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BUS7C2

Finance and Accounting for Business

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Lecture 2: Books of Accounts and Recording Transactions

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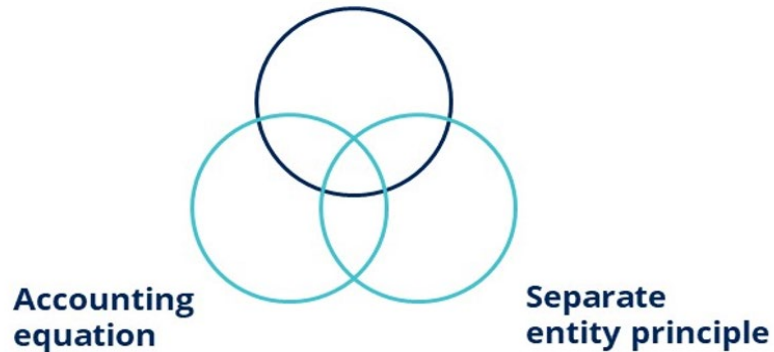
Learning Objective

At the end of this lecture; students will:

1. **Critically appraise** the application of the dual-effect principle in recording business transactions.
2. **Construct** ledger accounts for a range of business transactions using the double-entry bookkeeping system.
3. **Master the process** of balancing ledger accounts and preparing an initial trial balance.
4. **Evaluate the role** of the trial balance in ensuring the arithmetical accuracy of the bookkeeping process.

The Basic Principles of Accounting

Dual effect principle



Every transaction has two financial effects:

For example, you buy a new printer for £300 cash.

- You now have a new printer, which is an asset worth £300.
- But your cash has decreased by £300.

Assets = Liabilities

Assets = Liabilities + Capital

Assets – Liabilities = Capital

Assets – Liabilities = Capital + Profit* – Drawings

***NB: A loss would be subtracted from the capital**

The owner of the business is, for accounting purposes (not necessarily legal purposes), a completely separate entity from the business itself.

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Example : The Basic Principles of Accounting

1. Rhys started a business by putting £6,000 into his business bank account. What is the dual effect?

The business has £6,000 more cash – asset (cash) increases

The business owes £6,000 back to the owner – liability (capital) increases

2. Rhys pays himself £400 at the end of the first week. What is the dual effect?

The business has £400 less cash – asset (cash) decreases

The business has repaid some of Rhyn's investment – drawings increase (capital decreases)

3. Rhys business buys a van for £950. What is the dual effect?

The business has a van for £950 – asset (noncurrent asset-vehicles) increases

The business has £950 less cash – asset (cash) decreases

4. Rhys business buys a computer for £400 and promises to pay later (buys on credit). What is the dual effect?

The business has a computer for £400 – asset (noncurrent asset-computer) increases

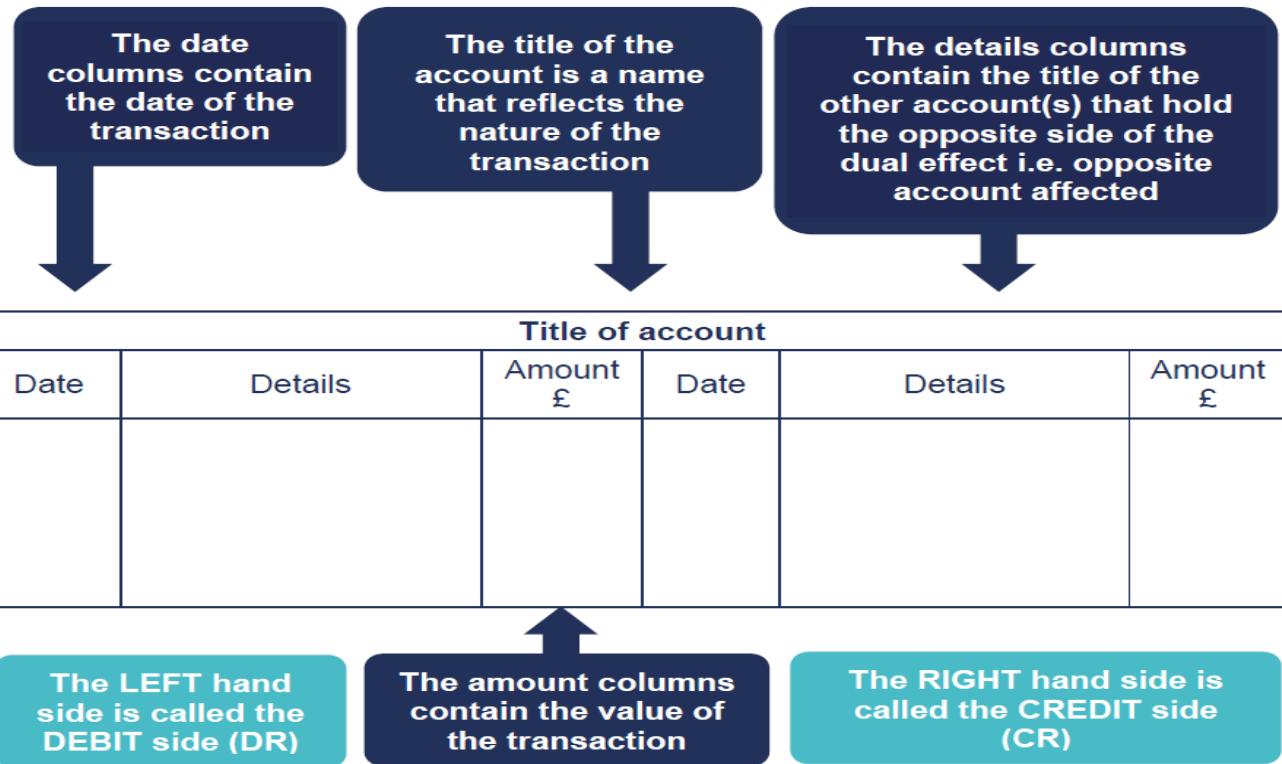
The business owes the supplier £400 – liability (payables) increases

Double Entry Bookkeeping

Double entry bookkeeping is a systematic method of recording an enterprise's transactions in a book called the (general) **ledger**.

Each page of the ledger is split into two halves, the left half called the **debit** side, and the right half called the **credit** side.

The ledger is divided into sections called **accounts**, each of which usually starts on a new page.



- The money value of each transaction is entered once on each side of the ledger in different accounts.
- ***The principle of double entry bookkeeping is that, for each transaction, every debit entry has an equal credit entry.***

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Ledgers

The Nominal Ledger

- Contains details of assets, liabilities, capital, income and expenditure, and therefore, profit and loss.

The Receivables Ledger

- Contained a separate ledger account for each credit customer

The Payables Ledger

- Contained a separate ledger account for each credit supplier

In a computerised accounting system, each ledger account is assigned a unique code.

Example : Post Rhys Transactions in Ledger Accounts

Cash Account					
Date	Details	Amount £	Date	Details	Amount £
	(1) Capital a/c	6,000			
				(2) Drawings	400
				(3) Van	950

Capital Account					
Date	Details	Amount £	Date	Details	Amount £
				(1) Cash a/c	6,000

Drawings Account					
Date	Details	Amount £	Date	Details	Amount £
	(2) Cash	400			

Van Account					
Date	Details	Amount £	Date	Details	Amount £
	(3) Cash	950			

Computer Account					
Date	Details	Amount £	Date	Details	Amount £
	(4) Payables	400			

Payables Account					
Date	Details	Amount £	Date	Details	Amount £
				(4) Computer	400

THE LEDGER ENTRIES FOR CASH TRANSACTIONS

Receipts:

Debit **Cash account (with cash)**
 or Bank account (with bank receipt)
Credit **Relevant account**

Payments:

Credit **Cash account (with cash)**
 or Bank account (with bank payment)
Debit **Relevant account**

THE LEDGER ENTRIES FOR CAPITAL INTRODUCED, DRAWINGS AND LOANS RECEIVED

Capital introduced:

Debit	Cash/bank account
Credit	Capital account

Drawings:

Debit	Drawings account
Credit	Cash/bank account

Money borrowed:

Debit	Cash/bank account
Credit	Loan creditors account

THE LEDGER ENTRIES FOR CREDIT TRANSACTIONS

Sales:

Debit	Customers account
Credit	Sales revenue account

Purchases:

Debit	Purchases account
Credit	Suppliers account

THE LEDGER ENTRIES FOR CREDIT TRANSACTIONS

Sales returns (inwards):

Debit Sales returns account

Credit Customers account

Purchases returns (outwards):

Debit Suppliers account

Credit Purchases returns account

THE LEDGER ENTRIES FOR CREDIT TRANSACTIONS

Receipts from customers:

Debit	Cash/bank account
Credit	Customers account

Payments to suppliers:

Debit	Suppliers account
Credit	Cash/bank account

THE LEDGER ENTRIES FOR CASH PAID INTO AND WITHDRAWN FROM THE BANK

Cash paid into the bank:

Debit Bank account

Credit Cash account

Cash withdrawn from the bank:

Debit Cash account

Credit Bank account

Balancing Ledger Accounts

- Step 1 Total both the debit and the credit side of the ledger account and make a note of each total.
- Step 2 Insert the higher of the two totals as the total on both sides of the ledger account leaving a line beneath the final entry on each side of the account.
- Step 3 On the side with the smaller total insert the figure needed to make this column add up to the total. Refer to this figure as the 'balance carried down' (or 'Bal c/d' as an abbreviation).
- Step 4 On the opposite side of the ledger account, below the total insert this same figure and refer to it as the 'balance brought down' (or 'Bal b/d' as an abbreviation).

The balance brought down is the balance that is transferred to the trial balance. These balances appear in the trial Balance on the same side as the balances are brought down on.

Example :Balancing Ledger Accounts

Rhys carried out the following additional transaction in the same period:

5. Opened a bank account for the business with Barclays Bank and paid in cash of £4,500
6. Purchased 500 Wrexham AFC hats for resale and paid by cheque. Each hat cost £5.
7. Purchased 200 Wrexham AFC scarfs for resale on credit. Each cost £10
8. Sold 200 Wrexham AFC scarfs for £15 each. Total sale value paid into bank account
9. Sold 400 Wrexham AFC hats to the Wrexham AFC Supporters Trust on credit for \$12.50
10. Paid Gas bill for £500 (Cheque)
11. Rhys got a loan of £2,000 (cheque) for the business from his uncle Owain, who expects repayment in two years' time.
12. Paid £1,500 (cheque) to the scarf's supplier
13. Received £3,000 from Wrexham AFC Supporters Trust, paid by electronic transfer
14. Rhys withdrew £750 from the business bank account for his personal use.

Enter the transactions in the appropriate ledger accounts and balance the accounts

Example :Balancing Ledger Accounts

Cash Account					
Date	Details	Amount £	Date	Details	Amount £
	(1) Capital a/c	6,000			
				(2) Drawings	400
				(3) Van	950
				(5) Bank	4,500
				Bal c/d	150
		6,000			6,000
	Bal b/d	150			

Capital Account					
Date	Details	Amount £	Date	Details	Amount £
				(1) Cash a/c	6,000
	Bal c/d	6,000			
		6,000			6,000
				Bal b/d	6,000

Drawings Account					
Date	Details	Amount £	Date	Details	Amount £
	(2) Cash	400			
	(14) Bank	750		Bal c/d	1,150
		1,150			1,150
	Bal b/d	1,150			

Example :Balancing Ledger Accounts

Van Account					
Date	Details	Amount £	Date	Details	Amount £
	(3) Cash	950			
				Bal c/d	950
		950			950
	Bal b/d	950			

Computer Account					
Date	Details	Amount £	Date	Details	Amount £
	(4) Payables	400			
				Bal c/d	400
		400			400
	Bal b/d	400			

Payables Account					
Date	Details	Amount £	Date	Details	Amount £
	(12) Bank	1,500		(4) Computer	400
	Bal c/d	900		(7) Purchases - Scarfs	2,000
		2,400			2,400
				Bal b/d	900

Example :Balancing Ledger Accounts

Barclays Bank Account					
Date	Details	Amount £	Date	Details	Amount £
	(5) Cash	4,500		(6) Purchases - Hats	2,500
	(8) Sales - Scarfs	3,000		(10) Gas	500
	(11) Loan	2,000		(12) Payables	1,500
	(13) Receivables	3,000		(14) Drawings	750
				Bal c/d	7,250
		12,500			12,500
	Bal b/d	7,250			

Purchases Account					
Date	Details	Amount £	Date	Details	Amount £
	(6) Bank	2,500			
	(7) Payables	2,000			
				Bal c/d	4,500
		4,500			4,500
	Bal b/d	4,500			

Sales Account					
Date	Details	Amount £	Date	Details	Amount £
				(8) Bank	3,000
				(9) Receivables	5,000
	Bal c/d	8,000			
		8,000			8,000
				Bal b/d	8,000

Example :Balancing Ledger Accounts

Receivables Account					
Date	Details	Amount £	Date	Details	Amount £
	(9) Sales - Hats	5,000		(13) Bank	3,000
				Bal c/d	2,000
		5,000			5,000
	Bal b/d	2,000			

Gas Account					
Date	Details	Amount £	Date	Details	Amount £
	(10) Bank	500			
				Bal c/d	500
		500			500
	Bal b/d	500			

Loan Account					
Date	Details	Amount £	Date	Details	Amount £
				(11) Bank	2,000
	Bal c/d	2,000			
		2,000			2,000
				Bal b/d	2,000

The Trial Balance

- ❖ The trial balance is a list showing the balance brought down on each ledger account.
- ❖ *It is a check point to ensure that every debit has an equal and opposite credit entry and;*
- ❖ Therefore, the totals of the trial balance columns should balance.
- ❖ However, it does not confirm that the account you have debited/credited is correct.
- ❖ The initial trial balance is not part of the double entry system, it is extracted from the double entry system.
- ❖ It is the starting point to preparing the financial statements.

Example : Trial Balance

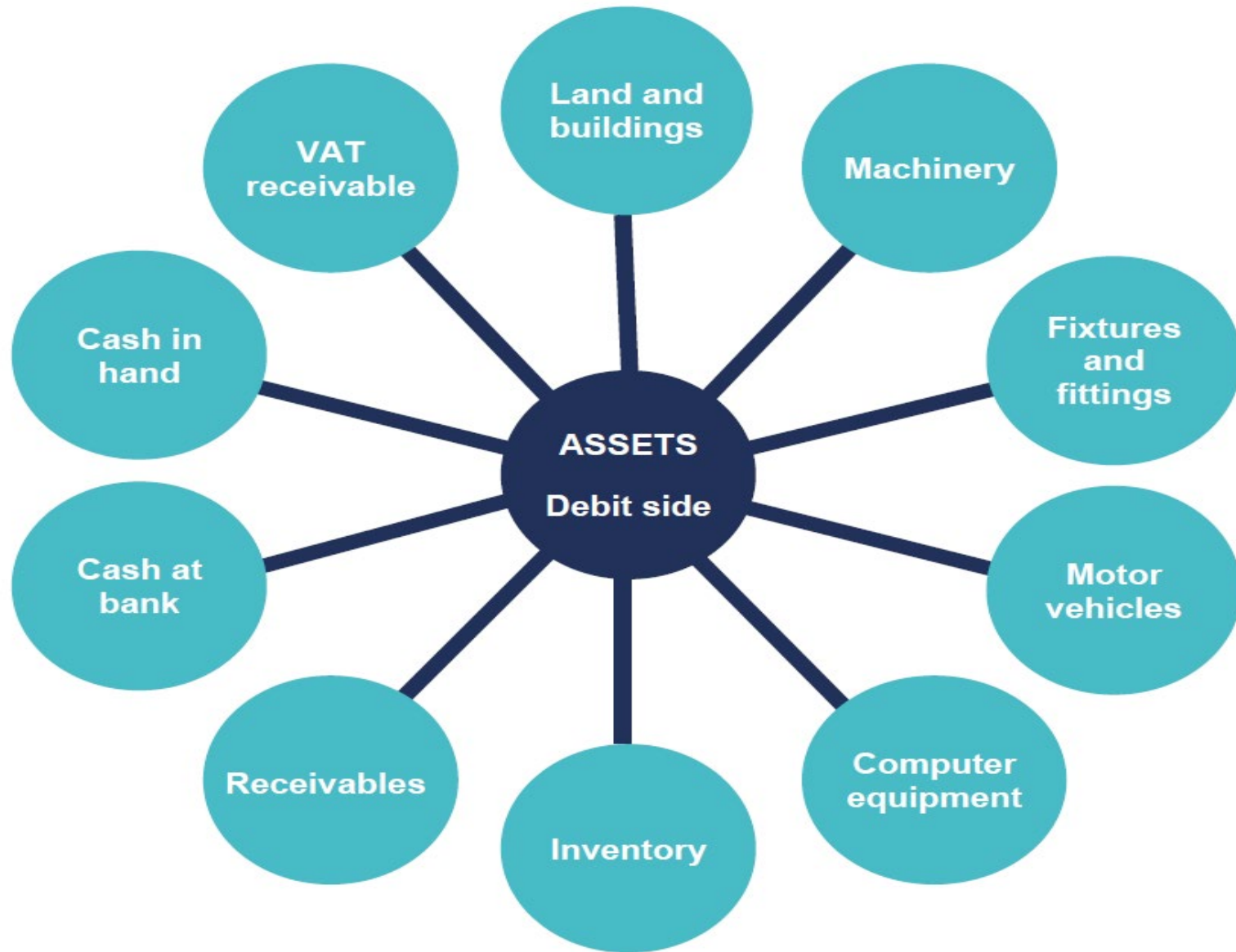
Extract Rhys Trial Balance for the same period:

Trial Balance (Rhys)		
Ledger Account	Dr	Cr
	£	£
Cash	150	
Capital		6,000
Drawings	1,150	
Van	950	
Computer	400	
Payables		900
Bank	7,250	
Purchases	4,500	
Sales		8,000
Receivables	2,000	
Gas	500	
Loan		2,000
Totals	16,900	16,900

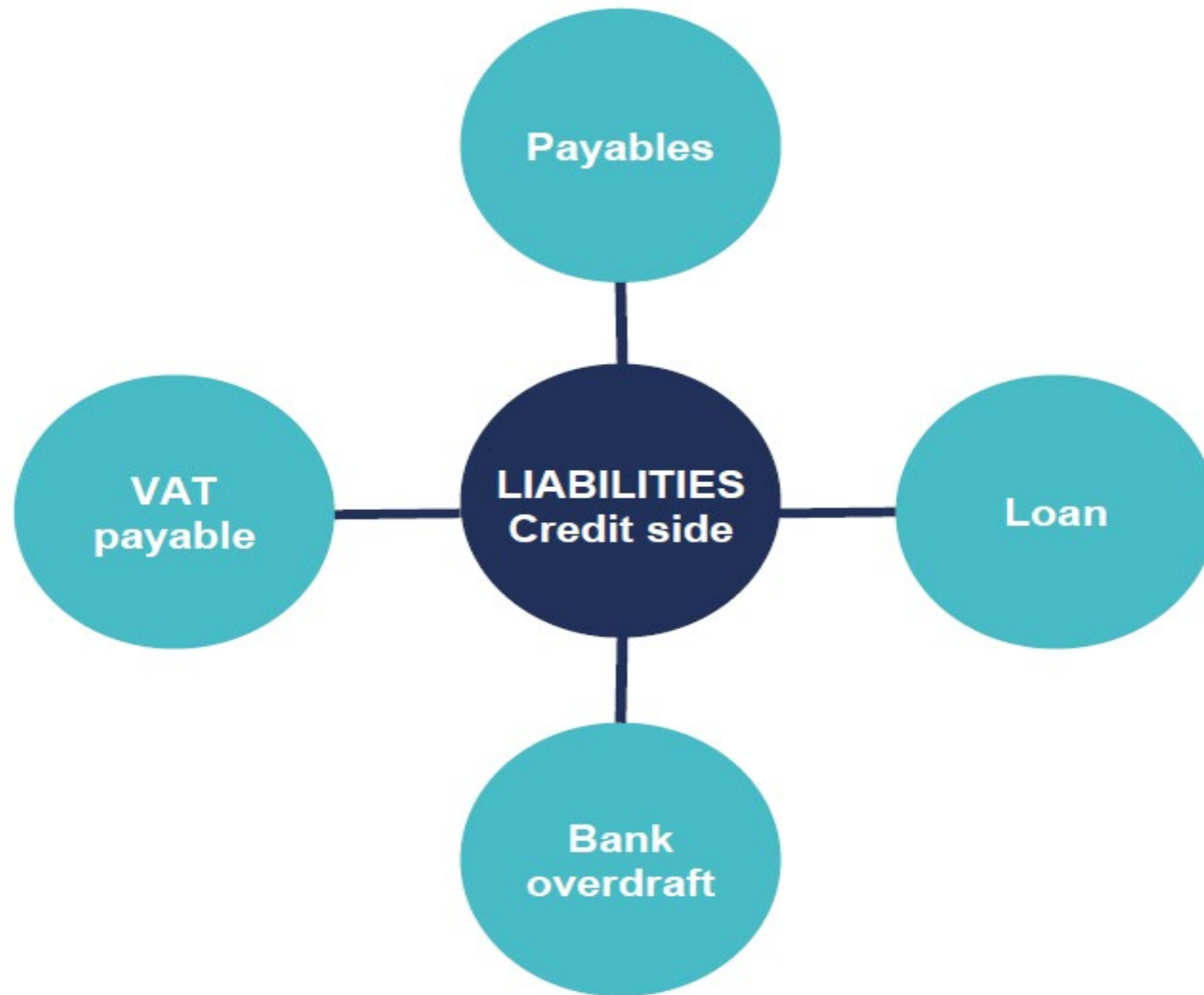
PROCEDURE TO BE FOLLOWED IF TRIAL BALANCE DON'T AGREE

1. Recast (add up) the trial balance.
2. Check that no ledger account has been omitted from the trial balance. This sometimes happens with the cash and bank account balances as they are usually in separate books.
3. Check that each amount entered in the trial balance is on the correct side. This is quick to do once you become familiar with the nature of different ledger accounts (debit or credit balances).
4. Check to see that the amounts entered in the trial balance are the same as those shown in the ledger accounts.
5. If the error has still not been found, it will then be necessary to check all the entries in the general ledger.
6. If the difference between the totals of the trial balance is divisible by nine, then it is likely that a ledger account balance or a transaction has been transposed incorrectly – for example, if the gas account had been recorded as £54 instead of £45, or the Van account had been recorded as £315 instead of £135.

Types of Assets, Liabilities, Income and Expenses



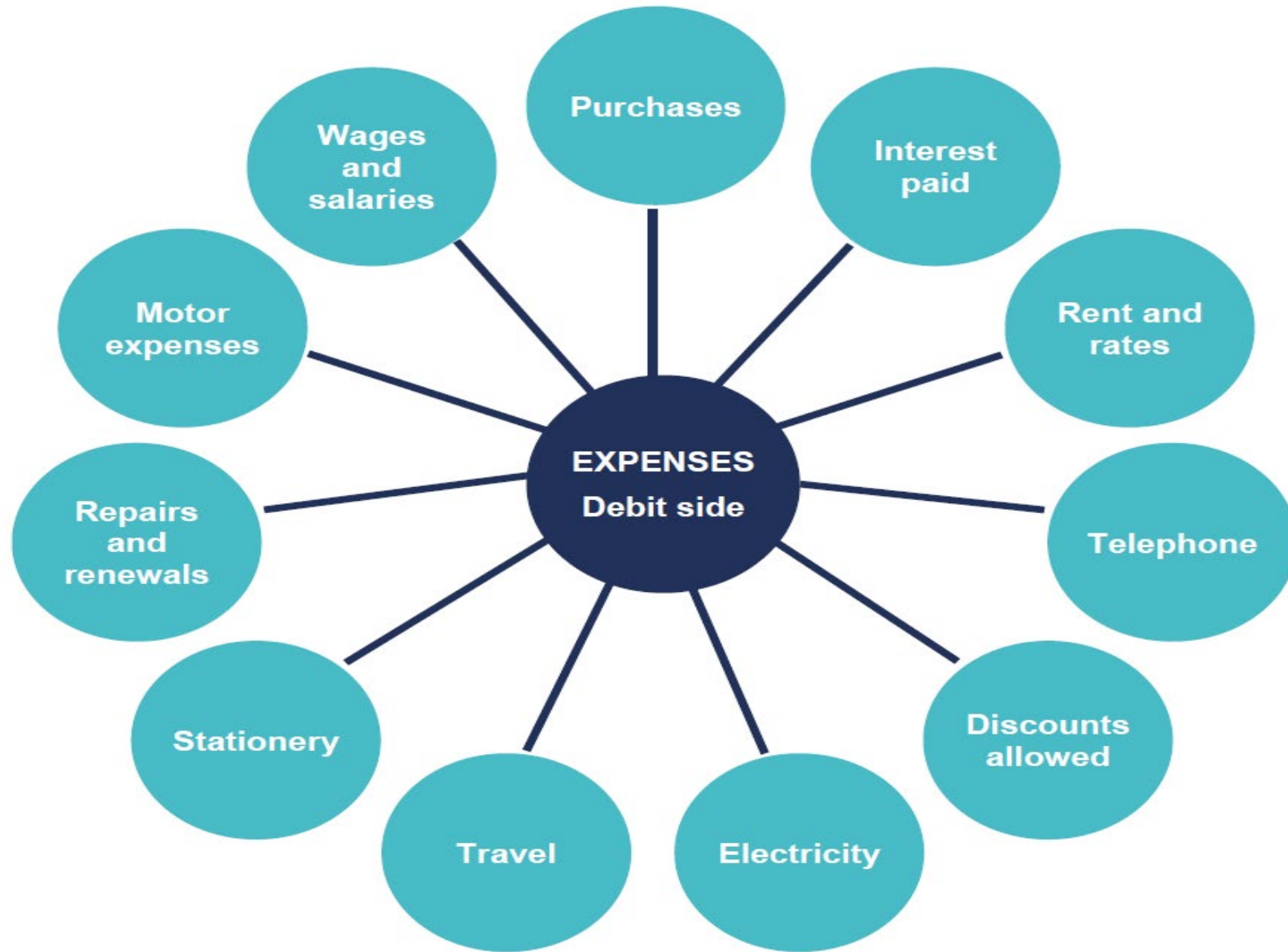
Types of Assets, Liabilities, Income and Expenses



Types of Assets, Liabilities, Income and Expenses



Types of Assets, Liabilities, Income and Expenses



Thank you, very much!

Any questions?



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References

ICAEW (2023) Accounting. 17th edn

Kaplan Publishing (2023) *AAT Level 3 Financial Accounting: Preparing Financial Statements (FAPS) Study Text*. Kaplan UK.