page number) is used in cross-referencing between the subsidiary books (see page 15) and the ledger. As the folio is not used in exams, this column is ignored throughout this text. It is hoped that in this way you will get to understand the principles of the accounting system without having to deal with too much detail.

Throughout this book we will show a simplified ledger account – commonly known as a 'T' account (it takes the form of the capital letter 'T'). This shows the date of the transaction, description of the transaction and the amount.

Through the use of these two sides of the ledger – and depending on the type of account (e.g. asset, liability, etc.) – we are able to show increases on the one side and decreases on the other. This does not mean that increases are always on the debit side or decreases are always on the credit side. This depends on the type of account that we are dealing with. To illustrate this, using the simplified T account, let us look at the examples below, starting with T accounts from the worked example on page 11:

Motor car

Date	**Details**	**£**	**Date**	**Details**	**£**
Date	Cash [1]	3 600			

Cash account

			Date	Motor car [1]	3 600
				Advertising [3]	68
				Wages [4]	190

Revenue

			Date	Mr Brown [2]	320

Mr Brown (Trade receivable)

Date	Sales [2]	320			

Advertising

Date	Cash [3]	68			

Wages

Date	Cash [4]	190			

Purchases

Date	Mr Green [5]	197			

Mr Green (Trade payable)

			Date	Purchases [5]	197

Dr **(Name of Account)** **Cr**

Date	**Details**	**£**	**Date**	**Details**	**£**

▲ Figure 2 Ledger account

WORKED EXAMPLE

The first account is for wages and shows the amounts that have been paid in January and February. We see that two wages payments (by cheques) occurred in January and February.

Account	Element	Increase/decrease	Dr/Cr
Wages	Expense	Increase	Dr
Bank	Asset	Decrease	Cr

When a business pays wages, the total amount of wages paid increases, therefore the wages account has been debited to reflect this increase.

This shows the date of each transaction

This shows the relevant account

This shows the amount of each transaction

Wages

Date	Details	£	Date	Details	£
31 Jan	Bank	500			
28 Feb	Bank	470			

The second account is one that relates to a non-current asset – a computer – and shows the purchase of a computer in April. In this account we see that we paid £1 200 by cheque on 30 April for a computer.

Account	Element	Increase/ decrease	Dr/Cr
Computer	Asset	Increase	Dr
Bank	Asset	Decrease	Cr

Computer (office equipment)

Date	Details	£	Date	Details	£
30 April	Bank	1 200			

The third account is the capital account of the business. It shows how the business was started with a capital investment of £5 000 and another amount, some three months later, of £11 000.

Account	Element	Increase/decrease	Dr/Cr
Bank	Asset	Increase	Dr
Capital	Capital	Increase	Cr

In this account we see that capital increased from £5 000 at the end of January to £16 000 at the end of April. In this instance we credited the capital account to reflect the increase.

Capital

Date	Details	£	Date	Details	£
			31 Jan	Bank	5 000
			30 April	Bank	11 000

From the worked examples, we learn that we can increase expenses, e.g. wages, by debiting the named account. This will also apply to assets, e.g. a computer, as they are on the debit side of the ledger.

We can increase a liability or capital by crediting the named account. This will also apply to revenue, e.g. **sales**, which is a credit to the relevant ledger accounts.

We also see how the accounting system records the many transactions. Clearly, we must record all transactions in at least two separate ledger accounts. You must always ask yourself an important question when posting transactions, and that is:

'Have I recorded this transaction in two accounts?'

If not, you have not entered the transaction according to the double-entry system. We will see the problem this causes when we discuss the trial balance in Chapter 7.

EXAM HINT

Steps to post a transaction to a ledger account:

Step 1: Enter the date.
Step 2: Enter the amount in the correct side of the ledger account.
Step 3: Enter the relevant account (the name of the other account on the double entry).

From now on, do not think that a credit means an increase or that a debit means a decrease. In accounting, this is far from the truth! As an additional guide, we must remember that assets and expenses are debits, while liabilities and income are credits. To illustrate this, we look at the following worked examples of double entry.

WORKED EXAMPLE

1 A motor vehicle is purchased for £1 145 cash on 2 June 2017.

Account	Element	Increase/ Decrease	Dr/Cr	£
Motor Vehicle	Asset	Increase	Dr	1 145
Cash	Asset	Decrease	Cr	1 145

Motor vehicle

Date	Details	£	Date	Details	£
2 June 2017	Cash	1 145			

Cash

Date	Details	£	Date	Details	£
			2 June 2017	Motor vehicle	1 145

2 The owner of the business funded it with a cash deposit of £2 000 on 2 June 2017.

Account	Element	Increase/ decrease	Dr/Cr	£
Cash	Asset	Increase	Dr	2 000
Capital	Capital	Increase	Cr	2 000

Capital

Date	Details	£	Date	Details	£
			2 June 2017	Cash	2 000

Cash

Date	Details	£	Date	Details	£
2 June 2017	Capital	2 000			

3 To start its trading activities, the business purchased £1 600 of goods on 4 June 2017 from A Wholesaler. An amount of £840 was paid in cash and the balance due for goods purchased was on credit.

Account	Element	Increase/ decrease	Dr/Cr	£
Purchases	Expenses	Increase	Dr	1 600
A Wholesaler (trade payable)	Liability	Increase	Cr	760
Cash	Asset	Decrease	Cr	840

Purchases

Date	Details	£	Date	Details	£
4 June 2017	Cash	840			
	A Wholesaler	760			

A Wholesaler (Trade payable)

Date	Details	£	Date	Details	£
			4 June 2017	Purchases	760

Cash

Date	Details	£	Date	Details	£
			4 June 2017	Purchases	840

4 A business purchased office equipment from A Supplier on 11 July 2018. This was a credit purchase of £543.

Account	Element	Increase/ decrease	Dr/Cr	£
Office equipment	Asset	Increase	Dr	543
A Supplier (trade payable)	Liability	Increase	Cr	543

Office equipment

Date	Details	£	Date	Details	£
11 July 2018	A Supplier	543			

A Supplier (trade payable)

Date	Details	£	Date	Details	£
			11 July 2018	Equipment	543

We can see that each of the items above are entered using a debit and a credit entry. We also note that in certain instances (items 1, 2 and 3) the cash account has been credited with part of the double entry. Instead of having three separate accounts for cash, we would have a single one. This account, showing all three transactions will appear as follows:

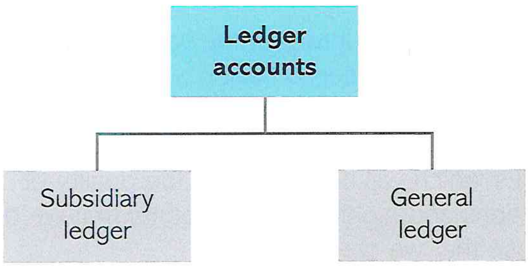
Cash

Date	Details	£	Date	Details	£
2 June 2017	Capital	2 000	2 June 2017	Motor vehicle	1 145
			4 June 2017	Purchases	840

It is important to note that the posting of transactions to the ledger accounts is done in a very formal way. The date of the transaction must be shown, as well as the description of the transaction. This description is normally the title of the other account of the double entry and allows anyone reading the ledger the opportunity to find the transaction on the opposite side.

All these accounts are collected together into a ledger and we will see later that it is from this ledger (or ledgers) that the financial statements are prepared.

TYPES OF LEDGER ACCOUNTS



▲ Figure 3 The types of ledger accounts

The ledger can be divided into a number of smaller ledgers. These smaller ledgers are additional to the main (general) ledger and record transactions prior to entry (or posting) to the main ledger, which is why they are called subsidiary books. Examples of these subsidiary books are:

- the trade receivables (or sales) ledger (which records individual trade receivables who owe us money)
- trade payables (or purchase) ledger (where we record what we buy and how much we owe to each individual trade payable).

All of these subsidiary books will be discussed later.

ACTIVITY 3

SKILLS CRITICAL THINKING

CASE STUDY: LEDGERS

Transactions	General ledger	Trade receivables ledger	Trade payables ledger
Cash sales			
Rent			
Bank			
Credit purchases			
Credit sales			
Wages paid			
Rent received			

1 Identify the ledger in which the above transactions would be shown.

UNDERSTANDING LEDGER ENTRIES

You should also be able to interpret and understand what each ledger account tells you. It sets out a transaction and you need to interpret it. Take the following ledger accounts and, by looking at each transaction, interpret what has happened.

Example 1

In the below account, we can 'read', for example, that rent of £500 was paid by the business on 1 March 2019. We also see that £10 000 was paid into the business as capital. We received £21 500 in cash sales and paid out various other items shown in the account below.

Bank

Date	Details	£	Date	Details	£
1 Mar 2019	Capital	10 000	1 Mar 2019	Rent	500
11 Mar 2019	Sales	21 500	3 Mar 2019	Gibson Wholesalers	1 000
			29 Mar 2019	Drawings	1 000
			30 Mar 2019	Motor expenses	1 900
				Other operating expenses	1 050
				Salaries	4 000

Example 2

Trade payable – J Smith

Date	Details	£	Date	Details	£
31 May 2019	Bank	15 300	31 May 2019	Purchases	45 990

Purchases

Date	Details	£	Date	Details	£
31 May 2019	J Smith	45 990			
	Cash	38 961			

In the accounts above, we see that the credit purchase from J Smith amounted to £45 990. In addition, we paid £38 961 for cash purchases. We also see that we paid J Smith £15 300 by cheque.

Example 3

Revenue

Date	Details	£	Date	Details	£
			31 May 2019	Cash	6 900
				J Jones	41 000

The above account shows us that we sold goods on credit to J Jones to the value of £41 000. A further amount of £6 900 was sold for cash.

Trade receivable – J Jones

Date	Details	£	Date	Details	£
31 May 2019	Sales	41 000			

Once we are able to interpret the various ledger accounts, we are closer to having a full understanding of double entry.

Before we continue, let us work through some examples which will help illustrate the duality of transactions and highlight the accounts that we debit and those that we credit.

WORKED EXAMPLE

Alex starts a new business selling office supplies on 1 January 2018. The first thing she does is to invest £8 000 into the business bank account.

Bank account

Date	Details	£	Date	Details	£
1 Jan 2018	Capital	8 000	2 Jan 2018	Purchases	1 200
4 Jan 2018	Sales	2 100	8 Jan 2018	Purchases	1 500
				Wages	110

On 1 January 2018, we debit the bank account (money paid into the bank, which is the receiver) and credit the owner's (Alex) capital account. This transaction tells us that Alex contributed additional cash to the business.

Capital account

Date	Details	£	Date	Details	£
			1 Jan 2018	Bank	8 000

We are now in a position to start up the business, having received the necessary capital from the owner.

On 2 January, Alex purchases, by cheque, some inventory for resale. Let us assume that she buys goods to the value of £1 200.

Purchases

Date	Details	£	Date	Details	£
2 Jan 2018	Bank	1 200			
8 Jan 2018	ABC	3 800			
	Bank	1 500			

We debit purchases with £1 200 and credit the bank account with a similar amount (note: we use one bank account for all transactions).

The important thing to notice in this last transaction is that we credit the bank account to decrease the value of the asset. We do not show a minus figure on the debit side, but a credit to the ledger account. After these transactions there is a positive bank balance of £6 800 and this will show as an asset of the business.

Having bought goods for resale, Alex then sells the goods on 4 January for £3 500. Of this amount, she receives a cheque for £2 100. The remainder of the transaction is a credit sale to G Bush.

Revenue

Date	Details	£	Date	Details	£
			4 Jan 2018	Bank	2 100
				G Bush	1 400

Trade receivable – G Bush

4 Jan 2018	Sales	1 400			

We credit the revenue account with the £3 500 (total) and debit the bank account with £2 100 and the trade receivable of G Bush with £1 400.

On 8 January, Alex buys additional goods for £5 300, of which £3 800 is bought on credit from I Supply & Co. She issues a cheque for £1 500 for the other purchases.

Trade payable – I Supply & Co.

Date	Details	£	Date	Details	£
			8 Jan 2018	Purchases	3 800

She hires D Smith to work with her and agrees to pay him a wage of £110 per day.

Wages

Date	Details	£	Date	Details	£
8 Jan 2018	Bank	110			

At the end of that day she would debit purchases with £5 000, credit the trade payable account of I Supply & Co. with £3 800 and credit the bank account with £1 200. She pays D Smith his wages for the day and so we debit the wages account and credit the bank account with £110.

Work through the worked example very carefully and make sure that you understand why we debit and why we credit various accounts. Once you are confident that you understand this example, you are ready to work through a number of additional activities on your own. You must at all times make sure that you are familiar with the debit and credit concept of the double-entry system.

ACTIVITY 4

SKILLS ANALYSIS, PROBLEM SOLVING, EXECUTIVE FUNCTION

CASE STUDY: AKSHAY'S SPORTS GOODS STORE

Akshay has set up his business and is preparing to commence trading in his sports goods store as from 1 April 2019. Before he started to trade, he introduced capital of £30 000. This was by way of a cheque paid into the business on 25 March 2019. On the same day, he purchased a motor van and paid out £7 400 by cheque. In addition, he paid for shop fittings (£2 900), purchases (£7 100) and half the rent for April for the shop (£2 000). All these payments were made by cheque. He purchased, on credit, goods for resale from Tennis Ltd to the value of £3 400.

Akshay's business transactions for the first week in April 2019 are as follows:

1 April	Paid £150 by cheque to the local newspaper for an advertisement.
2 April	Paid £2 000 for the balance of rent due by cheque.
3 April	Sold goods for cash, £150.
4 April	Sold goods for cash, £210.
5 April	Sold goods for cash, £80.
6 April	Sold goods for cash, £153.
6 April	Purchased additional goods from Tennis Ltd on credit for £1 500.
7 April	Cash sales, £197.
7 April	Paid £120 wages to shop assistant in cash.
7 April	Paid £600 cash into the bank.

1 Open the necessary ledger accounts for all the above transactions and post the entries to those accounts. Make sure that both the debit and credit entries are made for each transaction.

At the end of this period, you would balance the cash and bank accounts. (If you have entered the accounts correctly, you will see that an amount of £70 remains in the cash account and that the bank account shows a balance of £9 050.)

ACTIVITY 5

SKILLS ANALYSIS, PROBLEM SOLVING, EXECUTIVE FUNCTION

CASE STUDY: LARRY'S ANTIQUES

On 1 September 2018 Larry started an antiques business. The transactions for September 2018 were as follows:

1 September	Paid £40 000 into the business bank account.
2 September	Purchased antiques for £26 000. Cheque issued from the bank account.
4 September	Paid insurance premium of £980 for the year ending 31 September 2019. Payment was made by cheque.
10 September	Larry was charged £1 200 for packing material by Upack.
12 September	A bill was sent to Acquire for goods sold, £12 900.
19 September	A cheque for £8 000 was received from Acquire.
25 September	A bill for £5 300 was sent to Okay for antiques sold.
27 September	Larry paid D Brown, by cheque, wages of £1 100 for the month. Larry withdrew £2 000 from the bank account for personal use.
28 September	Goods invoiced for £1 900 were damaged and sent back by Okay for credit.

1 Prepare the ledger accounts for the month of September 2018.

ACTIVITY 6

SKILLS ANALYSIS, PROBLEM SOLVING, EXECUTIVE FUNCTION

CASE STUDY: JACK'S COSMETICS STORE

On 1 July 2017, Jack opened a cosmetics store. He transferred £20 000 cash from a personal bank account to the business. During the remainder of the month he completed the following transactions, all of which were by cheque:

10 July	Paid rent, £900.
11 July	Purchased a delivery truck from MotoTrade for £15 000. He paid £7 000 on the date of purchase. The balance due is to be paid on 31 December 2017.
12 July	Purchased shelving and other fixtures, £3 700.
14 July	Purchased goods, £885.
14 July	Paid insurance premiums, £750.
15 July	Sold goods and received immediate payment of £1 200.
16 July	Purchased £1 240 worth of goods on credit from Hilcom Cosmetics.
17 July	Paid wages, £600.
24 July	Sold goods on credit for £3 100, to Monica.
27 July	Paid telephone expenses, £1 205.
27 July	Paid gas expenses, £173.
28 July	Received payment from Monica, £1 350.
31 July	Paid wages, £1 350.
31 July	Withdrew money for personal use, £1 500.

1 Write up all the above transactions to the relevant ledger accounts.

ACTIVITY 7

SKILLS ANALYSIS, PROBLEM SOLVING, EXECUTIVE FUNCTION

CASE STUDY: MEI'S CLOTHING BUSINESS

On 1 June 2018, Mei started a clothing business. During the month, Mei completed the following transactions, all of which were by cheque unless stated otherwise:

5 June	Mei transferred £15 000 from a personal bank account to an account to be used for the business.
5 June	Paid rent for the month, £1 950.
7 June	Purchased office equipment on credit from File & Co. for £6 250.
8 June	Purchased a used car for £16 000 from NuVan Ltd and paid £9 500 on account. The balance was payable in 6 months.
10 June	Purchased goods, £725.
12 June	Cash sales of £1 600.
15 June	Paid wages to employees, £800.
20 June	Paid insurance premiums of £725.
22 June	Invoiced A Lu for clothes bought, £1 950.
24 June	Received an invoice from NuVan Ltd for motor expenses, £310.
26 June	Cash sales of £1 650.
28 June	Purchased goods, £590.
29 June	Paid gas and electricity expenses, £490.
29 June	Paid other operating expenses, £195.
30 June	Received from A Lu on account, £1 200.
30 June	Paid wages to employees, £200.
30 June	Paid File & Co. on account, £1 500.
30 June	Withdrew money for personal use, £500.

1 Show the transactions in the ledger accounts.

ACTIVITY 8

SKILLS CRITICAL THINKING

CASE STUDY: DEBITS OR CREDITS?

You have learned a lot in this chapter. It is a good time to test your understanding. How many of these can you complete correctly without looking back?

	Debit	Credit
Trade payables		
Capital		
Loan from bank		
Postages		
Drawings		
Liability		
Revenue		
Non-current asset		
Purchases		
Trade receivables		

1 Indicate whether the above ledger accounts are normally debits or credits.

WHAT THE BOOKS TELL US

The various records contained in the books of account assist in providing an understanding of the financial health and growth potential of the business. In particular, they set out:

- how much the business owes to others, and how much others owe the business
- the details of income, expenses, assets and liabilities
- the source of profits or losses
- the profit or loss for any given period
- the value of the business.

Accounting does not, and cannot, be kept separate from other business activities – it reflects the activities of the business, which reacts and interacts with the external environment. This is influenced by many different forces which may be political, social, legal or economic.

Business decisions have social as well as economic consequences. Businesses must accept responsibility for the social implications of their activities, such as their impact on the environment or the extent to which employment opportunities are provided.

BALANCING THE LEDGER ACCOUNTS

After all transactions are entered (posted), the ledger accounts are balanced – i.e. the difference between the debit side and the credit side is calculated. This is usually done at the end of a trading period.

The balance is transferred, as a single amount, to the following period, or to the statement of profit or loss and other comprehensive income, and to the statement of financial position (see Chapter 10).

Wages

Date	Details	£	Date	Details	£
31 March	Cash	800	30 June	Statement of profit or loss	2 700
30 April	Cash	600			
31 May	Cash	900			
30 June	Cash	400			
		2 700			2 700

In the above example, wages have been paid from March until June. At the end of June, a statement of profit or loss and other comprehensive income is to be prepared and therefore the total of the ledger account is transferred to the statement of profit or loss and other comprehensive income at that date. As the full amount (£2 700) is transferred, there is no balance on this account.

The balance is the amount by which one side of the account exceeds the other side. This allows you to see, at a glance, a single amount for each ledger account – what is in the bank, the value of trade receivables, or what we owe.

To balance an account there are a number of steps that we have to take. These are:

- add the money columns on the debit and credit sides and find the difference (the balance)
- enter the balance on the side where the total is less than the other. This is the balance carried down (c/d)
- the two sides are now equal, and the totals are written on the same line on each side and ruled off with a single line above and a double line below the total
- the balance is brought down (b/d) to the side with the higher total. Write this balance immediately below the total. This completes the double entry which is inherent in the balancing process
- the balance b/d is the opening balance for the next period.

The following account illustrates the above process:

Cash account

Date	Details	£	Date	Details	£
3 April	Sales	150	7 April	Bank	600
4 April	Sales	210	7 April	Wages	120
5 April	Sales	80	7 April	Balance c/d	70
6 April	Sales	153			
7 April	Sales	197			
		790			790
8 April	Balance b/d	70			

We have referred to the balancing of the accounts 'at the end of a period'. We must, however, understand that accounts can be balanced at any time, even when the ledger page is full and we need to carry the balance forward on to a new page. Usually, we balance the accounts at the end of a month, or year, as it is then that we prepare the financial statements.

EXAM HINT

When balancing off accounts with a balance c/d figure, ensure you complete the double entry by entering the balance b/d in the ledger account.

Do not use abbreviations for balances carried down and brought down. The minimum acceptable is likely to be Bal c/d and Bal b/d.

ACTIVITY 9

SKILLS ANALYSIS, PROBLEM SOLVING, EXECUTIVE FUNCTION

CASE STUDY: OLIVIER

Olivier commenced business on 1 January 2018. He paid an amount of £11 000 by cheque as capital and he also received a cheque for £7 000 as a loan from A Turner. The transactions for the six months, ending 30 June, were as follows:

Account	Amount £
Drawings	9 000
Cash received from trade receivables	12 500
Cash paid to trade payables	15 300
Expenses paid	7 900
Credit purchases	34 200
Cash purchases	21 900
Payment for motor vehicle	18 000
Cash sales	9 400
Credit sales	32 000
Returns inward	325
Returns outward	197

1 Show the bank account (all cash is banked immediately) as well as ledger accounts of the sales and purchases for the six months. The trade receivables and trade payables accounts at 30 June 2018 should also be shown.
2 Balance off the accounts at 30 June 2018 and bring down the balances at 1 July.

(Note: you can ignore dates in this answer. However, in most exam questions you must show the dates and carry down balances on the ledger accounts.)

Once we have balanced off the ledger accounts, the balances are then transferred to the trial balance. All debit balances are shown on the left side of the trial balance and all credit balances are on the right. After entering all the balances, we total them to ensure that it balances. For more details on this, see Chapter 7.

From this balanced trial balance we are then in a position to prepare the financial statements. We no longer have to go through the various ledger accounts to find information – it is all in one place: the trial balance.

At this stage it is important that you practise balancing off various ledger accounts. In the following examples you are given ledger accounts with opening balances and details of transactions for the following month. Enter these transactions and then balance off the accounts as explained above.

ACTIVITY 10

SKILLS ANALYSIS, PROBLEM SOLVING, EXECUTIVE FUNCTION

CASE STUDY: ANN

Ann owns a travel agency. You are presented with the following ledger account in Ann's books. The account gives details of the bank transactions for the month of July 2019.

Bank

Date	Details	£	Date	Details	£
1 Jul 2019	Capital	40 000	10 Jul 2019	Rent	1 900
15 Jul 2019	Sales	3 587	11 Jul 2019	Computer	2 100
28 Jul 2019	Trade receivables	2 984	12 Jul 2019	Phone	156
31 Jul 2019	Interest	143	14 Jul 2019	Purchases	1 123
	Sales	1 988		Drawings	1 200
			17 Jul 2019	Wages	950
			27 Jul 2019	Printer	287
				Electricity	342
			31 Jul 2019	Wages	1 980
				Insurance	3 500

1 Balance this account and show the opening balance at 1 August 2019.

ACTIVITY 11

SKILLS ANALYSIS, PROBLEM SOLVING, EXECUTIVE FUNCTION

CASE STUDY: CASH ACCOUNT

Cash account

Date	Details	£	Date	Details	£
1 Sept 2018	Loan	4 000	10 Sept 2018	Wages	1 000
15 Sept 2018	Revenue	2 000	11 Sept 2018	Rent	2 000
28 Oct 2018	Commission	500	12 Oct 2018	Postage	100
31 Oct 2018	Interest	850	14 Nov 2018	Purchases	2 300
11 Nov 2018	Revenue	2 300	19 Nov 2018	Wages	500
			24 Nov 2018	Purchases	900
			27 Nov 2018	Rent	1 000

1 Balance the cash account for September, October and November 2018.
2 Post the payments made for purchases and wages and show the balances on each of those accounts at 30 November 2018.

CARRY FORWARDS

Do not confuse the various terms used. We have read about the terms 'b/d' and 'c/d' earlier in the chapter. In addition, you will come across two other terms – carried forward (c/f) and brought forward (b/f). These terms are not used in carrying down a balance on an account. The only time they are used is when we carry an amount forward, from one page of the ledger to another. We add the two sides and carry forward the total of each side to the next page. At the top of the next page we show each total as having been brought forward. An example is shown below.

Cash account

Date	Details	£	Date	Details	£
3 April	Sales	150	7 April	Bank	600
4 April	Sales	210	7 April	Wages	120
5 April	Sales	80			
	Balance c/f	440		Balance c/f	720

As the ledger account continues on to the following page, we need to transfer the balances at the end of page one to page two. We do this by 'carrying forward' the balances from one page to the next.

Cash account

Date	Details	£	Date	Details	£
5 April	Balance b/f	440	7 April	Balance b/f	720
6 April	Sales	153	8 April	Balance c/d	70
7 April	Sales	197			
		790			790
8 April	Balance b/d	70			

ACTIVITY 12

SKILLS ANALYSIS, PROBLEM SOLVING, EXECUTIVE FUNCTION

CASE STUDY: MARIA'S GIFT SHOP

Maria started a gift shop on 1 March 2019. The following cheque payments were made during the month:

1 March	Maria transferred £10 000 to the business.
1 March	Paid rent for office, £500.
3 March	Purchased goods from Gift Wholesalers, £2 900.
8 March	Paid Gift Wholesalers on account, £1 000.
11 March	Cash sales, £21 500.
29 March	Withdrew cash for personal use, £1 000.
30 March	Paid motor expenses, £1 900, and other operating expenses, £1 050.
30 March	Paid office salaries, £4 000.

1 Prepare all the ledger accounts for the above transactions and balance them at the month end.
2 What is the total revenue recorded in the ledger?
3 State the amount of total expenses for the month.
4 What is the net income for March? (Assume that all goods purchased have been sold.)

EXAM HINT

You must remember to make two entries for each double-entry transaction – one Dr entry and one Cr entry. The debit entry values must equal the credit entry values.

There are a number of mnemonics which can be used to help you remember the rules of double entry. It is important you choose the one that works for you.

DEAD CLIC	**Dr**	**E**xpenses, **A**ssets and **D**rawings	
	Cr	**L**iabilities, **I**ncome and **C**apital	
CLEAR	**C**apital, **L**iability, **E**xpenses, **A**ssets and **R**evenue		
PEARLS	**Dr**	PEA	**P**urchases, **E**xpenses and **A**ssets
	Cr	RLS	**R**evenue, **L**iabilities and **S**ales

Given that accounting terminology is always being amended, none are perfect, but all offer some help.

CHECKPOINT

1 Every transaction requires a debit entry and a credit entry. True or false?

2 What is a ledger?

3 What are drawings?

4 What are assets?

5 If a business receives cash, on what side of the cash account is the entry?

6 Wages are an asset. True or false?

7 State three possible expenses.

8 State three possible assets.

9 Explain how ledger accounts are balanced.

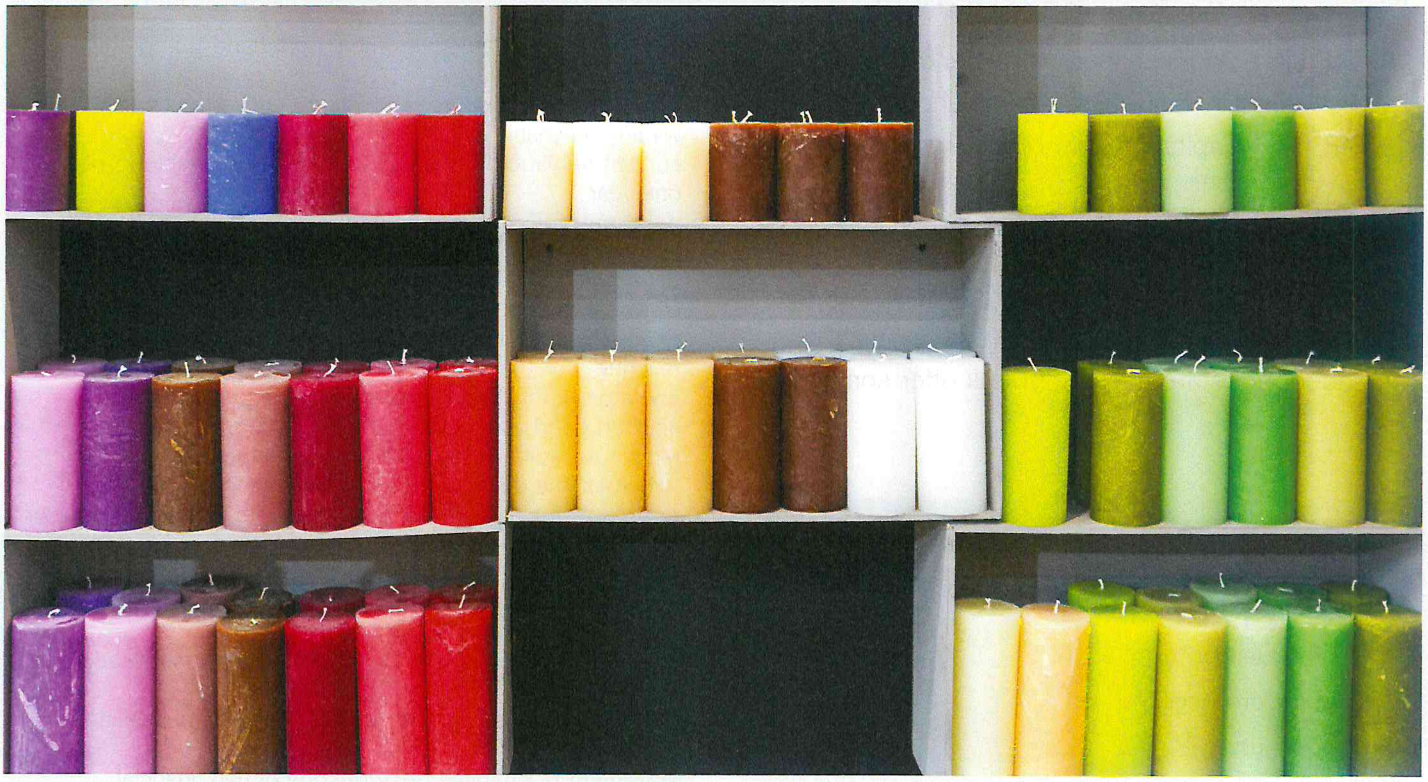
SUBJECT VOCABULARY

assets resources that are owned and used by the business
bring down (or carry down) the amount entered as the opening balance in the next accounting period, which is the balancing figure calculated for the current financial period. It is entered on the opposite side in the new financial period, this maintains the double entry
capital account the fixed account of a partner showing capital introduced or withdrawn
credit entry (Cr) an entry on the right-hand side of the ledger account
current assets resources which are converted to cash within one year
current liabilities amounts owed that are payable within one year
debit entry (Dr) an entry on the left-hand side of the ledger account
drawings resources removed from the business by the owner; these could be cash or inventory
expenses cost incurred by the business in generating revenue
inventory (stock) raw material, work in progress and finished goods held by a business
ledger account an account containing the double entry
liabilities the debts of a business owed to others
non-current assets (fixed assets) assets held by a business for more than one year
non-current liabilities (long-term liabilities) amounts owed with a repayment date greater than one year
purchases inventory bought for resale
revenue (or income) the monetary value of sales made by a business
sales inventory sold in the normal course of business to customers
statement of financial position one of two financial statements that shows the assets, capital and liabilities of a business
statement of profit or loss and other comprehensive income one of two financial statements which shows the profits or losses of the business
trade payables the total of all the individual persons and businesses that a business owes money to and will pay within one year
trade receivables the total of all the individual persons and businesses that owe money and will repay within one year

EXAM PRACTICE

CASE STUDY: FRAN'S CANDLE SHOP

SKILLS EXECUTIVE FUNCTION, CRITICAL THINKING, REASONING



Fran opens a shop selling candles and home decorations. The following cheque transactions have been made by Fran during the month of August 2018. The opening balance in the bank account was £225 Dr.

Account	£
Capital introduced	20 000
Computer	1 500
Drawings	2 000
Electricity	415
Insurance	1 200
Interest paid	55
Purchases	4 000
Rent	15 000
Revenue	3 500
Wages	1 100

Q

1 Prepare the ledger account for this bank account. Balance the account and show the opening balance at 1 September 2018. (Dates not required.) **(12 marks)**

2 Explain the significance of the credit balance brought down (b/d) in the bank account. **(4 marks)**

3 Explain the difference between drawings and expenses. **(4 marks)**