MAKERERE UNIVERSITY BUSINESS SCHOOL.

FINANCIAL ACCOUNTING 1

THEORETICAL FRAMEWORK OF ACCOUNTING.

Definition:

Accounting can be defined in several ways.

i) It can be defined as an art and a science of recording, classifying transactions in the books, summarizing and communicating financial information through the production of financial statements and reports and the interpretation of the operating results to facilitate decision making.
ii) It is the process of identifying, measuring, and communicating economic information to the users to allow rational decisions to be made.
iii) Accounting is a language of business through which business information is communicated to the users to aid them make informed decisions.
iv) It is explaining and defending (justifying) actions and effect or results of those actions. These actions must be of financial character.

Accounting Vs Accountability.

The role of accountants goes beyond the payment and receipt of money. They must defend and justify their actions. Ancient merchants had stewards who were required to give them accountability regarding the changes in their wealth that was in their custody.

Therefore since accountants deal with money, they, together with the management must justify and defend their financial statements to the owners of wealth; shareholders, and other interested parties like the customers.

Financial accountability methods.

Managers and accountants are required to show qualities of good financial management by submitting accountability of money received and spent to the owners. The following are the methods of accounting:

1- ***Production of documentary evidence:*** This involves producing documents as evidence of money received and spent. It is one of the popular methods of accountability. Some of the documents include;

- Receipts
- Vouchers
- Invoices
- Debit notes
- Credit notes
- Purchase orders
- Etc

- These are called source documents and are supposed to be attached and submitted to the auditors for examination.

2- Books of accounts: When the accounting period ends, financial statements/reports/or final accounts are prepared to show the result of the operation of the ended period. Major reports include:

i) The income statement (the profit &loss a/c) now called ***the statement of comprehensive incomes and expenses.***

ii) The balance sheet ***/the statement of financial position*** and

iii) The cash flow statements

Accountants and managers should be ready to defend these statements. Other supplementary statements such as bank reconciliation statements, trial balances and budget performance reports are also required.

3- Output/results. Today, the focus of accounting has moved from paper accounting to value for money. Results are emphasized to show the evidence of money well utilized.

NB: The first stage of accounting that involves recording of transactions is called **Book keeping.** The work of the book keeper stops at the preparation of the trial balance. An accountant has a responsibility of analyzing the transactions.

USERS OF ACCOUNTING INFORMATION.

These are persons or organizations who/which are interested in the accounting information of the given entity. They are either internal or external.

INTERNAL USERS: ***(Primary Users)***

1- Management. The mgt team is comprised of the senior executives, and other lower cadres who run the organization on behalf of the owners. They have to plan for profit, control activities, and take timely decisions. For instance; which markets to enter, whether to change prices, how to minimize costs, strategies to beat competitors etc. All these require accounting information. Reports produced must indicate whether the organization is making profits or losses and whether they are in the right business.

2- Employees. These are workers of the business. They use accounting information to support their claim for increased pay, depending on profitability, or to assess their job security.

EXTERNAL USERS: ***(Secondary Users)***

1) **Shareholders /Stakeholders /Investors /biz owners.** These are the owners of wealth. People or organizations who/which have staked their monies into the business. Accounting information helps them to decide whether to expand, close,

open new branches, downsize labor force, employ experts, etc. they get to know whether their business is managed well.

2) **Potential Investors.** These are interested in the accounting information in order to decide whether they should invest or not. They analyze the company's past performance and try to project its future. They also examine management's ability to sustain the company.
3) **Creditors/Suppliers.** These are individuals or institution that extend credit to a given organization. Credit suppliers and lending institutions are interested in getting paid. Financial institutions which offer loans have to assess the credit worthiness and this is possible only when accounting information exists.
4) **Donors.** Non-profit making organizations get funding from donor agencies. These agencies are interested in making sure that the money they donate achieves the objective for which it was released. Therefore they have to look at the financial statements and supporting documents.
5) **The government.** Government is interested in the accounting information of all organizations whether private or public. This information is useful when the govt is assessing tax or when it is gauging the performance of its enterprises. It also needs them to assess the effect of its policies on different entities.
6) **Competitors.** These are interested in accounting information of firms in the same industry so as to judge whether they are doing badly or fairly in comparison with other players in the same business.
7) **The general public.** This includes individuals and organizations that support an entity in its activities. The business must make sure that it makes profit in a socially acceptable manner without damaging the environment and consumer's health. (social responsibility accounting)

BRANCHES OF ACCOUNTING:

There are three broad categories. namely:

1). Private accounting
2).Public accounting
3).Government accounting.

PRIVATE ACCOUNTING.

This is the type of accounting that exist in a particular entity or organization usually a business firm though non-profit making organizations also have to use private accounting. It includes the following disciplines:

i).Financial accounting
ii).Cost accounting
iii).Management accounting and
iv).Social responsibility/environmental/green accounting.

FINANCIAL ACCOUNTING.

This is a branch of accounting that is concerned with the classification, measurement and recording of business transactions of an entity in monetary terms and in accordance with GAAP (Generally Accepted Accounting Principles). After a specified period of time (accounting /trading period), normally a year, accounting information is disclosed/communicated to the interested parties through financial statements i.e. the income statement, the balance sheet, and the cash flow statements.

The focus of financial accounting is to provide information to the outsiders (stakeholders). In order to protect the interests of the stakeholders, the preparation and presentation of financial statements is regulated by the Accounting regulations, and financial accounts must be subjected to Audit.

The information in financial accounts is summarized and historical, hence not very convenient for managerial decisions which are most of the time futuristic. However, the govt needs it for assessing tax.

COST ACCOUNTING.

It is primarily concerned with cost determination and allocation of costs to products and services in accordance with costing principles, methods, and techniques. Determining product costs and assigning costs to products is called *COSTING.*

Costing products with a view of setting selling price is very crucial. Costs should determine the least price to be charged to a product; unless the environment is too competitive in which case we may have to use the ruling market price. Cost control is also crucial.

MANAGEMENT ACCOUNTING.

The emphasis of management accounting is to provide the information to management for execution of their functions aimed at facilitating planning, control, and decision making. Management accounting is primarily concerned with *data gathering, processing, analysis, interpretation, and communication* of the resulting information to mgt so that they can more effectively plan, control operations, and make decisions.

There is no clear dividing line between cost accounting and Mgt accounting. Cost accounting is an important source of information for mgt purposes.

Mgt accounting arose when there was a need to bring an accountant closer to the mgt. i.e. advice received from an accountant is important in that situation.

SOCIAL RESPONSIBILITY ACCOUNTING.

This is the new phase in accounting and it widens the scope by considering social effects of business activities as well as their economic effects. The demand for social responsibility accounting stems from an increasing awareness and concern for undesirable by-products of economic activities that degrade the environment. A company might have made huge profits but when we consider the costs to the environment, the overall effect might be in a negative. Companies are supposed to pursue their profit objectives but leaving the environment green (green revolution).

PUBLIC ACCOUNTING:

The certified public accountants (CPAs), offer a variety of services to the public. These are professional, qualified, certified and chattered accountants, and belong to a governing body that regulates standards of performance. Practicing members do adhere to a code of ethics. Before one is accepted to enroll as a public accountant, he must possess CPA(K), CPA(U), ACCA, CIMA, e.t.c Public accountant do auditing work, provide tax consultancy services such as preparing tax returns, provide Mgt with advisory services such as designing and installing accounting systems and budgetary procedures.

Auditing. This is the most familiar role of the CPAs. Auditing is the examination of financial statements and underlying books of accounts and documents of an organization with a view to reporting whether the financial statements show a true and fair view of the financial stand/position. Auditing gives financial statement credibility and protects users from manipulated accounts. Auditors check whether the accounts prepared and the financial statements are in accordance with Generally Accepted Accounting Principles (GAAP).

GOVERNMENT ACCOUNTING:

Government needs accountants to develop and maintain accounting system. Government accounts are quite unique from accounts of other organizations. Government accounting emphasize budget discipline, by spending according to the amount voted (allocated). The types of accounts to be maintained and reports to be prepared are spelt out in the financial regulations or accounting manuals. In Uganda, central govt accountants refer to treasury accounting instructions while their counterparts in local govt refer to the local govt regulations.

THE ACCOUNTING REGULATORY FRAMEWORK (accounting rules).

The accounting information must be of good quality (credible) and objective especially for the interest of several users.

Therefore, they are prepared according to given regulatory or legal framework. This is to ensure that accountants report objectively without window dressing/doctoring the accounts. The accounting rules are imposed on the accountants in order to make sure that their reporting is free from bias. Accounting legislation requires that external financial accounts be prepared and presented in conformity with GAAP.

GAAP refers to accounting principles or practices that are regarded as permissible by the accounting profession and has substantial authoritative support. The boundaries of GAAP extend far beyond the accounting principles contained in the accounting standards. GAAP includes; the requirements of the companies act, stock exchange and other acceptable accounting treatment not incorporated in the official literature.

Definitions of some terms in the accounting regulatory framework.

Accounting principles/concepts/conventions/postulates.

These are basic ground rules which must be followed when financial accounts are being prepared and presented. They are also known as assumptions or propositions that underlie the preparation of financial statements.

Accounting bases. These are methods developed for applying a fundamental concept to transactions and items and in particular

For determining accounting periods in which revenue and costs should be organized in the profit and loss account.

For determining the amounts of which items should be stated in the balance sheet.

NB: Because of the complexity of types of business transaction, there may exist more than one legitimate accounting base for dealing with a particular item for example, depreciation can have many bases e.g fixed line, reducing balance, etc.

Accounting policies. These are accounting bases that have been selected by Mgt to be appropriate for their organization under the prevailing circumstances. They are therefore defined as “the specific bases selected and consistently followed by a business enterprise as being in the operation of Mgt, appropriate to its circumstances and best suited to present fairly its reserves and financial position.

Accounting standards. These are guidelines, statements or rules issued by professional accounting bodies, governing accounting practice in areas or countries under their jurisdiction, relating to how accounts should be prepared and presented.

Accounting standards spell out the accounting principles and bases to be applied. They overrun accounting policies chosen by Mgt. In case of conflict among the two, accounting standards prevail. They harmonize the approach to the preparation of financial statements hence permitting inter company and inter period comparison.

ACCOUNTING PRINCIPLES,CONCEPTS & CONVENTIONS.

ACCOUNTING PRINCIPLES

Also known as accounting concepts are basic ground rules / guidelines which must be followed when financial accounts are being prepared and presented. They are also referred to as assumptions that underlie the preparation and presentation of financial reports. To support the application of the "true and fair view", accounting has adopted certain concepts and conventions which help to ensure that accounting information is presented accurately and consistently. Attention is now to be focused on the fundamental postulates from which rational accounting judgments proceed and are comprehensively discussed below;

Business entity concept

The business entity concept means that the business is a separate entity from the owner and business transactions are accounted for separately from those of the owner. For example, when the owner invests Shs 500,000 in the business, the business owes Shs 500,000 to the owner. When the owner takes Shs 20,000 from the business for personal use, this is recorded as a drawing from the business that reduces his equity to Shs 480,000.

The concept ensures that financial statements show only the effects of business transactions that make them more useful in decision making about the business.

Accruals concept

The accruals concept requires that revenue is recognized when it earned and not when cash is received. Similarly, expenses are recognized when they are incurred and not when they are paid.

Duality concept (Dual)

This is the basis of double entry book-keeping that arises from the fact that every business transaction has a double effect (two fold effect) on the position of the business as recorded in the accounts. .eg. When an asset like a machine is acquired/bought using cash; an asset called machine is increased while Cash will reduce.

Money measurement concept

This concept means that all transactions must be quantified in monetary terms since money is a common denominator for all transactions. Eg. Sales, Machinery, Stock, etcthat are measured in monetary terms are recorded in accounting and included in financial statements.

Historical cost concept

This concept requires transactions to be recorded at the amount incurred when the transaction occurred or at a price that was ruling at that time. It is assumed that the currency’s purchasing power does not change over time. For example, if a business buys a building for Shs 500 million, it would be recorded in the books at Shs 500 million, even if its market value at that time may be Shs 550 million.

Materiality

Information is material if its omission or misstatements could influence the economic decisions of the users taken based on that information. Materiality refers to the relative importance of an item or transaction. Materiality depends on the size and nature of the item. Regarding size, for example, a bad debt of Shs 10,000 in immaterial to a bank having net assets of Shs 100 million. A bad debt of Shs 20 million is material.

Accounting period concept (Periodicity concept)

This concept requires a Company to prepare and disclose financial reports at the end of every given financial / accounting year. An accounting period is a period for which an entity prepares financial statements and it’s normally one year.

Consistency concept

The concept means that a business should use the same accounting policies, valuation methods; every year to year and only change them if it leads to better presentation of financial information or if it is required by new accounting standards or laws. Where accounting policies are changed, businesses should disclose this fact and explain the impact of the change.

Going Concern Concept

This requires accounting records to be maintained in such a way that the business is seen to continue in its foreseeable future. Ie. Financial Reports are prepared with the expectation that business will remain in operation indefinitely.

Matching Concept

This concept requires that revenues from business activities and expenses associated with earning that revenue are recorded in the same accounting period. Matching expenses with revenues gives a true picture of business operations for a given accounting period.

Materiality: if something is going to affect the decision of the user, then it is material.
Prudence/conservatism: an accountant should not anticipate profit but should provide for losses.
Realization: we recognize credit sales at the time of sale and not when money is received.
Consistency: when preparing financial statements, one is supposed to be consistent for instance on the style to be used, standard etc.
Objectivity: an accountant is supposed to have an explanation for every figure put down. Not creating figures through imagination but have to be supported by the documentary evidence.

Substance over form: when an accountant is recording, he should consider the financial substance and not the legal form. Eg in hire purchase, though the asset may not be legally ours, an accountant has to record its physical substance.

ACCOUNTING STANDARDS.

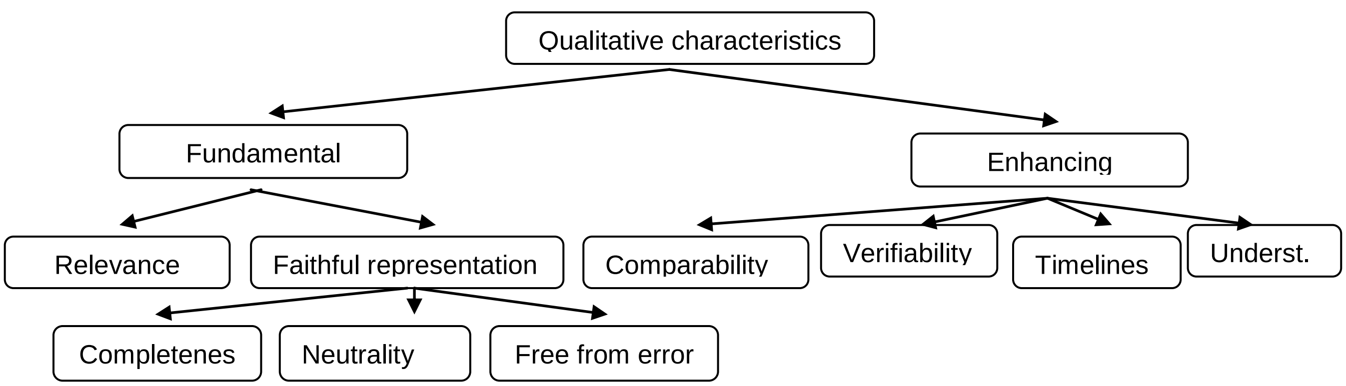
These are guide line statements or rules governing the preparation and presentation of financial statements. They are issued and monitored by the professional accountancy bodies. Their setting is done by the **International Accounting Standards Board (IASB).** Before 2001, those issued were called International accounting standards (IASs) and those issued later are called International Financial Reporting Standards (IFRSs). Accounting standards govern the application and the implementation of the concepts/conventions above. They spell out the contents and style of presentation of annual account. IAs specify accounting concepts that members must regard as fundamental and adopt them. They are not part of GAAP. There are many standards each spelling out the guidelines for the specific issue for instance IAS- is about presentation of financial statement, IAS38-intangible assets, IFRS 6-exploration for and evaluation of mineral resources etc.

Further reading *http://www.iasplus.com/country/useias.htm*

http://www.iasb.org

Qualitative characteristics of useful financial information

Qualitative characteristics are the attributes that make the information provided in financial statements useful to users. The framework identifies fundamental and enhancing qualitative characteristics (diagram).



Fundamental qualitative characteristics

Relevance

- Relevant financial information is capable of making a difference in the decisions made by users. Information influences decisions if it has predictive value, confirmatory value, or both. Financial information is capable of making a difference in decisions if it has predictive value, confirmatory value or both.

Faithful representation

Financial information is useful if it faithfully represents the economic aspects of an entity in words and numbers that it purports to represent. Information faithfully represents the entity if it is Complete – includes all necessary descriptions and explanations that is necessary for a user to understand the item like the nature and amount (whether original cost, or fair value) of an asset.

- Neutral – the information is presented without bias and is not manipulated to be received favorably or unfavorably by users.

- Free from error – means:
  - There are no errors or omissions in the description of the item
  - The process used to produce the reported information has been selected and applied with no errors in the process.

Comparability

- Information about a reporting entity is more useful if users can compare it with similar information for earlier periods of the same business. It enables users to identify and understand similarities in and differences among items.

Consistency

Refers to the use of the same methods for the same items, either from period to period within a reporting entity or in a single period across entities.

Timeliness

Timeliness means having information available to decision makers in time to be capable of influencing their decisions. Generally, the older the information is, the less useful it is. However, some information may continue to be timely long after the end of a reporting period because, for example, some users may need to identify and assess trends.

Understandability

Classifying, characterizing, and presenting information clearly and concisely makes it understandable. Financial reports are prepared for users who have a reasonable knowledge of business and economic activities and who review and analyze the information diligently.

THE FUNDAMENTAL ACCOUNTING EQUATION AND THE BALANCE SHEET.

This is the most important equation in accounting and is the basis of the entire recording system. The preparation of the balance sheet is based on it. It is the recognition of the dual concept of accounting.

A balance sheet (statement of financial position) is a detailed presentation of items making up the accounting equation. It is a financial statement showing what a business owns, what it owes and the owner's net investment into the business.

The accounting equation and indeed the balance sheet define the relationship between **assets, liabilities** and **owners' equity.**

A = C/OE + L

ASSETS CAPITAL/OWNERS'EQUITY LIABILITIES

ASSETS:

These are resources owned by the organization that aid in the income generating process. Anything of economic value **owned** by the organization or an individual is an asset; except human beings. Assets are resources controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity.

1- **Current assets.** These are short term assets, which have a useful life of only one financial year, though some can be carried forward like stock (inventory). They can be easily turned into cash (liquidated). Examples are:
    - Cash at hand (Cash)
    - Cash at bank (Bank)
    - Debtors (accounts receivable)
    - Stock (Inventory)
    - Pre-payments/payments made in advance eg prepaid rent, unused stationery, etc

2- **Non-current assets.** These are long term assets. They benefit more than one accounting periods. They cannot be easily turned into cash. Some are subjected to reduction in value (Depreciation with the exception of land which depletes). They are divided into two **intangible assets** and **fixed assets.**
    Intangible assets. These are assets that cannot be seen with eyes, touched or felt but of importance to the organization. They include:
    - Good will

- trade marks
- patent rights
- royalties etc

Fixed assets. These are tangible and can be seen and touched. They include:

- land
- machinery
- motor vehicles
- computers
- furniture/fixtures/fittings
- equipments
- plant etC

LIABILITIES:

These are debts/obligations of the organization that are to be discharged. The claim of outsiders against the assets of the organization. The present obligation of the entity arising from the past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits. They are divided into two **current liabilities** and **long-term liabilities.**

1- **Current liabilities**. These are short term debts which are to be discharged/paid with in a year of incurring them. They include:
   - Creditors (accounts payable)
   - Bank overdraft
   - Accruals/un paid expenses/payables eg rent payable, salaries due, dividends owing, water bills outstanding, etc
   - Un paid tax
   - Proposed dividends
   - Prepaid income

2- **Long term liabilities.** These are long term debts. They are to be settled anytime after one financial year. They usually carry an interest. Examples are:
   - Bank loan
   - Debentures
   - Bonds etc

OWNERS' EQUITY/CAPITAL/PROPRIETORSHIP.

This is the owners' net investment into the business. The amount of money he/she has put into the business thus his claim. The resources he/she uses in purchasing assets of the business.

Capital can be raised through personal savings/investment, borrowing from outside, trade credits and amalgamation.

Capital can be increased through

- Additional investment and
- Profit capitalization.

It can be decreased through

- Loss incurred from a bad trading period
- Drawings (removals/withdrawals) in form of cash and in kind (goods) for personal use.

Working capital is what remains after using the current resources to meet the current obligations.

WORKING CAPITAL (WC) =CURRENT ASSETS (CA) less: **CURRENT LIABILITIES**

WC = CA - CL

Current assets are always changing the form. This gives us circulating capital.

Illustration

Mukasa is a sole trader who set up his business in Kisenyi .The following were the transactions that took place in the month of January. Amounts are in UGX

i) Started business with cash of 10,000,000and cash at bank of 20,000,000
ii) Purchased stock of goods on credit of 3,000,000
iii) Bought a Motor vehicle for business operations using the cash at bank of 2,000,000
iv) Sold goods to James for 600,000cash which had cost him 500,000
v) Paid the shopkeeper 50,000cash as salary
vi) Bought more stock of goods for 500,000 cash
vii) Used business cash of 300,000 to buy for his wife and children Christmas clothes

Required Construct an accounting equation for each of the transactions above and extract prepare a simple balance sheet at the end.

i)

Assets =	**Liabilities**	**+ Owners equity**
Bank 20,000,000	---------------	Capital 30,000,000
Cash 10,000,000		
30,000,000		30,000,000

ii)

Assets =		**Liabilities**		**+ Owners equity**	
Stock	3,000,000	Trade creditors	3,000,000	Capital	30,000,000
Bank	20,000,000				
Cash	10,000,000				
	<u>33,000,000</u>				<u>33,000,000</u>

iii)

Assets =		**Liabilities**		**+ Owners equity**	
M/vehicle	2,000,000				
Stock	3,000,000	Trade creditors	3,000,000	Capital	30,000,000
Bank	18,000,000				
Cash	10,000,000				
	<u>33,000,000</u>				<u>33,000,000</u>

iv)

Assets =		**Liabilities**		**+ Owners equity**	
M/vehicle	2,000,000				
Stock	2,500,000	Trade creditors	3,000,000	Capital	30,000,000
Bank	18,000,000			Profit	100,000

Cash 10,600,000		
33,100,000		33,100,000

v)

Assets =	**Liabilities**	**+ Owners equity**
M/vehicle 2,000,000		
Stock 2,500,000	Trade creditors 3,000,000	Capital 30,000,000
Bank 18,000,000		Profit 50,000
Cash 10,550,000		
33,050,000		33,050,000

vi)

Assets =	**Liabilities**	**+ Owners equity**
M/vehicle 2,000,000		
Stock 3,000,000	Trade creditors 3,000,000	Capital 30,000,000
Bank 18,000,000		Profit 50,000
Cash 10,050,000		
33,050,000		33,050,000

vii)

Assets =	**Liabilities**	**+ Owners equity**
M/vehicle 2,000,000		
Stock 3,000,000	Trade creditors 3,000,000	Capital 30,000,000
Bank 18,000,000		Profit 50,000
Cash 9,750,000		Drawings (300,000)

32,750,000		32,750,000

Mukasa's Balance Sheet as at………

Non Current Assets		**Equity and liabilities**	
Motor vehicle	2,000,000	Capital	30,000,000
Current assets		Profit	50,000
Stock	3,000,000	less drawings	(300,000)
Bank	18,000,000	**Current liabilities**	
Cash	9,750,000	Trade creditors	3,000,000
Total Assets	**32,750,000**	Total Equity & Liabilities	**32 ,750,00**

Double-Entry accounting

Introduction

The double entry system of accounting recognizes the fact that every business transaction has two effects; that of the business 'receiving' (+), and that of the business 'giving' (-). This principle forms the basis of accounting.

The basic unit of double entry system is the account.

Accounts are a separate record that is kept of the increase and decrease in each asset, each liability, and each aspect of owner's equity.

Accounts Standard Form

- Account title and number are located at the top and identify each account as an asset, liability, or aspect of owner's equity.
  - Debit side – left side
  - Credit side – right side

The debit side and the credit side of an account contain the following columns:

- Date column – record date of transaction
- Item column – record description, if necessary
- P.R/folio column – record posting reference
- Debit or credit column – record amount

T- Accounts:

- Simplified version of the standard form of account
- Looks like the capital letter T.
- Contains title, debit and credit side

Title of Account

Debit side	Credit side
Left side	Right side

Debits and credits

The left side of any account is the debit side, and the right side is the credit side.

- To debit an account is to enter an amount on the left, or debit side.
- To credit an account is to enter an amount on the right, or credit side. Debit and credit
    - Dr used for debit
    - Cr used for credit.

The rule of debit and credit are based on the location of assets, liabilities, and owner's equity.

The table below summarizes the items that are represented by debits and credits.

A debit entry represents	A credit entry represents
1) An increase in the value of an asset Or 2) A decrease in the amount of a liability Or 3) An item of expenditure	1) A decrease in the value of an asset Or 2) An increase in the amount of a liability Or 3) An item of income

Consider the T- accounts below;

Assets		**Liabilities**	
Dr Any asset	Cr	Dr Any Liability	Cr
Increase	Decrease	Decrease	Increase
+	-	-	+

Capital

Dr Capital	Cr
Decrease	Increase
-	+

Expenses		**Revenue/ Income**	
Dr Expense	Cr	Dr Revenue/Income	Cr
Increase	Decrease	Decrease	Increase
+	-	-	+

Illustration

a. Ali Musa starts a travel agency with an investment of UGX25, 000 in cash. The owner's investment increases the assets cash by UGX25, 000. Assets accounts are debited to record an increase. Thus, the cash account must be debited for UGX25, 000.

(a) Entry

Cash	
+	-
(a) 25,000	

Ali Musa, Capital	
-	+
	(a) 25,000

b. Ali Musa buys a computer and other office equipment for the business for UGX 9, 000 on credit. The asset office equipment increased by UGX9, 000 and Asset accounts are debited to record an increase. Thus, the office equipment account must be debited for UGX9, 000.

The liability accounts payable increases by UGX9, 000. Liability accounts are credited to record an increase. Thus, the accounts payable account must be credited for UGX9, 000.

(b) Entry

Office Equipment	
+	-
(b) 9,000	

Accounts Payable	
-	+
	(b) 9,000

c) Ali Musa buys offices supplies for the business for UGX300 in cash. The assets office supplies are debited to record an increase. Thus, the office supplies account must be debited with UGX300. The asset office supplies increases by UGX300. Assets accounts are debited to record an increase. Thus, the office supplies account must be debited for UGX300.

(c) Entry

Office supplies	
+	-
(c) 300	

Cash	
+	-
(a) 25,000	(c) 300

d) Ali Musa pays UGX3000 of the amount her business owes for office equipment previously brought on credit.

The liability payable decreases by UGX3000. Thus, the account payable must be debited for UGX3000.

The asset cash decreases by UGX3000. Assets accounts are credited to record a decrease. Thus, the cash account must be credited for UGX3000.

(d) Entry

Accounts Payable	
-	+

Cash	
+	-

(d) 3,000 (b) 9,000 (a) 25,000 (c) 300

(d) 3,000

Exercise

1. Show the following transactions, as they are entered in the double entry system

a) Sold goods for cash UGX 8,000
b) Bought Furniture for UGX 5,000 and paid by cheque
c) Bought goods in trade for UGX 3,000 on credit
d) Part payment of UGX 1,000 cash was made to a creditor
e) Tom was paid UGX 2,000 cash
f) Some furniture, which had cost UGX 3,000, sold for cash at cost.

2. Show the following transactions, as they are entered in the double entry system

a) Bought goods in trade for UGX 7,000 on credit
b) Sold goods for UGX 5,000 cash
c) Sold goods on credit for UGX 2,000
d) Paid Salaries UGX 2,000 cash
e) Bought Goods UGX 3,000 cash
f) Sold goods UGX 6,000 by cheque
g) Paid creditors UGX 3,000 by cheque

The preparation of books of account

Subsidiary books

These are books of original entry. We post the transactions recorded in the subsidiary books to the ledger accounts at the end of every month and in case of some transactions, only total amounts are posted. The books used to record all transactions of a particular category prior to posting to the ledgers are the books known as subsidiary books or books of prime entry. They include;

- The purchase daybook or journal; this book records the details of all goods purchased on credit. We write up the purchases daybook is from the incoming invoices.
- Sales daybook or journal; this book records the details and amounts of all goods sold on credit. We write up the sales daybook from the outgoing invoices.

- Purchases return book or returns outwards journal; this book records the details and amounts of goods returned to the creditors. We write up the returns out ward daybook is written up from the incoming credit notes
- Sales return book or return inwards journal; this books records the details and amounts of goods returned by the debtors. We write up the return in wards daybook from the out going credit notes.
- Petty cash book; this book records the small cash receipts or payments. This books is also used to analyse the expenses the expenses paid in cash
- Journal or diary; the journal is that daybook in which we can record the details of any transaction that cannot be recorded in any other subsidiary book. We call all other books of original entry the division of journal for recording specific type of transactions. The main uses of the journal are the following.
    - To record purchases or sales of assets
    - To correct the errors
    - To record opening and closing entries
    - Writing off of bad debts; etc

JOURNALS

A journal may also be defined as a book of original entry where transactions are first recorded when they occur. Businesses maintain several types of journals and the nature of operations determine the number and the types of journals needed. The journal was once the most used book in bookkeeping, but today entries in the journal are limited to records of 'unusual' transactions, which are improperly recorded in any of other books of original entry that will be described. Such transactions are those which do not purely involve the receipt or payment of money (whether in cash or through the bank), and which are not credit sales or purchases or returns inwards or returns. However the types of Journals are;

a. General journal
b. Sales day book/sales journal
c. Purchases day book/purchases journal
d. Cash book
e. Returns inwards day book
f. Returns outward day book

A) General Journal

We can also use this journal for all types of transactions with two money columns, although in the diagram above we have said it used to record other types of transaction other than those specifically identified with other journals. We also call it a journal proper. XYZ Ltd journals below are examples of general journal.

Procedural steps for recording transactions in the General journal

a. Recording the date on which the transaction occurred.

b. Write the name of the account to be debited and recording the amount in the first money column
c. Write the name of the account to be credited in the second money column
d. A brief explanation is given about the transaction immediately after the account is credited
e. Journals have a Ledger page column .This column provides a convenient cross-reference with the ledger.

Illustration

The following were the transactions of XYZ ltd for the month of January

i) On January 1st XYZ ltd started business with cash of UGX 2,000,000 and money at the bank of UGX 3,000,000
ii) 3rd Jan Purchased goods for UGX 600,000 cash
iii) 6th Jan Bought a Motor vehicle for UGX 1,500,000 by cheque
iv) 7th Jan Sold goods for UGX 300,000 cash.
v) 15th Jan Purchased more goods on credit from TK ltd worth UGX 500,000
vi) 20th Jan obtained a bank loan of UGX 3,000,000 cash.
vii) 23rd Jan Sold goods for UGX 200,000 on credit to Mary
viii) 25th Jan Mary paid UGX 80,000 cash.
ix) 26th Jan Sold goods on credit to Peter for UGX 100,000.
x) 29th Jan purchased goods from John on credit for UGX 300,000

Required Enter the above transactions in the General Journal

XYZ LTD

GENERAL JOURNAL FOR THE MONTH OF JANUARY

Date	Account title & explanations	LP/Folio	Debit	Credit
1st Jan	Cash A/C	01	2,000,000	
	Bank A/C	02	3,000,000	
	Capital A/C	03		5,000,000
	For starting the business			
3rd	Purchases A/C	04	600,000	
	Cash A/C	01		600,000
	Being purchase of goods using cash			

6th	Motor vehicle A/C Bank A/C Being for purchase of a motor vehicle using cash	05 02	1,500,000	 1,500,000
7th	Cash A/C Sales A/C Being sale of goods for cash	01 06	300,000	 300,000
15th	Purchases A/C TK Ltd A/C (Creditors) For purchase of goods from TK Ltd on credit	04 11	500,000	 500,000
20th	Cash A/C Loan A/C Being a loan obtained	01 08	3,000,000	 3,000,000
23rd	Mary A/C(Debtor 's A/c) Sales A/C To record sale of goods on credit to Mary	09 06	200,000	 200,000
25th	Cash A/C Mary A/C (Debtor s A/c) To record receipt of cash	01 09	80,000	 80,000
26th	Peter A/C (Debtor's A/C) Sales A/C To record sold of goods to Peter on credit	09 06	100,000	 100,000
29th	Purchases A/C John A/C (Creditor's A/C)	04 07	300,000	 300,000

	To record purchase of goods from John on credit			
			11,080,000	**11,080,000**

Exercise

Kyeswa commenced a Hardware enterprise on March 1 with UGX 50,000,000 on his account in Stanbic Bank. The following transactions were carried out in that month.

Mar 2 Purchased goods of UGX10, 000,000 from Bridgestone Ltd on Credit.

3. Withdrew UGX3, 000,000 from the bank and kept it in the safe as petty cash.

5. Sold goods worth UGX5, 000,000 to Mukozi who paid UGX2, 000,000 by cheque; UGX1, 500,000 cash and issued a notes receivable for the balance.

7. Bought land of UGX8, 000,000 by cheque from Akright Ltd to construct the business premises

9. Paid a salary cheque of UGX800, 000 to his accountant

11 Returned goods of UGX100, 000 to Bridgestone Ltd because they had damages

13. Paid insurance to A.I.G of UGX200, 000 cash

15 Purchased goods worth UGX7, 000,000 from Kiseka Market and issued a Notes Payable.

17 Mukozi rejected and returned defective goods worth UGX300, 000.

18 Paid Bridgestone a cheque of UGX6, 000,000 for goods purchased on credit.

19 Received a cheque of UGX500, 000 from Mukozi for goods sold to him.

21 Disposed off Part of the land at UGX2, 000,000 cash because it was redundant.

22 A cheque from Mukozi bounced because there were insufficient funds on his account.

23 Paid rent of UGX600, 000 cash.

25 Sold goods to Kiyembe Ltd for UGX2, 000,000 on credit

27 Mukozi Paid 400,000 cash for goods sold to him on credit.

29 Purchsed goods of UGX4, 800,000 from City tyres on credit

30 Received a cash of UGX1, 000,000 from Kiyembe Ltd to clear his debt.

31 Used business cash of UGX 200,000 to organize a dinner party at Fang-fang Restaurant for his employees.

Required

Enter the above transactions in the general Journal.

B) SALESDAY BOOK (SALES JOURNAL)

In almost all businesses sales will be made on credit .The sales day book is used for recording the credit sales .The sales day book contains the following:

- Date on which the transaction occurred
- Name of the customer .The person who bought the goods on credit (individual or company)
- Invoice number .The number on the sales invoice. A sales invoice is a document showing details of goods sold and the prices at which they have sold
- Folio column
- Amounts or Prices at which goods have been sold

Illustration

The company sold goods on credit to the following people.

On May 1st sold goods to Jackie of 400,000 and the invoice number was 011

On May 4th sold goods to James of 300,000, invoice number 016

On 7th sold goods to Peter 700,000, invoice number 018

On 10th sold goods to Meyer 500,000 invoice number 020

Required: Prepare a Sales daybook

SALESDAY BOOK

Date	**Name of customer**	**Invoice number**	**Folio**	**amount**
May 1st	Jackie	011		400,000
4th	James	016		300,000
7th	Peter	018		700,000
10th	Meyer	020		500,000
				1,900,000

C) PURCHASES DAY BOOK

The purchases daybook is book of original entry for recording goods bought on credit.

The purchases daybook contains the following

- Date
- Name of creditor
- Invoice number
- Folio column
- Amount

Another illustration

The company bought the following goods on credit in the month of May

i) On May 3rd bought goods from Stephen for 1,500,000,invoice number 10
ii) On 7th purchased from Brian for 3,000,000,ivoice number 14
iii) On 20th purchased from Derrick for 2,000,000,invoice number 18
iv) On 22nd bought goods from Adrian for 700,000 ,invoice number 20

Required Record the above transactions in the purchases daybook

PURCHASES DAY BOOK

Date	Name of creditor	Invoice number	Folio	Amount
May 3rd	Stephen	10		1,500,000
7th	Brian	14		3,000,000
20th	Derrick	18		2,000,000
22nd	Adrian	20		700,000
				7,200,000

D) CASHBOOK

The cashbook is a book of original entry for recording cash and bank transactions. It shows the business receipts and payments. We also classify a cashbook as a ledger. A cashbook can have two columns or three columns.

Two-column cashbook

The two-column cashbook has the bank and cash column both on the debit and credit side. The cashbook therefore is a combination of the bank and the cash account.

Format of a two-column cashbook

Title

Date	Particulars	Bank	Date	Particulars	Cash	Bank

Using the illustration of XYZ ltd prepare a 2 column cashbook

XYZ two-column cashbook

Date	Particulars	Cash	Bank	Date	Particulars	Cash	Bank
Jan 1st	Capital	2,000,000		Jan 3rd	Purchases	600,000	
Jan 1st	Capital		3,000,000	Jan 6th	M. vehicle		1,500,000
7th	Sales	300,000					
20th	Loan	3,000,000			Bal c/d	4,780,000	1,500,000
25th	Mary	80,000					
		5,380,000	3,00,000			5,380,000	3,000,000

Use of folio columns in the cashbook

The particulars column of the cashbook just contains the name of the other accounts and tracing such accounts may be difficult .Folio columns will indicate where we find such accounts when we need more information.

The three-column cashbook

The three-column cashbook has additional columns of discount received and discount allowed column in addition to the cash and the bank columns.

Discount allowed This is the discount (reduction in the prices) that is given to customers by the business. It reduces the amount paid by the customer. We enter the discounts allowed in the discount column on the debit side of the cashbook

Discount received

This is a discount received by the business from its suppliers. It reduces the amount paid to suppliers. The discounts received are entered in the discounts column on the credit side of the cashbook.

Illustration

The company purchased goods on credit from Mary for UGX2, 000,000.

i) The company was able to pay on 4 May (in time) using a cheque and therefore qualified for a discount of 5%.

ii) The company has a debtor John whose balance was UGX200, 000. He paid cash on 10 April (in time) and this made him qualify for discount of 2%.

Required Show how the above transactions will appear in the cashbook

Discount received

2,000,000*5/100 = 100,000 (To be entered on the credit side of the cashbook)

The amount of money that the company paid to Mary amounted to

2,000,000-100,000 =1,900,000

Discount allowed

2/100*200,000 = 4,000

The discount allowed is UGX 4,000 (will appear in the discount column on the debit side of the cash book)

The amount received from John a debtor was 200,000-4,000 = 196,000

Three-column cashbook

Date	Details	Discount	Cash	Bank	Date	Details	Discount	Cash	Bank
10/4	John	4,000	196,000		4/05	Mary	100,000		1,900,000

Exercise:

Refer to the General Journal of Kyeswa Ltd and prepare a Cash book

RETURNS DAY BOOKS/JOURNALS

The returns day books record goods, which have been returned to and by the business

These books are:

- Return inwards day book
- Return outwards day book

Return inwards day book/Journal

Return inwards refers to goods which have been sold but have been returned to the business .When the goods are returned and the amounts are refunded, a credit note is issued to the customer .It is called a credit note because the customers account will be credited. The returns on the credit notes will be recorded in the:

- The return inwards account
- Sales ledger (Debtors subsidiary ledgers) by crediting the individual customers accounts

Illustration

The following customers returned goods to the company:

i) On 3rd September David returned goods for UGX50,000 ,credit note number 012
ii) On 8th September Isaac returned goods for UGX80,000 ,credit note number 019
iii) On 20th September Deborah returned goods for UGX100,000, credit note number 020

Required Record the above transactions in return in wards daybook

Return in wards daybook

Date	**Details**	**Credit note number**	**Folio**	**Amount**
3rd September	David	012		50,000
8th "	Isaac	019		80,000
20th "	Deborah	020		100,000
Amounts to be transferred to the return inwards account				**230,000**

Return outwards account

The return outwards day book records the goods which have returned by the business to its suppliers .When goods are returned ,the business issues a debit note to the supplier and gives reasons for their return.

The amounts of the debit note will be recorded thus;

- Return out wards account
- Purchases ledger by debiting in the individual accounts

Illustration

The company returned goods to the following suppliers

i) On 4th May returned goods to peter of UGX80,000,debit note number 013
ii) On 28th May returned goods to Ivan of UGX130,000,debit note number 015
iii) On 30th May returned goods to Mark of UGX200,000,debit note number 018

Required: Record the above transactions in the return outwards daybook

Return outwards daybook

Date	**Details**	**Debit note number**	**Folio**	**Amount**
4th May	Peter	013		80,000
28th May	Ivan	015		130,000
30th May	Mark	018		200,000
Amounts to be transferred to the return outwards account				**410,000**

After recording transactions in the journals, we post them to the ledgers. We sometimes refer to a ledger as the book of secondary entry. A ledger is a group of accounts (A/C) and in the manual accounting system the ledger is a book where the accounts are kept.

THE LEDGER

The recording function of accounting is called **preparation of books of accounts/book keeping**. The purpose of bookkeeping is to provide an accurate and detailed record of **every** transaction involving the exchange of money or money's worth between the enterprise and others, whether they are individuals or organizations.

The books that are the subject of bookkeeping are referred to as the "books of accounts". The main book of accounts is the ledger. In a summarized form it records – and can provide – all the following information:-

A) The total income of the business, and in general the different sources from which it is derived;

B) The amounts involved in meeting each type of expense, and the total expenditure incurred by the business;
C) What assets are owned by the business, the values of each general type and the total value of all its assets;
D) The values of the different liabilities of the business, and the total value of all its liabilities;
E) Who its debtors are, how much they owe to the business, and the total amount owed to the business;
F) Who the creditors of the business are, how much is owed to each by the business, and the total amount owed by the business;
G) Whether the business has made a profit or a loss during a given period of time, and the amount of that profit or loss;
H) The amount of working capital available to the business at the point in time

A ledger comprises many different sections, each of which is called an account. In a ledger 'book', there will usually be one account on each page of it; in a large business, each account may have its own card or sheet – all the account – cards or account – sheets together jointly make up the business' ledger.

The following important points must be noted about ledger accounts:

1. Each individual account is headed by a name or by a title. That name or title may be the name of a person or an organisation or a type of assets, a type of liability, a type of expense or a source of income
2. Only information about the transactions concerning the person, organisation or item named at its head may be recorded in that account.
3. Each account must be kept separate, or treated separately, from all the other accounts in the ledger, and there must be only one account in then ledger for any one particular person, organization or item.
4. Each ledger account is divided into two sides by a line – or by two close parallel (although for purposes of this book, we one line) lines – drawn down the middle of it, from top to bottom (see the specimen below).
5. The left-hand side of an account is called its debit side, and it records all values received by the person, organisation or item named at the head of it.
6. The right-hand side of an account is called its credit side, and it records all values given (or paid out by) the person, organisation or item named at its head.

In addition to a name or title, each account also has a number located to it; that number is called a folio or an account number.

A specimen ledger account

Debit side (receipt) **CLARENDON HOTEL** **credit** side (value given out)

19 –-----			**UGX**	**19------**			**UGX**
May 2	purchases	SB7	474.60	May 4	returns	R1 3	14.00
8	purchases	SB7	339.40	15	payment	CB 43	800.00
12	purchases	SB7	162.50		balance	c/d	458.70
14	purchases	SB7	296.20				
			1,272.20				1,272.20
16	balance	b/d	458.70	27	returns	R1 4	21.00
25	purchases	SB7	113.10	31	balance	c/d	551.10
			572.10				572.10
June1	balance	b/d	551.10				

The transactions – or entries – are rarely recorded direct into the ledger account. Generally, information is first recorded in one of the 'subsidiary books' or 'day to day' – which are collectively often called 'the books of original entry'. The information is then transferred – or 'posted', as the process is called in bookkeeping – to the appropriate ledger accounts in a summarized form. The most commonly used subsidiary books are the cashbook, the sales book, the purchases book and the returns inwards and outwards book, which have all been described in this Topic already.

Now let us turn to an examination of the specimen ledger account and note the meaning of the following abbreviations used in the specimen account, and which will frequently be met with in bookkeeping and accounting;-

c/f – this is the abbreviation for "carried forward" and means that the figure, total or balance against which it appears has been transferred to another place, for example from the bottom of one page to the top of another, or to one book or account to another.

b/f – this abbreviation stands for "**brought forward**" and means that the figure, total or balance alongside which it appears was transferred from another place, e.g. to the top of one page from the bottom of another, or to another book or account from another.

c/d – this is the abbreviation for "**carried down**" and indicates that the balance alongside which it is written has been transferred to a lower position on the same page

b/d – this abbreviation stands for "**brought down**" and means that the balance against which it is written has been transferred from a higher position on the same page.

bal – this is the common abbreviation for the word "**balance**", which is the difference between the total value of the debit entries in an account and the total value of the credit entries in it.

Balancing a ledger

After making the entry for the payment from Clarendon on the 15th, Mr. Trader needed to know how much was still owed to his business by Clarendon. To obtain that information, he carried out a process called balancing. What he did was first to add up the values of the entries on the debit side of Clarendon's account in the ledger; their total amount to UGX 1,272.70. He wrote that total below the fourth entry – remember that fig. 1/1 shows an 'historical record', and that on the 14th the other entries shows in the account had not yet been made.

Next, he added up the value of entries on the credit side of the account – their total, which was UGX. 814, was deducted from UGX 1,272.70 to give the balance – the amount still owing by Clarendon – of UGX 458.70. that amount was entered on the credit side, making the totals of the entries on both sides equal, and so the total was entered on the credit side, on the same line as the total of the debit entries; and both – equal – totals are neatly underlined, or 'ruled off' as the process is called.

Finally, the balance was carried down from the credit side to the debit side, showing that Clarendon had received an excess value of UGX 458.70 over what it had been given out.

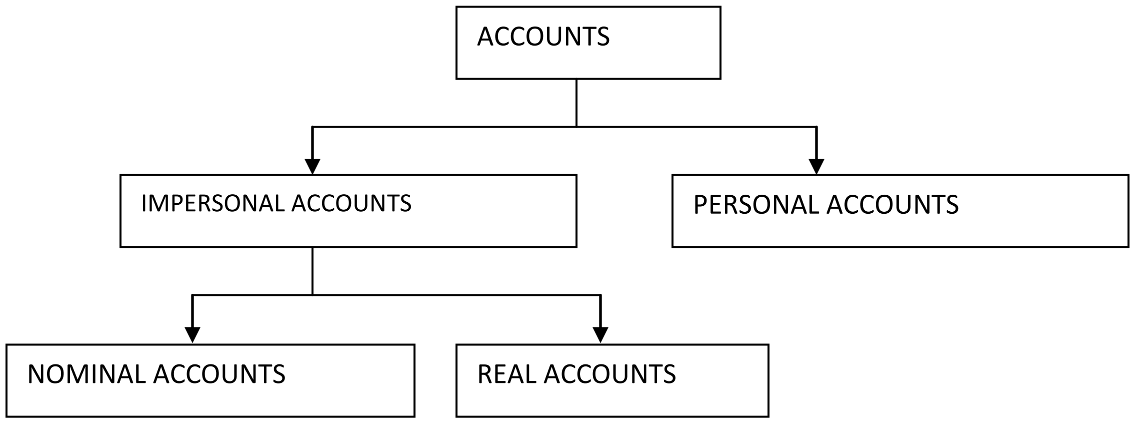
Balancing is an easy process and can be carried out on any account at any time it is considered necessary to do so. It is generally carried out on the account of all debtors and creditors at the end of each month, and on each account at the end of a financial or trading year or other accounting period and you will learn why that is done as you progress with your studies.

Before we proceed, it is important to look at the classification of accounts.

Classification of accounts

An account may be defined as a record of transactions of a particular type or with a particular person usually expressed in financial terms and maintained in a ledger. Each page of a ledger is given a heading or title and it is used to record transactions of a similar nature. For example, all sales of goods are recorded on one page and it is known as sales account and so on.

In a ledger, we classify various accounts as under;



Adopted from: Saleemi (1982)

We explain these as under;

Personal accounts - These accounts contain the name of a business, person or firm. In a ledger, there may be three types of personal accounts.

- **Capital account**; this account records the transactions between the proprietor and the business. Any amount invested or withdrawn by the proprietor is recorded in this account.
- **Creditors' account**; the persons to whom money is owed by the business are called creditors. The goods purchased on credit basis from suppliers create a liability of the business. These amounts owing to creditors are recorded in their personal accounts, which are opened separately for each creditor.
- **Debtors' account**; debtors are the persons owing money to the business. This money is owed to the business against goods sold to the customers on credit basis. A separate account is opened for each debtor.

Impersonal accounts – The accounts, which do not contain the name of any person or business, are called impersonal accounts. They may be of two kinds;

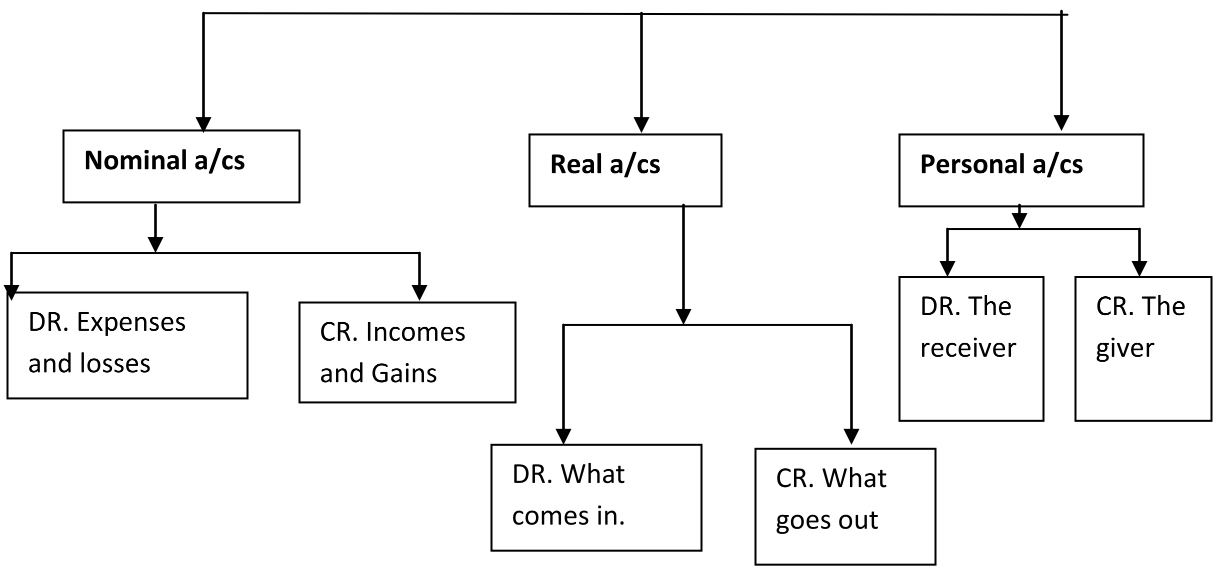
- **Real accounts**; these relate to tangible items. These are accounts always represent something we can see, touch, or move. The accounts of assets like land and buildings, plant and machinery, motor vehicles, furniture and fittings and cash are real accounts.
- **Nominal accounts**; these relate to tangible items. These accounts record transactions for which we have nothing tangible to show; for example, purchases, rent, sales, wages and salaries, electricity, printing and stationery and so on.

Accounts and the dual concept The classification of accounts enables us to establish rules for making double entry (we saw double entry principle in operation in Topic 4) in case of different transactions. When faced with any transaction, the following three points must be considered.

1) What two accounts are affected?
2) What type of accounts are they?
3) Which account is to be debited and which one to be credited?

The following figure gives an idea of making double entry in case of different transactions.

ACCOUNTS



Adapted from: Saleemi (1982)

We divide all the many accounts, which jointly make up the ledger of a business, into these three classes – Real accounts, personal accounts and nominal accounts.

General ledger

It is a ledger for all accounts in an organisation .In an organisation the general ledger will contain accounts such as cash account, bank account, purchases account etc but on different pages. It is important to note that the general ledger will not contain individual accounts for the debtors and creditors. For example, the account for Mary as a debtor will not appear in the general ledger but the debtors account will appear having information about all the debtors.

Subsidiary ledgers

Businesses have so many customers and suppliers therefore it is necessary to have each individual debtor or creditors account separate to determine each one’s balance.

We call these individual accounts subsidiary ledgers because they support and general ledger controls them.

Types of subsidiary ledgers

- Debtors subsidiary ledger
- Creditors subsidiary ledger
- Private ledger
- Cash book

Debtors' subsidiary ledger

This is a summary of an individual debtor's transaction. The general ledger shows information concerning all the debtors but does not bring out the details about each individual debtor. The subsidiary ledger brings out these details. For example, Mary who is a debtor will have transactions concerning her alone summarized in Mary's account.

Creditors' subsidiary ledger

This is a summary of individual creditor's transactions. The general ledger will show information concerning all the creditors but will not details of each individual creditor. In the creditors subsidiary ledger each creditor will have their account.

Private ledger

The private ledger columns contain accounts that the proprietors wish to keep secret from other people .These accounts may include: capital A/C, drawings A/C, income A/C depending on the organization etc

Posting transactions from the Journals to the Ledgers

The transfer of transactions from the journals to the ledgers is referred to as posting. The transactions that appear in the debit column of the general journal will be posted to the debit side of the respective ledger.

The transactions that appear in the credit column of the general journal will be posted on the credit side of the respective ledger account.

Balancing off the ledger accounts (you may wish to refer to the specimen of ledger account of Clarendon Hotel)

There, we noted that the ledger accounts are balanced off to determine the balance by the end of the financial period. Balancing off the accounts involves the following stages:

i) Adding both sides of the account to determine the total for each side
ii) For example the debit side of the account below adds up to 5,000,000 while the credit side to 700,000
iii) Leave space after all the transactions have been posted for inserting in the end of period balances.

iv) The Larger amount after adding both sides will become the total for both sides.
v) iv) Subtract the smaller total from the larger total (e.g. 5,000,000-700.000= 4,300,000)
vi) Enter the difference (4, 300,000) on the side with the smaller amount and it is represented as balance carried down (bal c/d)

vii) Now both the debit and credit side will have the same total
viii) Double entry of the balances should be fulfilled by carrying down the balance to the beginning of the next period.
ix) If the balance carried down is on the credit side of the account then the balance brought down will be on the debit side of the same account.

Normal Balances

Liabilities, capital and revenue accounts should have credit balances. Assets (apart from the bank overdraft), expenses and drawings account should have a debit balance. If these accounts have different balances from the normal then the accounts were not properly prepared.

With this in mind, the ledger accounts for **XYZ Ltd** now appear as follows;

General ledgers for XYZ ltd

Cash A/C

Jan 1	Capital	2,000,000	Jan 3	Purchases	600, 000
7	Sales	300,000			
20	Loan	80,000			
			31	Bal c/f	4,780,000
		5,380,000			5,380,000
Feb 1	Bal b/f	4,780,000			

Bank A/C

Jan 1	Capital	3,000,000	Jan 6	M.vehicle	1,500,000
			31	Bal c/f	1,500,000
		3,000,000			3,000,000
Feb1	Bal b/f	1,500,000			

Capital A/C

Jan 31 Bal c/f 3,000,000	Jan 1 Cash 2,000,000
	1 Bank 3,000,000
5,000,000	5,000,000
	Feb 1 Bal b/f 3,000,000

Purchases

Jan 3 Cash	Jan 31 Bal c/f 1,400,000
15 Creditors (Tk) 500,000	
29 Creditors (John) 300,000	
1,400,000	1,400,000
Feb 1 Bal b/f 1,400,000	

Motor vehicle A/C

Jan 6 bank 1,500,000	Jan 31 Bal c/f 1,500,000
1,500,000	1,500,000
Feb 1 Bal b/f 1,500,000	

Debtors A/C

Jan 23 Sales 200,000	Jan 25 Cash 80,000

26 Sales	100,000	31 Bal c/d	220,000
	300,000		300,000
Feb 1 Bal c/f	220,000		

Creditors A/C

Jan 31 Bal c/f	800,000	Jan 15 Purchases	500,000
		29 Purchases	300,000
	800,000		800,000
Feb 1 Bal b/f	300,000		

Loan A/C

Jan 31 Bal c/f	3,000,000	Jan 20 Cash	3,000,000
	3,000,000		3,000,000
		Feb 1 Bal b/f	3,000,000

Sales A/C

Jan 31 Bal c/d	600,000	Jan 7 Cash	300,000
		23 Debtor (Mary)	200,000
		26 Debtor (Peter)	100,000
	600,000		600,000
		Feb 1 Bal b/f	600,000

XYZ subsidiary ledgers

Debtors' subsidiary ledgers

The debtors for **XYZ Ltd** are Mary and Peter .We are going to have Mary and Peter accounts separately.

Mary's A/C

Jan 23 Sales 200,000	Jan 25 Cash 80,000 31
Bal c/f 120,000	
200,000	200,000
Feb 1 Bal b/f 120,000	

Peter's A/C

Jan 26 Sales 100,000	Jan 31 Bal c/F 100,000
100,000	100,000
Feb 1 Bal b/f 100,000	

Note that the balance in the debtors' account (220,000) should always be equal to the total of all individual balances. In this example the total of individual balances (for Mary and Peter is 120,000 + 100,000 = 220,000

Creditors' subsidiary ledgers

The creditors for **XYZ Ltd** are John and TK ltd

TK Ltd A/C

Jan 31Bal c/f 500,000	Jan 15 Purchases 500,000
500,000	

Feb 1 Bal b/f 500,000

Johns A/C

Jan 31	Bal c/f	300,000	Jan 29	Purchases	300,000
		300,000			300,000
			Feb 1	Bal b/f	300,000

Similarly, the balance in the creditors account in the General ledger (800,000) should always be equal to the total of all individual creditors (i.e. of TK Ltd and John in this example) (500,000+300,000 =800,000)

Exercise

Refer to journal of Kyeswa Ltd, post to the ledgers including the general ledger and extract a trial balance

The trial balance always has to balance that is the debit side always has to be equal to the credit side as shown in the XYZ ltd trial balance above.

Failure of the trial balance to agree implies that:

- Arithmetical errors may have been committed while balancing off the accounts
- The double entry rule was not properly observed .For example if goods were sold for cash, the cash account has to be debited while the sales account credited. If the cash account is debited but the sales account is not credited the trial balance will not agree

However the trial balance can agree when there still errors that have been committed. These are referred to as errors that cannot be detected by the trial balance – trial balance will be covered in details in the later chapters.

The cashbook preparation

Introduction

Cash and Cash transactions is an important and easy area to understand in accounting and bookkeeping. Every business and indeed every person receives cash and makes payments.

All businesses and many people should keep records of all receipts and payments. It is important to note that although cash is still used, most business receipts and payments are made through the banking system.

Receipts and payments are recorded in a book called the **cashbook.** The cashbook therefore is a book in which are recorded detailed particulars of all moneys received and paid. From the beginning of the double entry bookkeeping, businesses have found that a very large number of transactions consist of receiving and paying sums of money. Originally, these transactions involved actual payment and receipt of cash. Hence the need to draw and keep a cashbook

In later times, while cash is still used, receipts and payments are also made by cheque through a bank account. Other small and few cash transactions as do happen are recorded in the petty cash book. Thus, a cashbook is now used to record bank transactions but it is still called the cashbook.

Retail transactions for instance shops are still carried out using cash or more correctly a mixture of cash and cheques. We still regard these as bank transactions as at the end of each day the retailer will count the takings (Cash, cheques) and pay the lot into the bank.

Cash Book Types

Two cashbooks types are maintained by business firms i.e.

- Main cash book
- Petty cash book

Nevertheless, generally a cashbook is maintained in a columnar format particularly in a manual accounting system. Thus a cashbook can be;

- Single column
- Two column
- Three column

Single Column Cash Book

This is a type of cashbook maintained where small business owners retain cash received for use in the business and therefore the cash received is debited in the only cash column.

Moreover, where the money is paid out from cash, the entry is credited in the only cash column.

This traditional type of cashbook is phasing out since almost every business owner operates an account with the bank. Thus giving rise to a two-column cashbook.

Two Column Cash Book

This is the most commonly used format of the cashbook. It involves recording bank and cash transactions.

Bank transactions are recorded in the bank column and cash transactions are recorded in the cash column on Debit and Credit side respectively.

Three-Column Cashbook

Where a business entity frequently allows or receives cash discount, it is usually convenient to use a three-column cashbook so as to include all the information relating to cash and balk transactions in a single book. In this Topic emphasis is more on two and three column cashbooks.

Drawing up a Cash Book

Already you have been told that in reality a cashbook is a ledger account, which for convenience and also because of the multiplicity of the entries passing through it, it's not included in the ledger, but it's bound as a separate volume.

It is important to note that cash transactions need not to be journalized because the cashbook fulfils the functions both of a ledger account and book of "original entry" in which cash transactions are recorded as they occur.

Now let us look at hypothetical example of how we design a cashbook. The example adopts a two-column cashbook.

Date	**Details**	**Cash**	**Bank**	**Date**	**Details**	**Cash**	**Bank**
2004							
Oct 1	Bal b/f		10,000	2	Rent		1000
2	Cash sales	3300		10	Purchases	4000	
3	Debtors	2500		11	Fuel	2000	
9	**Rent income**	3000		19	Telephone		1500
30	Interest Income		20,000				
				29	Payments to suppliers		1200
				31	Bal c/d	2800	26300
		8800	**30,000**			**8800**	**30,000**

Note the following: -

a) Receipts are on the left hand side and payments are on the right hand side of the cashbook.

b) On the left side of the debit and of the credit side is the date for each transaction. The cashbook is on going and may last for years, so this is very important

c) The receipts and payments could be by cash or by cheque

The Bank column contains details of the payments made by cheque and of the money received and paid into the bank account.

The bank will have a copy of the account in its own books. The bank will send a copy of the account we know as the bank statement in its books to the firm or organization. When the firm receives the bank statement, it will check it against the bank column in its own cashbook to ensure that there are no errors.

d) As receipts are entered on the debit side of the cashbook, they are subsequently posted to the credit side of the appropriate accounts in the ledger. Moreover, when payments are entered on the credit side of the cashbook, they are subsequently posted to the debit side of the appropriate ledger accounts. We do this to comply with the principle of double entry.

The details column shows the entries against each item stating the name of the account in which the completion of the double entry has taken place.

e) At the beginning of the period that is Oct 1st 2004 the balance in the bank was 10,000 and this appears on the debit side.

At times, a firm may have both cash and bank balances. They should both appear on the debit side of the cashbook at the beginning of the period. It is only on few occasions that a cashbook will have Balance brought forward on the credit side in the bank column. In addition, this is when a firm made an over draft in the previous period.

During the month, bankings were 20,000. The total in the bank would thus be 30,000 if there had been no payments out. In fact, there were payments out of 3700. You can now see that the balance left is 30,000 – 3700 = 26300. The custom is to put this on the credit side with a description; Balance c/d (Carried down). The essence is to have both debit and credit with 30,000. The procedure of finding and entering the balance at the end is called **balancing the account.**

The procedure is the same for the cash column.

f) Finally, the closing balance forms the opening balance of the next period and it is entered in the new period on the debit side.

Cash paid into the Bank

From our previous hypothetical example, the payments into the bank have been cheques received by the firm that have been banked immediately. We must now consider **cash being paid into the bank**.

A. Let us look at the position when a customer pays his account in cash, and later part of this cash is paid into the bank. The receipt of the cash is debited to the cash column on the date received, the credit entry being in the customer's personal account. The cash banked has the following effect needing action as shown.

Effect	Action
1. Asset of cash is decreased	Credit asset account, that is the cash account which is represented by the cash column in the cash book
2. Asset of bank is increased.	Debit the asset account, which is the bank account, which is represented by the bank column in the cashbook.

For example, cash receipt of 10,000 from Kato on 3rd June 2004, later followed by the banking on 5th June 2004 of 6000 of this amount. This would appear in the cashbook as follows.

Cashbook

Date	**Details**	**Cash**	**Bank**	**Date**	**Details**	**Cash**	**Bank**
2004		UGX	UGX	2004		UGX	UGX
June 3	Kato	10,000		June 5	Bank	6000	
5	Cash		6000				

The details column as we have said before shows entries against each item stating the name of the account in which the completion of the double entry has taken place. Against the cash payment of UGX 6000 appears the word "bank" meaning that the debit of UGX 6000 is to be found in the bank column, and the opposite applies.

B. Where the whole of the cash received is banked immediately, the receipt can be treated in exactly the same manner as a cheque received i.e. it can be entered directly in the bank column.

C. If the firm requires cash, it may withdraw cash from the bank. This is done by making out a cheque to pay itself certain amount in cash. The bank will give cash in exchange for the cheque over the counter.

Here is the two-fold effect and the action required.

Effect	Action
1. Asset of bank decreased	Credit asset account, i.e. the bank column in the cash book
2. Asset of cash increased.	Debit the asset account, ie the cash column in the cashbook.

For example a firm made a withdraw from the bank on 4th August 2004 of UGX.75000/=. In the cashbook, this transaction would appear as follows.

CASHBOOK

Date	**Details**	**Cash**	**Bank**	**Date**	**Details**	**Cash**	**Bank**
2004		UGX	UGX			UGX	UGX
August 4	Bank	75000		August 4	Cash		75000

Note: Both the debit and credit entries for this item are in the same book. When this happens it is known as a **contra item.**

The use of folio columns

As you have already seen, the details column in an account contains the name of the other account in which double entry completed. Any one looking through the books would therefore be able to find where the other half of the double entry was.

However, when many books are being used, just to mention the name of the other account would not be enough information to find the other account quickly. More information is needed, and this is given by using **folio columns.**

In each account and in each book being used, a folio column is added, always shown on the left of the money columns.

In this column the name of the other book, in abbreviated form and the number of the page in other book where double entry is completed is stated against each entry in the books.

An entry of receipt of cash from Kalisa whose account was on page 45 of the sales ledger and the cash recorded on page 37 of the cashbook would use the folio column thus;

In the cashbook, the folio column would appear SL45.

In the sales ledger, the folio column would appear CB 37.

By this method full cross-reference would be given. Each of the contra items being shown on the same page of the cashbook would use the letter **"C"** in the folio column.

The act of using one book as a means of entering the transaction to the other account so as to complete double entry is known as **"posting"** the items.

Example 1

Enter the following transactions into a cashbook - Year 2005 , Month of Oct

Oct. 1. Kibonge started business with cash at bank amounting to UGX 940,000

2. Received a cheque from G.W Kato worth UGX 115000
4. Cash sales 102000
6. Paid rent by cash 3500
7. Banked 50,000 of the cash held by the firm
15. Cash sales paid direct into the bank 40,000
23. Paid by cheque to S. Forks 277000
29. Withdrew cash from bank for business use 120,000
30. Paid wages in cash 118000

CASHBOOK

Date	Details	Folio	Cash	Bank	Date	Details	Folio	Cash	Bank
2005			UGX	UGX	2005			UGX	UGX
Oct 1	Capital	GL1		940,000	Oct 6	Rent	GL65	35000	
“ 2	G.W.	SL98		115000	Oct 7	Bank	C	50,000	
“ 4	Kato sales	GL	102000		Oct 23	S. Forks	PL23		277000
“ 7	Cash	87		50,000	Oct 29	Cash	C		120,000
“ 15	Sales	C		40,000	Oct 30	Wages	GL39	118000	
“ 29	Bank	GL87	120,000						
		C			Oct 30	Balances	C/d	19000	748000
			222000	**1145000**				**222000**	**1145000**
Nov 1	Balances	B/d	19000	748000					

The abbreviations used in the folio column are as follows: -

GL= General Ledger, **SL** = Sales Ledger, **C** = Contra, **PL** = Purchases Ledger

The folio column is not always an examination requirement and little emphasis is usually put on this; but very important in practical writing up of books of accounts for any organisation /firm. Let us look at the comprehensive example

Exercise

The following balances were extracted from the books of **O &M** on 31/05/2005.

Cash 5000 UGX

Bank (credit balance) 3300

During the month of June 2005, the following transactions occurred.

June 1. Bought goods on credit for UGX 6500
2. Sold goods on credit for UGX 8000
4. Received a cheque from UGX 5000 from a debtor and banked it.
7. Paid creditors UGX 1500 cash and UGX 500 by cheque
10. Rejected and returned goods worth UGX 300 to a creditor
12 A debtor rejected and returned goods worth 100/=
14. Banked UGX 1500 cash
16. Paid rent UGX 400 cash and UGX 800 by cheque and electricity UGX 250 cash
20. Withdrew UGX 1000 from the bank and put it in the cash box for payment of Cash expenses.
22. Paid UGX 2000 by cheque for retirement loan
25. Sold land inherited = from father for UGX 10,000 cash and the rest he put into the business
27. Received cash of UGX 100 and cheque of UGX 2000 from a debtor and banked both cash and cheque.
30. Used business cash UGX 300 for a social evening with his friend at a club

Required

Prepare **O&M’s** Cash Book for June 2005 properly balanced off as at 30 /6 2005.