Final Term Notes

Topic 1: Fundamentals of accounting
1.1:

Book keeping ~~vs~~ vs Accounting.

Book keeping is the activity of recording financial transactions.
- It has to be done with care and accuracy, so correct allocation of resources take place
- It includes, when and how much money was spent
- Books of prime entry: have similar transactions and are seperated according to their type
- Ledger accounts: They contain the accounts of the business example: capital, assets, liabilities.

- Accounting includes book keeping, but along with that it monitors other things.
- The financial records from book keeping are ~~used~~ used to make financial statements, which tell the owner about the state of the business. Displays
- Income statement: ~~Manages~~ Profit & Loss ~~are~~ of the business
- Statement of financial position: shows business resources and how they are financed.
- Accounting also assesses the progress of the business financially to see how well the business is doing.

Why Measure Profit & Loss.

Business objectives:
Are the aims and objectives of a business

Profit Maximization:
Aiming to earn maximum profit possible.

~~Reasons:~~ Objectives:

Growth: The volume of sales
Market Share: How much & the sales account for in the market!
Survival: Buying ~~Need of~~ Resources to make Business run as long as possible
Break-even: Having equal profit & loss (non profit org)
Social objectives: Having money to serve the community
Environmental objectives: Being ~~stastaib~~ sustainable.

Why objectives change over time
Sometimes the situation changes, example: If the business is going down then the objective would be survival but if the business is successful then objective would be sales or market share.

Profit = income earned − expenses paid for in an accounting period (A time period for which financial statements are prepared.)
Profit ≠ Money
Money is used to gain profit
Loss = expenses > income
Profit is recorded in the income statement (A financial statement showing income & expenses for an accounting period)

Why measure how much profit
- If a business owner need to take out money, he needs to know how much he can take out so as to not ruining the flow of the business
- The profit can be reinvested in the business to allow it to expand
- Profit can be used to pay of the company's debts.

- Paying taxes: Many business' pay taxes ~~to~~ as a percentage of their profit.
- Obtaining credit: Lenders often lend money to business' that are likely to survive, which is displayed by profit.
- Encouraging ~~Ent~~ Entrepreneurships: When profits are ~~to~~ high ~~a~~ entrepreneurs are more likely to take risks to expand business.
- Keeping shareholders happy: Limited companies need to know how much dividend payments ~~to~~ they can give to shareholder based on how ~~mu~~ much profit they have.
- Attracting Investments: High profit is a sign of a good investment thus attracting people to put money into the business.

Where does accounting play a role?

Accounting involves the process of keeping track and analysing financial ~~a~~ progress. which provides information about the business.

Monitoring progress.
- Owners are interested in the profits of the business and need to see how much they progress by comparing the size of profits from the current year ~~to~~ from previous years.
- If debts are rising there is a risk that the debts can rise to a higher ammount than the profits, thus this need to be monitored.
- Suppliers want prompt and early payment, when buying goods on credit, ~~&~~ and the financial statement show the stability of a business.

Decision Making:
- knowing size of ~~pa~~ profit allows the owner to decide if they can get more assets.
- knowing cash balance allows business to decide whether they should ~~they a~~ arrange a new source of finance.
- knowing sales revenue allows ~~an~~ owners to decide whether ~~ather~~ to hire more staff ~~on~~ and expand operations.

1.2: The Accounting Equation

Every transaction has 2 effects on the financial records. This is called the Duality Principle. i.e: 1 credit & 1 debit.

- Assets: Resources used within the business activities (vans, premises, inventory)
- Liabilities: Ammounts borrowed to fund business activities (loans, inventory bought on credit)
- Owner's equity: Business resources supplied by the owner. aka capital (owner's savings, car or computer)

The Accounting Equation:

Assets = Capital + Liabilities
Capital = Assets - Liabilities
Liabilities = Assets - Capital

Duality means each transaction has two different perspectives. The accounting equation states that the two elements or two sides of the ~~eq~~ equation must always be equal.

Resources used within the business either come from the equity or have been borrowed, even if its a donation. Profit goes to the capital and can be used to get more assets.

Statement of financial position: A financial statement showing the assets & how they are financed (capital or liability)
Liquidity: A measure of how fast an asset can be made into cash without losing it's value (The least at the top of SOFP)
Inventory: Goods held by a business for resale, either raw, partly manufactured or completely manufactured.

Busin
Statement of
Resources used within
business
Assets

Trade payables: The
supplier, for goods tha
sum of all the ammou
Trade receivable: The
by a customer for
the sum of all the

Business Name

Statement of financial position as at date

Resources used within the business
Assets

How the assets were financed
Capital and/or Liability.

Trade payables: The ammount that a business owes to its supplier, for goods that were bought on credit. (Payables is the sum of all the ammounts that a business owes)

Trade receivable: The ammount that a business is owed by a customer for goods or services supplied. (receivables is the sum of all the ammounts owed to the business)

Chapter 2

2.1 Double entry book keeping

Double entry book keeping: A system of recording business transactions by making two entries, one credit & one debit for each transaction.
This maintains the concept of duality.
This was created in 1494 by Luca Pacioli

Account Name
(e.g: Bank)

Debit side (Dr)			Credit side (Cr)		
Year Date	Particulars	$ Ammount	Year Date	Particulars	$ Ammount

For Assets (Inventory, Van, Bank)

Debit	Credit
Increases (in asset) on this side	Decreases (in asset) on this side.

For Liabilities (Loans, credit purchase)

Debit	
Decreases (in ~~asset~~ liability) on this side	Increases (in ~~asset~~ liability) on this side.

For Capital/Owners Equity (cash, ~~car, laptop~~)

Debit	
Decreases (in ~~asset~~ capital) on this side	Increases (in capital) on this side

Accounting for inventory
An asset is classified depending on its use. A computer to be used would have a computer account, but if its for resale then it counts as inventory.
Trader: A business that runs on the basis of ~~by~~ buying & selling goods, no production takes place.

There are 4 differen

Purchases Account: For
Sales Account: For sales
Purchase Returns Accou
a problem
Sales Returns Account:
due to any problem.

Cash Sales: Sales po
Cash Purchases: Purc

Recording Inver

Account to be
Purchases
or
Sales R

Trade Receivables:
Trade Payables:

Acc

Expenses are
Examples:
Wages
Office Expenses

Account to
Expense A

There are 4 different accounts used in Inventory transactions.

- Purchases Account: For purchase of inventory.
- Sales Account: For sales of inventory
- Purchase Returns Account: For returning inventory back to supplier due to a problem.
- Sales Returns Account: For return of ~~a~~ inventory back to business due to any problem.

Cash Sales: Sales paid for immediately by cash
Cash Purchases: Purchases paid for immediately by cash.

Recording Inventory ~~in~~ Double Entry Accounts

Account to be debited	Account to be credited
Purchases	Sales
or	or
Sales Returns	Purchas returns.

Trade Receivables: Asset
Trade Payables: Liability.

Accounting for Expenses

Expenses are incurred in running a business, ~~u~~ usually paid for by cash or bank
Examples:
- Wages
- Office Expenses
- Heating costs
- Rent
- General Expenses
- Insurance
- Advertising cost
- Administration cost

Accounting for Expenses
~~Expense Account~~

Account to be debited	Account to be credited.
Expense Account	Bank or Cash.

Accounting for Income

Main source of income: ~~by~~ buying & selling goods or services.
other sources:
- Rent received
- Commision received

Accounting for Income

Account to be debited	Account to be credited
Bank or Cash.	Income Account

Accounting for Drawings

Drawings: Asset (money or other resources) that an owner withdraws from business for personal use
Follows same rule as Capital Account

Accounting for drawings

Account to be debited	Account to be credited
Drawings Account.	Relevant asset acc (~~money~~ cash)

Balancing Accounts

At the end of an accounting period the owner balances the double entry accounts. Which allows them to see the Balance on each individual account.
Balance (of an account): The overall difference between credit & debit sides of an account at a certain point in time.

When there is an outstanding Balance
1. Find total of each column
2. Calculate difference between the totals
3. Add balancing figure to equalise the totals. (Balance c/d)
4. Balance b/d has to be ~~be~~ written on the start of new accounting period (same value as Balance c/d)

Interpreting leadger Accounts & their balances
How to interpret Account balances

After an account has been balanced, it can be interpretted.
example: If a business has a credit or a debit balance.
Things to look at.

- Cash Balance (Always Debit): How much cash a business has
- Debit Balance: How much the business has in the bank
- Credit Balance: The ammount the business owes to the bank.
- Credit balance on sales acc: sales made for a period
- Debit Balance on purchases acc: purchases made for a period

Debit Balance on a personal account: ammount owed to business from a costumer.

Credit Balance on a personal account: ammount the business ownes to a supplier

Personal Account: Accounts of other businesses or people that the business has a financial relation with.

Making transfers to financial statement

- At the end of the accounting period the income statement is prepared. This shows the profit & loss.
- Profit or loss is calculated by minusing income with expenses
- The leadger accounts are closed and all outstanding balances are transferred to the income statement.

For bigger businesses we divide the leedgers into 3

Sales leadger: Trade receivables
Purchases leadger: Trade payables
Nominal ledger: Assets, Liabilities, Capital, Expenses, Income

2.) Business Documents

Business Document: A document issued or received by a business when a transaction takes place containing the details of the transaction.

Why do we need them?

- They are used as:
  - A source of information to make entries in the accounts
  - To confirm agreements between businesses
  - To solve any dispute (used as evidence)

- Pro Forma Documents: Documents that contain all the details and just need to be filled out such as (adress, space for details of items, space for dates, totals, discounts, etc.

The different business documents.

Invoice: refer page 38
A document issued by a business when making a credit sale
It contains:
- Name & Address of the business making the sale
- Name & Address of customer
- Date of sale
- Details of sale: items, quantities & prices (individuals & totals)
- Delivery cost
- Payment conditions such as trade discounts and discounts for early payment.

Trade discount: A discount given to encourage other businesses to buy larger quantities, it is given as a percentage of reduction in the invoice.
* Trade discounts are not included in the double entry accounts.

Debit Note: refer
A document issued by
is an issue with
Problems include:
wrong quantities
wrong specs (wrong c
A debit note vari
Name & Address o
Name & Address
date
details of goods
Value of the
The debit note
the supplier agr

Credit Note: re
A document issu
goods are bein
unsuitable.
It includes:
Name & addr
Name & Ad
Date
Details of
Value of c
The debit
supplier.
The credit

Debit Note: refer page 39

A document issued by the business to the supplier when there is an issue with the goods received.

Problems include:

- wrong quantities
- faulty products
- incorrect goods
- wrong specs (wrong colour, size, etc.)

A debit note varies, but most include:

- Name & Address of the business (customer)
- Name & Address of the supplier
- date
- details of goods being returned
- Value of the unsuitable goods.

The debit note doesn't go into the double entry accounts until the supplier agrees to allow the goods to be returned.

Credit Note: refer page 40

A document issued by a business to a customer when goods are being returned to the business because they are unsuitable.

It includes:

- Name & address of the business (supplier)
- Name & Address of the customer
- Date
- Details of goods being returned by the customer
- Value of credit note.

The debit entry is in the sales returns account of the supplier.

The credit entry is in the account of customer.

Statement of Account: refer page 41

A document issued to all the customers that still owe money to the business, it contains the details relating to the transactions that took place. i.e: summary of transactions between the business & the customer over the month.

It normally shows:

- Name & Address of Business
- Name & Address of Supplier
- Relevant transactions & dates (for that month)
- Balance owing by the customer at the start & end of the month
- Details of invoices sent to the customer during the month.
- Details of any credit notes agreed.

Cheque refer page 43

A written document authorising a payment from the bank account of a business to another person.

Automated methods of payment:

- credit transfer: direct payment of money from 1 bank to another
- Automated payment that is set to pay for example rent at the end of the year.

Pre printed cheques contain:

- Name & Address of the bank used by the business
- The sort code & Account number.
- The name of the business

To complete the payment, the business adds the following details to a cheque before passing it on to the payee

- payee: The person or business receiving the payment. aka drawee
- Name of payee
- Ammount to be paid
- date of payment

- signature of the payer

payer: The ~~name & signatu~~ person making the payment to another aka drawer.

Cheque counterfoil: Part of the cheque (left hand portion) which is kept by the business as a record of the payment. aka cheque stub.

refer page 43

Pay in slip: A document used to deposit cheques, notes or coins into a bank account.

Banks can issue these slips to customers, and like cheque's they are preprinted and just need to be filled in.

There are two ways in which the business records that the money has been deposited into the account.

- The business receives a stamped copy of the slip.
- They complete the counterfoil attached to the slip book which gets stamped and then the business keeps it.

Receipt: refer page 44

It is a written document which is issued by & a business when it receives payment. (it is kept as a proof of payment)

Receipts contain the following:
- Ammount received
- Date of payment
- Details of payment.

Receipts are not needed when paying by cheques because the bank already keeps a record.
A receipt is kept as part of the income received.

- signature of the payer

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Bank Statement: refer page 45
Bank statements are document issued by the bank showing all the transactions for a certain time period. These are issued on a regular basis & presented in the bank's point of view.

Bank's view =

Debit balance = Owners credit
Credit balance ~~Owner's credit~~ = Owner debit.

~~These~~ This contains:

- Date of transactions
- Details of transaction
- Type of ~~pa~~ payment (payment or receipt)
- ~~B~~ Owner's name, sort code & account number
- Name of Bank
- Total ~~&~~ closing balance.

Summary of Documents and their entry in ledgers

Business Document	Account to be debited	Account to be credited
(Sales) invoice	Credit customer	sales
(Purchase) invoice	Purchases	Credit supplier
Cheque counter foil	~~R~~ Account related to payment	Bank
Cheque received	Bank	credit customer
credit note	Sales return	credit customer
receipt	Bank or cash	Account related to receipt
paying in slip	Bank	Cash or Credit
Bank statement	Bank (if money received)	Bank (if money is paid out)

* Debit note isn't included as it is a request, which is not nesessarily accepted.

by the bank
time period
is & presented

in ledgers

Account to be credited

sales
Credit supplier
Bank
credit customer
credit customer
Account related to receipt
Cash or Credit
Bank (if money is paid out)

2.3 Books of prime entry

Books of prime entry: A book, or journal in which transactions are recorded before being posted to the double entry accounts. These provide back up to the double entry accounts and make sure they aren't filled with lots of tiny payments.

Posting: The process of transferring information into double entry accounts from the books of prime entry.

The different books

Book of prime entry:	Type of transaction recorded in the book
Cash book	All cash & Bank transactions
Petty Cash book	All small items of cash payments.
Sales journal	All credit sales of goods
Purchases journal	All credit purchases of goods (bought for resale)
Sales returns journal	Sales return of goods sold previously
Purchases returns journal	Purchase returns of goods bought previously
General journal	Any transaction not covered by other journal's example: Depreciation, Bad debts

Why use books of prime entry:

- Only the totals are posted into the ~~double~~ double entry acc which makes it easier to interpret.
- They provide back up to double entry account incase anything is missing
- The responsibility can be split up & different workers can be delegated to work ~~of~~ on different books.

The Cash Book:
A combined cash & bank account that records all the transaction including payments and receipts

It works like a double entry account but has 2 debit & 2 credit columns. (1 for cash & 1 for bank)

Electronic Bank Transfer
An electronic payment made from one bank account straight to another.
Methods include:
- Direct debits
- Standing orders
- Bank transfers
- Credit transfers

Cash Discounts: A reduction in the ammount owing to encourage prompt payment.

Discount allowed: offered by business to credit customers
Discount received: received by business from credit suppliers.

Trade discount vs Cash discount
- Trade discounts do not appear in the double entry accounts, cas discounts do.
- Trade discounts are offered between businesses in the same industry, cash discounts are given to anyone, to encourage prompt payment.

Posting discounts in the double entry
Credit sale to Jacob

Jacob

	$		$
Sales	480	Bank	468
		Disc. allowed	12

Discounts allowed

	$		$
Jacob	12		

Gloria				Discount received			
	\$		\$		\$		\$
Bank	790	Purchases	800			Gloria	10
Discounts received	10						

Three column cash book

This cash book has an ~~a~~ additional column showing cash discounts which decreases the entries needed for discount ~~a~~ allowed & received.

Petty cash book

A book used for small items of payment by cash (tea ~~groceries~~, water, etc.)

- Imprest system: A system used in the petty cash book which ensures the ~~opean~~ opening balance for each month is the same.
- Float: the ammount ~~available~~ of petty cash at the start of each ~~the~~ month.

Advantages:

- stops main cash book being filled up with small payments.
- Allows ~~mang~~ manager to ~~d~~ delegate the job of petty cashier to a junior member of staff.

The Sales journal

The book of prime entry used to record sales. This only includes the sale of goods that were purchased for resale, example a car that has been used, then sold doesnt come in the ~~credit~~ sales journal

The Purchases journal

The book of prime entry that is used to record purchase of good that are specifically bought for resale.

The sales returns journal
The book of prime entry used to record sales returns, credit notes issued are recorded here.

The purchase returns journal
The book of prime entry used to record purchase returns, credit notes received are recorded here.

The general journal
Book of prime entry used to record transactions not found in any other journal. This is used for transactions that occur less frequently.

The layout is different compared to another journals.

	Journal Entry	Dr	Cr
		$	$
Year			
Date	Name of acc to be debited	AMOUNT	
	~~Narrative~~		
	Name of acc to be credited		Amount

Narrative: A ~~bre~~ brief ~~narrative~~ description of the transaction.

Chapter 3.
3.1 Trial Balacnce

Trial Balance: A list of all balances from the double entry accounts.

How it works:
- The trial balance lists the balances is in two colodmns. 1 contains the list of debit balance & the other contains the credit balances.
- If the entries (in ledgers) are correct then
debit column = Credit balance
↓
Why?

Because every entry made in the leadger accounts consists of a credit entry & a debit entry of equal value.

Debit vs Credit in trial balance

Debit:	Credit:
Assets	Liabilities
Purchases	Sales (Revenue*)
sales returns	Purchase returns
Drawings	Capital
Expenses	Income
	Provisions.

* ~~Revenuey~~ Revenue: Income generated by a business from it normal activities, usuall the sale of goods & services. It can also be called sales revenue, sales, or turnover.

Some accaunts can either have a debit or a credit balace. example: Bank; it can either have a debit or a credit balance, this depends on if there is money in the bank or the balance is overdrawn.

An account can ~~both~~ have a debit or a credit depending on whether the business owes or is owed money.

Format:

- The title of the financial statement should always mention:
  - What the statement is for
  - Name of business
  - Date

This can be simplified as
  - What
  - Who
  - When

Inventory & the Trial Balance

Inventory has no single account, the balance for inventory is taken by the stocktake*

The value of inventory held at the end of the accounting period appears as a note under the trial balance

The value of unsold inventory is recorded in an account in the nominal ledger.

Inventory	Where in the TB
Opening inventory	Debit balance in TB
Closing inventory	Under the TB

* ~~Stocktake~~ stocktake: A physical count and valuation of inventory held by a business.

Pro's & Con's of TB

Pro's:

Provides arithmetic check on the accuracy of journal entries

Checks for mistakes

Makes it easier to prepare financial statement (income statement & statement of financial position.

Con's:

Time consuming

Errors exist, some undet

Errors & the T

Errors that do n

Commission

Error caused due

account. example: o

Compensating

Two or more e

the same amoun

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The entries

but too

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When the

incorrect

payment

of $3

Con's:
- Time consuming
- Errors exist, some undetectable.

Errors & the TB
Errors that do not affect the trial balance

Commission
Error caused due to a transaction entered in the wrong personal account. example: a credit sales of 100$ to barney may be debited to barney.

Compensating
Two or more errors that affect the debit & credit columns by the same ammount, the totals of debit & credit are equal but the totals are wrong. example: if the sales & purchases acc are both understated by $1000 then the totals of both columns are equal but $1000 too low.

Completer Reversal:
When the transaction is entered into the correct account and is the correct ammount but are on the wrong side of the double entry. example: Bobby made an inventory ~~credit~~ purchase, instead of crediting bank & debiting inventory, the opposite happened (ie: bank was debited & inventory was credited.

~~Ommission~~ Omission:
The entries are missing from the trial balance, the totals are equal but too low.

Original Entry:
When the transactions are written in the correct accounts but have incorrect ammounts. The totals are equal but not correct. example: cash payment for purchasing inventory was written as ~~$103~~ $103 instead of $301

Principle:
When the transaction has the correct ammount but is written in the incorrect accounht. example: if a car used in the business was sold, the correct entry would debit the bank. however the transaction is recorded in the sales account. this is wrong as sales is only for goods that were meant for resale.

3.2 Correction of errors

Reasons for errors:

key terms:

undercasting: The ammount entered in the account is lower than the correct ammount

overcasting: The amount entered in the account is higher thaln the correct amount

Transposition: The numbers are mixed or reversed.

Errors do not affect the trial balance if the same amount is used in the debit & credit entry.
If there is an error in only one account (credit or debit) the totals will be different.

Procedure for correcting errors:

① Enter the correction in the general journal

② Correct the accounting entries in the double entry accounts.

All corrections are made by adjusting the accounts so that the result gives the same affect if it were to be correct. example if a sale 600 is written as 6000, we would need to debit the sales account by 5400.

Correcting errors: (do not e

Error of ~~comission~~ commis

Error of Journal entr

and put it into the c

Compensating error: refer

Cancel the error b

each account.

Complete Reversal: a

Double the ammoun

Error of omission

The entry is the

Error of original

Write entry for

amount.

Error of princi

cancel out of

Correcting errors

Suspense accounts

cause a diff

Suspense account:

differ.

Using suspense

Correcting errors: (do not effect)

Error of ~~omission~~ commission: refer page 82
~~Error of~~ Journal entry: cancel out the wrong persons' account and put it into the correct persons account.

Compensating error: refer page 82
Cancel the error by putting ammount on opposite sides of each account.

Complete Reversal: refer page 83
Double the ~~amounts~~.

Error of ~~commission~~ omission: refer page 83
The entry is the same as what you would usually put.

Error of original entry: refer page 84
Write entry for the difference between correct & incorrect amount.

Error of principle: refer page 84
cancel out of the wrong account & put into correct account.

Correcting errors that DO affect the trial balance.

Suspense accounts need to be created to correct these errors that cause a difference in the trial balance totals.

Suspense account: A temporary account used when trial balance totals differ.

Using suspense acc: refer page ~~85,86~~ 85,86