

Accounting: AS Level and A Level

CAMBRIDGE

AS Level and A Level
Accounting

Harold Randall

PUBLISHED BY THE PRESS SYNDICATE OF THE UNIVERSITY OF CAMBRIDGE
The Pitt Building, Trumpington Street, Cambridge, United Kingdom

CAMBRIDGE UNIVERSITY PRESS

The Edinburgh Building, Cambridge CB2 2RU, UK
40 West 20th Street, New York, NY 10011-4211, USA
477 Williamstown Road, Port Melbourne, VIC 3207, Australia
Ruiz de Alarcón 13, 28014 Madrid, Spain
Dock House, The Waterfront, Cape Town 8001, South Africa

<http://www.cambridge.org>

© Cambridge University Press 2005

This book is in copyright. Subject to statutory exception and to the provisions of relevant collective licensing agreements, no reproduction of any part may take place without the written permission of Cambridge University Press.

First published 2005

Printed in the United Kingdom at the University Press, Cambridge

A catalogue record for this book is available from the British Library

ISBN 0 521 53993 5 paperback

ACKNOWLEDGMENTS

Cover image © Philip James Corwin/CORBIS

Past examination questions are reproduced by permission of the University of Cambridge Local Examinations Syndicate.

Contents

Preface	vii
Topics grid	ix
I The accounting system	1
1 Double-entry bookkeeping: cash transactions	2
2 Double-entry bookkeeping: credit transactions	7
3 Books of prime (or original) entry	12
4 Balancing accounts	19
5 The classification of accounts and division of the ledger	21
6 The trial balance	23
II Financial accounting	27
7 Trading and Profit and Loss Accounts for sole traders	28
8 Balance Sheets for sole traders	36
9 Accounting principles or concepts	39
10 Accruals and prepayments (the matching concept)	43
11 Provisions for the depreciation of fixed assets	48
12 Bad and doubtful debts	56
13 Bank reconciliation statements	62
14 Control accounts	66
15 Suspense accounts	76
16 Incomplete records	84
17 Non-profit-making organisations (clubs and societies)	94
18 Departmental accounts	103
19 Manufacturing Accounts	110
20 Valuation of stock	117

21 Partnership accounts	125
22 Partnership changes	133
23 An introduction to the accounts of limited companies	148
24 Cash flow statements	164
25 Limited companies: more about share capital and debentures; capital reductions and reconstructions	181
26 Business purchase	192
27 Published company accounts	200
III Financial reporting and interpretation	209
28 Interpretation and analysis	210
29 Company financing	227
IV Elements of managerial accounting	233
30 Costing principles and systems: total (or absorption) costing	234
31 Unit, job and batch costing	245
32 Process costing	249
33 Marginal costing	255
34 Budgeting	266
35 Standard costing	277
36 Investment appraisal	288
Appendix 1: Table showing net present value of \$1	295
Answers to exercises and multiple-choice questions	297
Index	353

Part I

The accounting system

1 Double-entry bookkeeping: cash transactions

In this chapter you will learn:

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

1.1 What is double-entry bookkeeping?

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

1.2 Ledger accounts

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

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

The left-hand side of the account is called the debit side and is used to record cash received (that is, coming into the account). The right-hand side of the account is the credit side and shows cash paid (that is, going out of the account). All accounts have a debit side on the left to

record what is received, and a credit side on the right to record what is given. In practice, the words 'debit' and 'credit' are not shown because bookkeepers do not need to be reminded of them.

1.3 How to record cash transactions

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

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

Example

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

Transaction 1 April 1. Abdul starts business as a trader by paying \$10 000 into a Bank account which he opens for the business. Abdul gives, and the business receives, \$10 000. An account for Abdul will be opened (his Capital account) and credited with his 'capital'. The business Bank account will be debited.

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

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

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

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

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

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

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

Note. Purchases of stock are always debited to a Purchases account. An account called Stock account is used for a special purpose, which will be explained in chapter 7.

Transaction 4 April 4. Abdul sells a quantity of stock for \$800 and banks the cash.

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

Sales of stock are always credited to Sales account, never to Stock account.

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

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

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

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

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

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

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

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

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

Transaction 8 April 11. Tania lends the business \$5000.

Bank					
	\$			\$	
Apr 1	Abdul – Capital	10 000	Apr 2	Motor Vehicles	2000
Apr 4	Sales	800	Apr 3	Purchases	3000
Apr 8	Purchases Returns	100	Apr 7	Sales Returns	40
Apr 11	Tania – Loan	5 000	Apr 10	Motor Vehicles	4000
Tania – Loan					
	\$			\$	
			Apr 11	Bank	5000

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

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

Transaction 10 April 14. Abdul sublets part of the warehouse and receives \$300 rent.

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

Rent Receivable			
	\$		\$
		Apr 14	Bank
			300

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

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

Bank					
	\$			\$	
Apr 1	Abdul – Capital	10 000	Apr 2	Motor Vehicles	2000
Apr 4	Sales	800	Apr 3	Purchases	3000
Apr 8	Purchases Returns	100	Apr 7	Sales Returns	40
Apr 11	Tania – Loan	5 000	Apr 10	Motor Vehicles	4000
Apr 4	Rent Receivable	300	Apr 12	Rent Payable	1000
			Apr 15	Wages	1200
Wages					
	\$			\$	
Apr 15	Bank	1 200			

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

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

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

Exercise 1

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

- May 1** Martine started business as a florist by paying \$3000 into a business Bank account.
- 2** Charline lent the business \$1000.
Martine then had the following transactions.
- 3** Paid rent, \$100.
- 4** Purchased shop fittings, \$400.
Purchased stock of flowers \$300.
- 5** Received refund of \$20 for flowers returned to supplier.
- 6** Sold some flowers and received \$40.
- 7** Paid wages, \$60.
- 8** Withdrew \$100 for personal use.

Exercise 2

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

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

1.4 Examination hints

- All transactions are recorded from the point of view of the business, not from those of its customers and suppliers.

- When recording transactions think very carefully about which account ‘gives’ and which account ‘receives’. Credit the account that ‘gives’ and debit the account that ‘receives’.
- Make sure you complete the double entry for every transaction before starting to record the next one.
- Date every entry and enter the name of the other account in which the double entry is completed in the details column.
- If you make a mistake in an exercise, study the answer given at the end of the book and make sure you understand what you should have done *and why*.

1.5 Multiple-choice questions

- 1** Joel occupies part of Natasha’s business premises. Which entries in Natasha’s books record the rent Joel pays her?

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

- 2** Yasmina purchased some office equipment for use in her business. The equipment was faulty and she returned it to the supplier who refunded the cost to Yasmina.

Which entries in Yasmina’s books record the return of the equipment?

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

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

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

- 4 A trader returns goods to the supplier and receives a refund.

Which entries record the refund in the trader's books?

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

1.6 Additional exercises

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

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

Amna lent the business \$5000.

Farook then had the following business transactions:

- 2 Purchased premises and paid \$8000.

3 Bought office furniture for \$2000 and paid by cheque.

4 Paid \$5000 by cheque for goods for re-sale.

5 Sold some goods for \$1500 and banked the proceeds.

6 Paid insurance premium by cheque, \$600.

7 Bought motor van and paid \$3000 by cheque.

8 Drew cheque for \$50 to pay for petrol for motor van.

9 Bought some goods costing \$2000 for re-sale and paid by cheque.

10 Sold goods for \$2400 and banked the proceeds.

Drew cheque for wages, \$400.

11 Repaid \$1200 by cheque to customers for goods returned.

12 Received a refund of \$900 from suppliers for goods returned.

13 Received a refund of insurance of \$100.

Withdrew \$200 from business bank account for personal expenses.

14 Returned some office furniture that was damaged and received a refund of \$800.

15 Repaid \$1000 of the loan from Amna.

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

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

* Carriage inwards is the delivery cost added to the price of goods by the supplier.

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

2 Double-entry bookkeeping: credit transactions

In this chapter you will learn:

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

2.1 What are credit transactions?

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

2.2 How to record credit transactions

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

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

Example

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

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

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

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

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

Purchases			
	\$		\$
May 31 Lai	500		
Lai			
	\$		\$
		May 31 Purchases	500

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

Goods returned

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

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

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

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

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

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

Trade discount

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

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

Cash (or settlement) discount

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

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

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

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

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

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

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

Example

Andrew had the following transactions in May.

May 1	Purchased goods from David. The goods cost \$1000 less 10% trade discount.
2	Purchased goods from Rodney for \$1600 less 15% trade discount.
3	Purchased a computer for the office on credit from Bernard for \$2000.
4	Sold goods to Mario for \$800.
5	Returned goods which had cost \$100 after trade discount to David.
6	Purchased goods from Ludovic for \$700 less trade discount of 20%.
7	Sold goods to Ravin for \$500.
8	Mario returned goods which had been sold to him for \$40.

- 9 Received cheque from Ravin for amount owing, less cash discount of 5%.
- 10 Paid amount owing to David, less cash discount of 5%.
- 11 Paid amount owing to Rodney, less cash discount of 5%.
Paid Bernard for computer.
- 12 Received cheque from Mario for amount owing, less 5% cash discount.
Paid amount owing to Ludovic, less 5% cash discount.

These transactions are recorded as follows.

David			
	\$		\$
May 5 Purchases Returns	100	May 1 Purchases	900
May 10 Bank	760		
May 10 Discounts Received	40		
Rodney			
	\$		\$
May 11 Bank	1292	May 2 Purchases	1360
May 11 Discounts Received	68		
Bernard			
	\$		\$
May 11 Bank	2000	May 3 Office Computer	2000
Ludovic			
	\$		\$
May 12 Bank	532	May 6 Purchases	560
May 12 Discounts Received	28		
Mario			
	\$		\$
May 4 Sales	800	May 8 Sales Returns	40
		May 12 Bank	722
		May 12 Discounts Allowed	38
Ravin			
	\$		\$
May 7 Sales	500	May 9 Bank	475
		May 9 Discounts Allowed	25

Purchases			
	\$		\$
May 1 David	900		
May 2 Rodney	1360		
May 6 Ludovic	560		
Purchases Returns			
	\$		\$
		May 5 David	100
Sales			
	\$		\$
		May 4 Mario	800
		May 7 Ravin	500
Sales Returns			
	\$		\$
May 8 Mario	40		
Discounts Allowed			
	\$		\$
May 9 Ravin	25		
May 12 Mario	38		
Discounts Received			
	\$		\$
		May 10 David	40
		May 11 Rodney	68
		May 12 Ludovic	28
Office Computer			
	\$		\$
May 3 Bernard	2000		
Bank			
	\$		\$
May 9 Ravin	475	May 10 David	760
May 12 Mario	722	May 11 Rodney	1292
		May 11 Bernard	2000
		May 12 Ludovic	532

Calculations

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

Exercise 1

Post the following transactions in the books of Geraud.

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

2.4 Examination hints

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

2.5 Multiple-choice questions

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

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

- 2** Kristal bought goods on credit from Prisca. The goods had a list price of \$1000 but Prisca allowed Kristal trade discount of 10% and cash discount of 4%.
How much did Kristal have to pay Prisca?
A \$860 **B** \$864 **C** \$900 **D** \$960
- 3** Shirley bought goods from Corrine. The goods had a list price of \$800. Corrine allowed Shirley trade discount of 20% and cash discount of 5%.
In Corrine's books, which entries record the cheque she received from Shirley?

	Account to be debited	Account to be credited
A	Bank \$608 Discounts Allowed \$32	Shirley \$640
B	Bank \$608 Discounts Received \$32	Shirley \$640
C	Bank \$608 Discounts Allowed \$152	Shirley \$760
D	Bank \$608 Discounts Received \$152	Shirley \$760

2.6 Additional exercises

1 Fleming had the following transactions.

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

Required

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

2 Streak had the following transactions in March.

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

Required

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

3 Books of prime (or original) entry

In this chapter you will learn:

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

3.1 What is a book of prime entry?

A **book of prime entry** is used to list all transactions of a similar kind *before* they are posted to ledger accounts. They are sometimes known as books of first (or original) entry but for convenience they will be referred to as books of prime entry in this text. Because they list

transactions before they are posted to ledger accounts they are *outside* the double-entry model. *It is important to remember that they are not part of double-entry bookkeeping.* There is, however, one exception to this rule, and that is the cash book, as explained later in §3.4.

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

Book of prime entry	Use
Sales journal (or sales day book)	To record all sales made on credit. The entries are made from copies of invoices sent to customers.
Sales returns book (or sales returns journal, or returns inwards journal)	To record all goods returned from customers. When customers return goods that were bought on credit they are sent credit notes showing the amount credited to their account for the returns. The sales returns book is prepared from the copies of credit notes sent to customers.
Purchases journal (or purchases day book)	To record all purchases of stock in trade (goods for resale) made on credit. These are entered in the purchases journal from suppliers' invoices.
Purchases returns journal (or purchases returns book, or returns outwards journal)	To record all goods returned to suppliers. The purchases returns journal is prepared from credit notes received from suppliers.
Cash book	To record all cash transactions. (But see §3.4.)
Journal (or general journal)	To record all transactions for which there is no other book of prime entry. (Also see §3.11.)

3.2 How to write up books of prime entry

Example

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

Invoices sent to customers	Amount of invoice		
	\$		
May 1 Atapattu	2350		
May 4 de Silva	1746		
May 6 Arnold	520		
Credit notes sent to customers	Amount of credit note		
	\$		
May 3 Atapattu	350		
May 5 de Silva	146		
May 7 Arnold	60		
Invoices received from suppliers	Amount of invoice		
	\$		
May 2 Vaas	5000		
May 5 Fernando	3600		
May 7 Mubarak	2200		
Credit notes received from suppliers	Amount of credit note		
	\$		
May 6 Vaas	1000		
May 7 Fernando	600		
The transactions will be entered in the books of prime entry as follows:			
Sales journal	\$	Sales returns journal	\$
May 1 Atapattu	2350	May 3 Atapattu	350
May 4 de Silva	1746	May 5 de Silva	146
May 6 Arnold	<u>520</u>	May 7 Arnold	<u>60</u>
	<u>4616</u>		<u>556</u>
Purchases journal	\$	Purchases returns journal	\$
May 2 Vaas	5 000	May 6 Vaas	1000
May 5 Fernando	3 600	May 7 Fernando	<u>600</u>
May 7 Mubarak	<u>2 200</u>		<u>1600</u>
	<u>10 800</u>		

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

Example

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

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

Atapattu			
	\$		\$
May 1 Sales	2350	May 3 Sales Returns	350
de Silva			
	\$		\$
May 4 Sales	1746	May 5 Sales Returns	146
Arnold			
	\$		\$
May 6 Sales	520	May 7 Sales Returns	60
Vaas			
	\$		\$
May 6 Purchases Returns	1000	May 2 Purchases	5000
Fernando			
	\$		\$
May 7 Purchases Returns	600	May 5 Purchases	3600
Mubarak			
	\$		\$
		May 7 Purchases	2200

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

Sales			
	\$		\$
		May 7 Sales journal total	4616
Sales Returns			
	\$		\$
May 7 Sales returns journal total	556		

Purchases			
	\$		\$
May 7	Purchases journal total	10 800	
Purchases Returns			
	\$		\$
May 7	Purchases returns journal total		1600

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

3.4 The cash book

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

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

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

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

3.5 How to enter discounts in the cash book

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

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

Example

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

Atapattu			
	\$		\$
May 1	Sales	2350	
May 3	Sales Returns		350
May 7	Bank		1900
May 7	Discounts Allowed		100
de Silva			
	\$		\$
May 4	Sales	1746	
May 5	Sales Returns		146
May 7	Bank		1520
May 7	Discounts Allowed		80
Arnold			
	\$		\$
May 6	Sales	520	
May 7	Sales Returns		60
May 7	Bank		437
May 7	Discounts Allowed		23
Vaas			
	\$		\$
May 6	Purchases Returns	1000	
May 7	Bank		3800
May 7	Discounts Received		200
Fernando			
	\$		\$
May 7	Purchases Returns	600	
May 7	Bank		2850
May 7	Discounts Received		150
Mubarak			
	\$		\$
May 7	Bank		2090
May 7	Discounts Received		110
May 7	Purchases		2200