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Introduction

The textbook

This book has been written with the needs of students in mind, and I have tried to maximise, as far as is possible, the achievement of positive learning. Also, the book has been developed based on my many years of experience as both an examiner and a teacher of the subject to Advanced Level students both in the UK and overseas.

The book has been endorsed by Cambridge International Examinations, listed as an endorsed textbook for students who study the Cambridge International Examinations syllabus 9706. The text covers the whole of the syllabus, organised and split in accordance with the examination papers in the syllabus, and follows as far as is possible the order in which topics appear in the published syllabus. The sections covered by each chapter are listed. Each area of the syllabus is given as a reference point.

Syllabus coverage

The first 31 chapters cover the AS syllabus in its entirety. At the end of the AS Level syllabus chapters there are examination-style questions. Some of the questions are from past exam papers. Where appropriate the original questions have been modified to reflect recent changes in accounting terminology and practice. *Readers are advised that all topics in the AS section of the syllabus may also be examined at Advanced Level.*

Chapters 32 to 46 deal with topics that may be examined at Advanced Level. The examination-style questions at the end of the A Level chapters are written to reflect recent changes in accounting exam papers.

Features of the book

Each chapter starts with the relevant syllabus statement. Throughout the chapters there are Examples and Worked examples, with answers, to illustrate the introduced concepts. They are followed by a few 'Now try ...' questions leading students to additional questions in the CD as well as some self-test questions, which allow students to further explore the concept and test themselves. Meanwhile, important terms are explained and sometimes tips are given to help students to better understand the related concepts. Each chapter ends with a summary, which covers all the key points.

How the syllabus points are covered in the 46 chapters

AS Level content – Paper 1 and Paper 2		Additional A Level content – Paper 3	
Syllabus points	Chapters	Syllabus points	Chapters
1.1	Chapters 1 – 7 and 14	1.1.1	Chapter 32
1.2	Chapters 6 and 19	1.1.2	Chapter 33
1.3	Chapters 10 – 12	1.1.3	Chapters 34 and 35
1.4.1	Chapters 9 and 18 – 20	1.1.4	Chapter 36
1.4.2	Chapters 15 – 17 and 22	1.1.5	Chapter 37
1.4.3	Chapters 23 and 24	1.2	Chapter 38
1.4.4	Chapter 25 and 26	1.3	Chapters 39 and 40
1.5	Chapter 27	1.4	Chapter 41
2.1	Chapters 20 and 28	1.5	Chapter 42
2.2.1	Chapter 28	2.1	Chapter 43
2.2.2	Chapter 29	2.2	Chapter 44
2.2.3	Chapters 29 and 30	2.3	Chapter 45
2.3	Chapter 31	2.4	Chapter 46

Key concepts

The 9706 syllabus is built around five fundamental concepts that should be applied to all accounting transactions. They are:



A true and fair view

The concept of true and fair view ensures that financial statements accurately and truthfully reflect the transactions of the business.



Duality (double entry)

The method of systematically recording transactions to show the giving and receiving of value.



Consistency

The treatment of similar transactions and items in the same way each year so that the results of business activity can be compared with previous results.



Business entity

The separation of the ownership of a business from the actual business itself. Only business assets and transactions are recorded in the business books of account.



Money measurement

The business financial records only deal with transactions that can be measured in monetary terms.

These key concepts will dictate the way that you study accounting. They underpin the work that you will study during your course. You should find that they provide themes that run through all the accounting topics that you study. The above icons appear in the text, indicating where each Key concept is covered,

When you are studying a topic, relate one or more of these key concepts to that topic.

The Student's CD-ROM

There is a student's CD-ROM accompanying the book to help students further their study in accounting. It includes:

- Additional questions – they are referred to in the book as 'Now try ...' questions which illustrate more about the concept where introduced and test if you have grasped the knowledge.
- Interactive tests – these are different types of questions such as true or false and multiple choice, designed to improve the understanding of accounting.
- Revision checklist to check if you have understood every syllabus point covered in the chapter.
- Answers to additional questions.
- Materials to help you prepare for the examinations in Accounting.

In accounting, there are certain layouts that you must learn so it is important that you practise questions based on each topic area on a regular basis. Use each piece of work in the book and the CD to build up a bank of knowledge and skills that you may be able to apply to subsequent pieces of work. As a subject, accounting is rather like a detective solving a crime; the pieces of information collected some weeks ago might help to solve today's problem. Most importantly, you must learn the concepts for each topic. This is usually easier than you might first think; the difficult part is applying the appropriate knowledge to the questions.

I hope you enjoy exploring in accounting and may you have good performance in your AS/A Level examinations.

Ian Harrison

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1 The double-entry system

→ Content

1.1 The accounting cycle

- Explain and apply the principles of the double-entry system to record business transactions

By the end of this chapter you should be able to:

- use double-entry book-keeping to record financial transactions
- enter financial transactions into a ledger using debit and credit entries
- understand and explain the purpose of using a ledger
- understand and explain why a ledger is generally divided into three parts.

1.1 Debit and credit entries in the double-entry system

There are two main ways in which the managers of businesses record their financial transactions. They use either:

- a double-entry system of recording transactions
- a single-entry system of recording transactions.

This chapter looks at the double-entry system, which provides the accountant with the information needed in order to produce the data required to prepare an **income statement** that will show whether or not the business has been profitable. You will encounter the single-entry system in Chapters 22 and 23.

As the name implies, double-entry book-keeping recognises that there are two sides or aspects to every business transaction. See, for example, the two sides of each of the following transactions:

I fill my car with \$20 of fuel.

- I receive the fuel.
- The filling station attendant puts the fuel into my vehicle.

I buy a pair of soccer boots costing \$13.

- I receive the boots.
- The sports shop 'gives' me the boots.

There are two more aspects to each of these transactions:

When I give the filling station attendant my \$20

- she receives the cash
- I 'give' the cash.

When I give the shop assistant my \$13

- he receives the cash
- I 'give' the cash.

This way of recording both sides of any transaction is known as the **dual aspect** principle of accounting.

An **income statement** is a statement that calculates the profit that a business has made for a period of time (usually a financial year).

Tip

Like all areas of study, accounting has its own jargon. Whenever a new word or term is introduced, an explanation or definition will be given. Make sure you read and understand what these terms mean and how they are used in accounting.

A **ledger account** contains the detailed record of financial transactions undertaken by a business. Since all accounts appear in a ledger (or book), the term is often shortened to the single word **account**.

A **ledger** is the book where all accounts are kept.

All financial transactions involving the business are recorded in a format called a **ledger account** or simply an **account**.

You would find each account on a separate page in the **ledger**. In fact, if a great many transactions of a similar nature are undertaken, an account may spread over several pages.

For the sake of convenience this one book (the ledger) is divided into several smaller books. You can imagine that large businesses like the Toyota Motor Corporation or McDonalds could not possibly keep all their financial records in one book.

Initially, to make our task a little simpler, we shall keep all our records together. When the other books are introduced, you will see that it does make sense to split the ledger into several different parts.

Do not worry if all this seems a little strange. You will soon be familiar with it but it does require *practice*. The key to success in accounting is practice.

An account looks like a 'T' shape, like this:

--	--

Each account has two sides.

- The *left* side is known as the **debit** side.
- The *right* side is known as the **credit** side.

An account	
Debit	Credit
The debit side of an account is always the receiving side or the side that shows gains in value.	The credit side of an account is always the giving or losing side – the side that shows value given.
Debit is often abbreviated to Dr.	Credit is often abbreviated to Cr.

Dr	An account	Cr
Receives		Gives
or		or
Gains		Loses

An account in the ledger would be headed thus:

Dr	***** account	Cr

Note

There should always be a heading; if the account shown is not a personal account, the heading should include the word 'account'.

The golden rule of the game of 'double entry' is that every time you enter something on the debit side (left side) of an account you must enter an equivalent amount on the credit side (right side) of another account.

This is all fairly straightforward, but *it does require practice*.

Worked example

Bola owns a business selling meat. During one week the following financial transactions take place:

- 1 Bola purchases meat \$210 from Scragg, a meat wholesaler. She will pay for the meat in a couple of weeks' time.
- 2 Bola's cash sales for the week amount to \$742.
- 3 Bola supplies meat to the Grand Hotel \$217. They will pay for the meat at the end of the month.
- 4 Bola pays the rent for her shop \$75.
- 5 She pays her telephone bill \$43.

Required

Enter the transactions in Bola's ledger.

Answer

- 1 Bola receives meat ... and Scragg 'loses' the meat ...

Dr	Purchases account	Cr	Dr	Scragg	Cr
	\$				\$
	210				210

- 2 Bola 'loses' (sells) some meat ... and she gains cash ...

Dr	Sales account	Cr	Dr	Cash account	Cr
		\$		\$	
		742		742	

- 3 Bola 'loses' meat ... and the Grand Hotel gains the meat ...

Dr	Sales account	Cr	Dr	Grand Hotel	Cr
		\$		\$	
		217		217	

- 4 Bola gains the use of her premises ... and she 'loses' (pays) cash ...

Dr	Rent account	Cr	Dr	Cash account	Cr
	\$				\$
	75				75

- This is can be a confusing entry because we are used to talking about 'paying rent'.
- Bola pays money to a landlord for the use of his building.
- Bola receives/gains the use of the premises.
- In cases like this, think of the cash entry first and then put in the second entry.

- 5 Bola gains the use of her telephone ... and she loses cash

Dr	Telephone account	Cr	Dr	Cash account	Cr
	\$				\$
	43				43

- Another confusing entry. Bola receives/gains the use of the telephone.
- Bola gives the telephone company cash for the service they provide to her.

Purchases are any items that are purchased with the intention of selling them to customers.

Sales are any items that are sold in the normal course of business to customers.

If you are uncertain about the telephone account ask whether Bola has gained cash or 'lost' cash. You know that Bola has paid cash to the telephone company so the cash has to be a credit entry (right side); the other entry has to be a debit entry (left side) according to the rules of double entry.

▶ Now try Question 1.

1.2 Treatment of similar transactions

If there are a number of similar transactions that need to be recorded, we enter them all in one account.

Worked example

Greta Teer owns and runs a store selling newspapers, magazines and candies. The following transactions took place over the past few days:

- 1 Cash sales of newspapers amounted to \$68.
- 2 Cash sales of chocolate and candies amounted to \$151.
- 3 Greta purchased candies, potato chips and soft drinks \$135, paying cash to her wholesaler.
- 4 She paid \$160 cash for local taxes.
- 5 Greta sold four boxes of potato chips to a local club for cash \$30.

Required

Enter the transactions in Greta's ledger.

Answer

Dr	Sales account	Cr	Dr	Cash account	Cr
		\$		\$	\$
		68	68		135
		151	151		160
		30	30		
Dr	Purchases account	Cr	Dr	Local taxes account	Cr
	\$			\$	
	135		160		

Note

All the transactions involving cash have been entered in one cash account. All the sales transactions have also been entered in one account.

▶ Now try Question 2.

It should be obvious that as well as keeping money in the business, the owners of businesses will bank money and will pay many bills by means of cheques. So, as well as having a cash account in the ledger, the business would also keep a bank account to record transactions using the business bank account.

Worked example

Sven Drax owns and runs a hotel. He supplies the following information:

- 1 Sven purchases a deep freeze unit \$415, paying by cheque.
- 2 He purchases for cash \$127 fruit and vegetables for the hotel restaurant.
- 3 Sven purchases petrol \$45 for the hotel mini-bus using cash.

Drawings is the term used to describe the withdrawal of resources (cash or goods) from the business by the owner for private use outside the business.

4 He pays for a family holiday \$1500 paying with a business cheque.

5 He pays \$2178 cash takings into the bank account.

Required

Enter the transactions in the hotel ledger.

Answer

Dr	Freezer account	Cr	Dr	Bank account	Cr
	\$			\$	\$
	415			2178	415
					1500
Dr	Purchases account	Cr	Dr	Cash account	Cr
	\$				\$
	127				127
					45
Dr	Motor expenses account	Cr	Dr	Drawings account	Cr
	\$			\$	
	45			1500	
Dr	Sales (or takings) account	Cr			
		\$			
		2178			

Note

The freezer unit is not purchases – it is capital expenditure. There was not already an account, so *when in doubt open an account*. The cheque paid out to the holiday company is drawings – it is not a business expense.

Self-test questions

- 1 Every _____ needs a corresponding debit entry.
- 2 Define the term 'account'.
- 3 In which account would goods purchased for resale be entered?
- 4 Denzil pays the rent on his factory with \$300 cash. The entries to record this transaction are debit rent account \$300; credit cash account \$300. True/False?
- 5 Bradley pays the telephone bill \$120 cash. The entries to record this transaction are debit cash account \$120; credit telephone account \$120. True/False?
- 6 Which side of an account is the 'receiving' side?
- 7 Which side of an account is the 'giving' side?



1.3 The division of the ledger

All accounts are entered in one book called the ledger. Because the number of accounts could run into many hundreds, it is more convenient to split the ledger into a number of different books.

Credit customers are people (or businesses) that we sell goods to; they will pay for their goods at some time in the future. The goods are sold on **credit**.

Until credit customers have paid for the goods that have been purchased, they are **trade debtors**. Trade debtors are collectively known as **trade receivables**.

Credit suppliers are people (or businesses) that we purchase goods from; we will settle the debt that we owe at some future date. The goods are purchased on **credit**.

A person or business supplying goods on credit is known as a **trade creditor** until the debt is settled. A number of trade creditors are collectively known as **trade payables**.

Personal accounts are accounts that record transactions with credit customers and credit suppliers.

Nominal accounts, real accounts and liability accounts will all be found in the general ledger.

Nominal accounts record expenses, profits, losses and gains.

Real accounts record the acquisition and disposal of **non-current assets** like land, buildings, equipment and vehicles.

Liability accounts record the acquisition and repayment of loans and overdrafts.

► **Now try Question 3.**

Can you think of how you might split the ledger to make it more manageable? We make it more manageable by grouping together similar accounts. We put:

- **credit customers'** accounts together in one ledger
- **credit suppliers'** accounts together in one ledger
- all other accounts in another ledger.

All transactions involving credit customers will be found in the **sales ledger** (also known as the **debtors' ledger**).

All transactions with credit suppliers will be found in the **purchases ledger** (also known as the **creditors' ledger**).

All other transactions will be found in the **general ledger**. (For those of you familiar with computerised accounts, the general ledger is often called the **nominal ledger** in accounting packages.)

Initially you will make mistakes when asked which accounts would appear in which ledger; do not worry about this – we have all made similar mistakes in the past.

The difficult ones are as follows:

- The sales account, which is *not* found in the sales ledger, is reserved for the **personal accounts** of our credit customers. The sales account would be found in the general ledger.
- The purchases account will *not* be found in the purchases ledger. It is reserved for the personal accounts of credit suppliers only. The purchases account would be found in the general ledger.

We only record credit transactions in the sales ledger and the purchases ledger.

- If a sale is made for cash it is *not* entered in the sales ledger.
- If something is purchased for cash it is *not* entered in the purchases ledger.

These transactions appear in the general ledger.

Worked example

- 1 Nadhim purchases goods for resale \$73; he pays cash.
- 2 He sells goods \$19 for cash.

Required

List the two entries in Nadhim's ledger for each transaction.

Answer

	Debits	Credits
1	Purchases account	Cash account
2	Cash account	Sales account

When you go to a takeaway food store and you order your meal, the proprietor does not open an account for you; he simply takes your money and gives you your meal.

He debits – cash account (the sale of your meal would be included in his total cash sales for the day).

He credits – sales account (using the total sales figure for the day).

Remember that each account would be in a different ledger according to the classification we have discussed.

Each account would be shown on a separate page in the ledger. There is not enough space in this book to afford such a luxury. We will write the accounts on the same page.