TOPIC ONE: INTRODUCTION TO ACCOUNTING

Learning Objectives
Upon completion of this topic you should be able to:

- Define the nature and purpose of accounting
- Explain the users of financial information and their needs
- Explain accounting concepts and conventions
- Explain qualities of useful accounting information

1.1 The Nature and Purpose of Accounting

Definition Accounting is defined as the process of identifying, measuring and reporting economic information to the users of this information to permit informed judgment

Many businesses carry out transactions. Some of these transactions have a financial implication i.e. either cash is received or paid out. Examples of these transactions include selling goods, buying goods, paying employees and so many others.

Accounting is involved with identifying these transactions measuring (attaching a value) and reporting on these transactions. If a firm employs a new staff member then this may not be an accounting transaction. However when the firm pays the employee salary, then this is related to accounting as cash involved. This has an economic impact on the organization and will be recorded for accounting purposes. A process is put in place to collect and record this information; it is then classified and summarized so that it can be reported to the interested parties.

The main *purpose* of Accounting is to provide financial information about an economic entity. It provides a means where the steward reports to the owner how the funds entrusted to him are used to enhance the wealth of the business.

Business Transaction is an event which involves the transfer of money or money‘s worth of financial events. The following summarises the business transaction that a firm might have:

- Acquisition of assets from owners and other creditors
- Investing resources in assets to produce goods or services
- Using resources to produce goods and services
- Selling goods or services of the firm
- Paying those to whom money is owned
- Returning assets to owners

Difference between Book-Keeping and Accounting

Book-keeping means the recording of transactions of a business in methodical manner so that information relating to them may be quickly obtained. It intends to be mechanical and repetitive.

Accounting includes the design of accounting system, preparation of financial statements, and development of budgets, cost studies, audits, income tax work, and computer applications to accounting processes and the analysis and interpretation of accounting information as an aid to making business decision.

Types of Business Firms

- Proprietorship—a business owned by one person
- Partnership—co-owned by two or more persons
- Limited Companies—owned by investors called stockholders (The business—not the owners—are responsible for the company's obligations.)

1.2 Users of Accounting Information

Accounting information is produced in form of financial statement. These financial statements provide information about an entity financial position, performance and changes in financial position.
Financial position of a firm is what the resources the business has and how much belongs to the owners and others.
The financial performance reflects how the business has performed, whether it has made profits or losses. Changes in financial positions determine whether the resources have increased or reduced.
The users of accounting information have an interest in the existence of the firm. Therefore the information contained in the financial statements will affect the decision making process.

The following are the users of accounting information:

i. *Owners:* They have invested in the business and examples of such owners include sole traders, partners (partnerships) and shareholders (company). They would like to have information on the financial performance, financial position and changes in financial position. This information will enable them to assess how the managers of the business are performing whether the business is profitable or not and whether to make drawings or put in additional capital.

ii. *Customers:* Customers rely on the business for goods and services. They would like to know how the business is performing and its financial position. This information would enable them to assess whether they can rely on the firm for future supplies.

iii. *Managers:* The managers are involved in the day-to-day activities of the business. They would like to have information on the financial position, performance and changes in financial position so as to determine whether the business is operating as per the plans. In case the plan is not achieved then the managers come up with appropriate measures (controls) to ensure that the set plans are met.

iv. *Lenders:* Lenders are long term providers of capital to the firm. They have provided loans and others sources of capital to the business. Such lenders include banks and other financial institutions. They would like to have information on the financial performance and position of the business to assess whether the business is profitable enough to pay the interest on loans and whether it has enough resources to pay back the principal amount when it is due.

v. *Government and its agencies:* The Government is interested in the financial performance of the business to be able to assess the tax to be collected in the case there are any profits made by the business. The other government agencies are interested with the financial position and performance of the business to be able to come with National Statistics. This statistics measure the average performance of the economy.

vi. *Financial Analyst and Advisors:* Financial analyst and advisors interpret the financial information. Examples include stockbrokers who advise investors on shares to buy in the stock market and other professional consultants like accountants. They are interested with the financial position and performance of the firm so that they can advise their clients on how much is the value their investment i.e. whether it is profitable or not and what is the value. Others advisors would include the press who will then pass the information to other relevant users.

vii. *Employees:* They work for the business/entity. They would like to have information on the financial position and performance so as to make decisions on their terms of employment. This information would be important as they can use it to negotiate for better terms including salaries, training and other benefits.
They can also use it to assess whether the firm is financially sound and therefore their jobs are secure.

viii. *Members of the Public:* Institutions and other welfare associations and groups represent the public. They are interested with the financial performance of the firm. This information will be important for them to assess how socially responsible is the firm. This responsibility is in form the employment opportunities the firm offers, charitable activities and the effect of firm's activities on the environment.

ix. *Suppliers* They supply goods or services to the firm. The supplies are either for cash or credit. The suppliers would like to have information on the financial performance and position so as to assess whether the business would be able to pay up for the goods and services provided as and when the payment falls due.

1.3 Accounting Concepts and Conventions

Concepts/conventions/principles

Accounting Concepts are broad basic assumptions that underlie the periodic financial accounts of business enterprises. Examples of concepts include:

i) *The going concern concept:* implies that the business will continue in operational existence for the foreseeable future, and that there is no intention to put the company into liquidation or to make drastic cutbacks to the scale of operations.
Financial statements should be prepared under the going concern basis unless the entity is being (or is going to be) liquidated or if it has ceased (or is about to cease) trading. The directors of a company must also disclose any significant doubts about the company's future if and when they arise. The main significance of the going concern concept is that the assets of the business should not be valued at their ‗break-up' value, which is the amount that they would sell for it they were sold off piecemeal and the business were thus broken up.

ii) *The accruals concept (or matching concept):* States that revenue and costs must be recognized as they are earned or incurred, not as money is received or paid. They must be matched with one another so far as their relationship can be established or justifiably assumed, and dealt with in the profit and loss account of the period to which they relate.
Assume that a firm makes a profit of Sh.100 by matching the revenue (Sh.200) earned from the sale of 20 units against the cost (Sh.100) of acquiring them.
If, however, the firm had only sold eighteen units, it would have been incorrect to charge profit and loss account with the cost of twenty units; there is still two units in stock. If the firm intends to sell them later, it is likely to make a profit on the sale. Therefore, only the purchase cost of eighteen units (Sh.90) should be matched with the sales revenue, leaving a profit of Sh.90.
If, however the firm had decided to give up selling units, then the going concern concept would no longer apply and the value of the two units in the statement of financial position would be a break-up valuation rather than cost. Similarly, if the two unsold units were now unlikely to be sold at more than their cost of Sh.5 each (say, because of damage or a fall in demand) then they should be recorded on the statement of financial position at their net realizable value (i.e. the likely eventual sales price less any expenses incurred to make them saleable, e.g. paint) rather than cost. This shows the application of the prudence concept.

In this example, the concepts of going concern and matching are linked. Because the business is assumed to be a going concern it is possible to carry forward the cost of the unsold units as a charge against profits of the next period.

Essentially, the accruals concept states that, in computing profit, revenue earned must be matched against the expenditure incurred in earning it.

iii) *The Prudence Concept:* The prudence concept states that where alternative procedures, or alternative valuations, are possible, the one selected should be the one that gives the most cautious presentation of the business's financial position or results.

Therefore, revenue and profits are not anticipated but are recognized by inclusion in the profit and loss account only when realized in the form of either cash or of other assets the ultimate cash realization of which can be assessed with reasonable certainty: provision is made for all liabilities (expenses and losses) whether the amount of these is known with certainty or is best estimate in the light of the information available.

Assets and profits should not be overstated, but a balance must be achieved to prevent the material overstatement of liabilities or losses.

The other aspect of the prudence concept is that where a loss is foreseen, it should be anticipated and taken into account immediately. If a business purchases stock for Sh.1, 200 but because of a sudden slump in the market only Sh.900 is likely to be realized when the stock is sold the prudence concept dictates that the stock should be valued at Sh.900. It is not enough to wait until the stock is sold, and then recognize the Sh.300 loss; it must be recognized as soon as it is foreseen.

A profit can be considered to be a realized profit when it is in the form of:

- Cash
- Another asset that has a reasonably certain cash value. This includes amounts owing from debtors, provided that there is a reasonable certainty that the debtors will eventually pay up what they owe.

A company begins trading on 1 January 20X2 and sells goods worth Sh.100,000 during the year to 31 December. At 31 December there are debts outstanding of Sh.15, 000. Of these, the company is now doubtful whether Sh.6,000 will ever be paid.

The company should make a provision for doubtful debts of Sh.6,000. Sales for 20x5 will be shown in the profit and loss account at their full value of Sh.100,000, but the provision for doubtful debts would be a charge of Sh.6,000. Because there is some uncertainty that the sales will be realized in the form of cash, the prudence concept dictates that the Sh.6, 000 should not be included in the profit for the year.

iv) *Consistency concept:* The consistency concept states that in preparing accounts consistency should be observed in two respects.

a) Similar items within a single set of accounts should be given similar accounting treatment.
b) The same treatment should be applied from one period to another in accounting for similar items. This enables valid comparisons to be made from one period to the next.

v) *Business entity concept:* The concept is that accountants regard a business as a separate entity, distinct from its owners or managers. The concept applies whether the business is a limited company (and so recognized in law as a separate entity) or a sole proprietorship or partnership (in which case the business is not separately recognized by the law.

vi) *Money measurement concept:* The money measurement concept states that accounts will only deal with those items to which a monetary value can be attributed.

For example, in the statement of financial position of a business, monetary values can be attributed to such assets as machinery (e.g. the original cost of the machinery; or the amount it would cost to replace the machinery) and stocks of goods (e.g. the original cost of goods, or, theoretically, the price at which the goods are likely to be sold).

The monetary measurement concept introduces limitations to the subject matter of accounts. A business may have intangible assets such as the flair of a good manager or the loyalty of its workforce. These may be important enough to give it a clear superiority over an otherwise identical business, but because they cannot be evaluated in monetary terms they do not appear anywhere in the accounts.

vii) *Separate valuation principle:* The separate valuation principle states that, in determining the amount to be attributed to an asset or liability in the statement of financial position, each component item of the asset or liability must be determined separately.

These separate valuations must then be aggregated to arrive at the statement of financial position figure. For example, if a company‘s stock comprises 50 separate items, a valuation must (in theory) be arrived at for each item separately; the 50 figures must then be aggregated and the total is the stock figure which should appear in the statement of financial position.

viii) *Materiality concept:* An item is considered material if it‘s omission or misstatement will affect the decision making process of the users. Materiality depends on the nature and size of the item. Only items material in amount or in their nature will affect the true and fair view given by a set of accounts.

An error that is too trivial to affect anyone‘s understanding of the accounts is referred to as immaterial. In preparing accounts it is important to assess what is material and what is not, so that time and money are not wasted in the pursuit of excessive detail.

Determining whether or not an item is material is a very subjective exercise. There is no absolute measure of materiality. It is common to apply a convenient rule of thumb (for example to define material items as those with a value greater than 5% of the net profit disclosed by the accounts). But some items disclosed in accounts are regarded as particularly sensitive and even a very small misstatement of such an item would be regarded as a material error. An example in the accounts of a limited company might be the amount of remuneration paid to directors of the company.

The assessment of an item as material or immaterial may affect its treatment in the accounts. For example, the profit and loss account of a business will show the expenses incurred by he business grouped under suitable captions (heating and lighting expenses, rent and rates expenses etc); but in the case of very small expenses it may be appropriate to lump them together under a caption such as _sundry expenses‘, because a more detailed breakdown would be inappropriate for such immaterial amounts.

Example:

a) If a statement of financial position shows fixed assets of Sh.2 million and stocks of Sh.30, 000 an error of Sh.20, 000 in the depreciation calculations might not be regarded as material, whereas an error of Sh.20, 000 in the stock valuation probably would be. In other words, the total of which the erroneous item forms part must be considered.

b) If a business has a bank loan of Sh.50,000 balance and a Sh.55,000 balance on bank deposit account, it might well be regarded as a material misstatement if these two amounts were displayed on the statement of financial position as _cash at bank Sh.5,000‘. In other words, incorrect presentation may amount to material misstatement even if there is no monetary error.

ix) *Historical cost convention:* It‘s a basic principle of accounting (some writers include it in the list of fundamental accounting concepts) is that resources are normally stated in accounts at historical cost, i.e. at the amount that the business paid to acquire them. An important advantage of this procedure is that the objectivity of accounts is maximized: there is usually objective, documentary evidence to prove the amount paid to purchase an asset or pay an expense. Historical cost means transactions are recorded at the cost when they occurred.

In general, accountants prefer to deal with costs, rather than with _values‘. This is because valuations tend to be subjective and to vary according to what the valuation is for. For example, suppose that a company acquires a machine to manufacture its products. The machine has an expected useful life of four years. At the end of two years the company is preparing a statement of financial position and has decided what monetary amount to attribute to the asset.

x) *Objectivity (neutrality):* An accountant must show objectivity in his work. This means he should try to strip his answers of any personal opinion or prejudice and should be as precise and as detailed as the situation warrants. The result of this should be that any number of accountants will give the same answer independently of each other. Objectivity means that accountants must be free from bias. They must adopt a neutral stance when analysing accounting data. In practice objectivity is difficult. Two accountants faced with the same accounting data may come to different conclusions as to the correct treatment. It was to combat subjectivity that accounting standards were developed.

xi) *Realization concept:* Revenue and profits are recognized when realized. The concept states that revenue and profits are not anticipated but are recognized by inclusion in the income statement only when realized in the form of either cash or of other assets the ultimate cash realization of which can be assessed with reasonable certainty.

xii) *Duality:* Every transaction has two-fold effect in the accounts and is the basis of double entry bookkeeping.

xiii) *Substance over form:* It's the principle that transactions and other events are accounted for and presented in accordance with their substance and economic reality and not merely their legal form e.g. a non current asset on hire purchase although is not legally owned by the enterprise until it is fully paid for, it is reflected in the accounts as an asset and depreciation provided for in the normal accounting way.

Example

It is generally agreed that sales revenue should only be _realized' and so _recognized' in the trading, profit and loss account when:

a) The sale transaction is for a specific quantity of goods at a known price, so that the sales value of the transaction is known for certain.
b) The sale transaction has been completed, or else it is certain that it will be completed (e.g. in the case of long-term contract work, when the job is well under way but not yet completed by the end of an accounting period).
c) The critical event in the sale transaction has occurred. The critical event is the event after which:

    i) It becomes virtually certain that cash will eventually be received from the customer.
    ii) Cash is actually received.

Usually, revenue is _recognized'

(a) When a cash sale is made.
(b) The customer promises to pay on or before a specified future date, and the debt is legally enforceable.

The prudence concept is applied here in the sense that revenue should not be anticipated, and included in the trading, profit and loss account, before it is reasonably certain to _happen'.

Required
Given that prudence is the main consideration, discuss under what circumstances, if any, revenue might be recognized at the following stages of a sale.

(a) Goods have been acquired by the business, which it confidently expects to resell very quickly.
(b) A customer places a firm order for goods.
(c) Goods are delivered to the customer.
(d) The customer is invoiced for goods.
(e) The customer pays for the goods.
(f) The customer's cheque in payment for the goods has been cleared by the bank.

Answer

(a) A sale must never be recognized before a customer has even ordered the goods. There is no certainty about the value of the sale, nor when it will take place, even if it is virtually certain that goods will be sold.

(b) A sale must never be recognized when the customer places an order. Even though the order will be for a specific quantity of goods at a specific price, it is not yet certain that the sale transaction will go through. The customer may cancel an order, the supplier might be unable to deliver the goods as ordered or it may be decided that the customer is not a good credit risk.

(c) A sale will be recognized when delivery of the goods is made only when:

   i) The sale is for cash, and so the cash is received at the same time.
   ii) The sale is on credit and the customer accepts delivery (e.g. by signing a delivery note).

(d) The critical event for a credit sale is usually the dispatch of an invoice to the customer. There is then a legally enforceable debt payable on specified terms, for a completed sale transaction.

(e) The critical event for a cash sale is when delivery takes place and when cash is received, both take place at the same time. It would be too cautious or _prudent' to await cash payment for a credit sale transaction before recognizing the sale, unless the customer is a high credit risk and there is a serious doubt about his ability or intention to pay.

(f) It would again be over-cautious to wait for clearance of the customer's cheques before recognizing sales revenue. Such a precaution would only be justified in cases where there is a very high risk of the bank refusing to honour the cheque.

Accounting Bases

Bases are the methods that have been developed for expressing or applying fundamental accounting concepts to financial transactions and items. Examples include:

- Depreciation of Non current Assets (e.g. by straight line or reducing balance method)
- Treatment and amortization of intangible assets (patents and trade marks)
- Stocks and work in progress (FIFO, LIFO and AVCO)

Accounting Policies

Accounting policies are the specific accounting bases judged by business enterprises to be the most appropriate to their circumstances and adopted by them for the purpose of preparing their financial accounts.

1.4 Qualities of useful Financial Information

The four principal qualities of useful financial information are understandability, relevance, reliability and comparability.

Understandability: an essential quality of the information provided in the financial statements is that it is readily understandable by users. For these reason users are assumed to have a reasonable knowledge of business and economic activities and accounting.

Relevance: information has the quality of being relevant when it influences the economic decisions of users by helping them evaluate past, present or future events or confirming or correcting their past evaluations. The relevance of information is affected by its nature and materiality.

Reliability: information is useful when it is free from material error and bias and can be depended upon by users to represent faithfully that which it purports to represent or could reasonably be expected to represent. To be reliable then the information should:

a) Be represented faithfully,
b) Be accounted for and presented in accordance with their substance and economic reality and not merely their legal form,
c) Be neutral i.e. free from bias,
d) Include some degree of caution especially where uncertainties surround some events and transactions (prudence),
e) Be complete i.e. must be within the bounds of materiality and cost. An omission can cause information to be false.

Comparability: users must be able to compare the financial statements of an enterprise through time in order to identify trends in its financial position and performance. Users must also be able to compare the financial statements of different accounting policies, changes in the various policies and the effect of these changes in the accounts. Compliance with accounting standards also helps achieve this comparability.

1.5 Review Questions

Question One

Explain, with examples, each of the following terms:

- Fundamental accounting concepts
- Accounting bases
- Accounting policies

Question Two

Accounting practice depends upon the guidance provided by a number of accounting concepts, some of which are to be found in IAS 1 and/or in the conceptional framework of the International Accounting Standards Committee.
Required:

(a) Define and explain the relevance of the following accounting concepts.

- Neutrality
- Money measurement
- Accruals
- Substance over form
- Consistency (15 marks)

(b) Give two examples of situations in which there is a clash or inconsistency between two accounting concepts or conventions, and explain how the inconsistency should be resolved. (In answering this part of the question, you need not confine yourself to considering the concepts listed in part (a)) (5 marks)

Question Three

If the information in financial statements is to be useful, regard must be had to the following:

- Materiality
- Comparability
- Prudence
- Objectivity
- Relevance

Required

Explain the meaning of each of these factors as they apply to financial accounting including in your explanations one example of the application of each of them.

(4 marks for each)

Question Four

a) Explain what is meant by materiality in relation to financial statements and state two factors affecting the assessment of materiality. (4 marks)

b) Explain what makes information in financial statements relevant to use (5 marks)

c)

i) Two characteristics contributing to reliability are ‗neutrality‘ and ‗prudence‘. Explain the meaning of these two terms.

ii) Explain how a possible conflict between them could arise and how that conflict should be resolved. (5 marks)

d) One of the requirements of financial statements is that they should be free from material error. Suggest three safeguards, which may exist, inside or outside a company to ensure that the financial statements are free from material error. (6 marks)

TOPIC TWO: RECORDING BUSINESS TRANSACTIONS

2.1 Introduction

A business can be set up in two ways-

i) Owner supplying all the resources

ii) Owner supplying some of the resources and the rest being supplied by outside parties.

The two cases bring out the *accounting equation* also called book- keeping equation

Case one: owner supplying all the resources

In this case we say that-

Resources in the business = Resources supplied by the owner**…………… (i)**

Resources in business are called *assets* and resources supplied by the owner are called *capital*

Therefore equation (i) can be re -written as-

ASSETS = CAPITAL

Case two: resources supplied by owner and outside parties

In this case we say that-

Resources in business = Resources supplied by the owner + Resources supplied by out- side parties… .... (ii)

The new term in the equation is *resources supplied by out side parties*, in accounting, we call them *liabilities.*

Therefore equation (ii) can be re-written as-

ASSETS = CAPITAL + LIABILITIES……………………………………………………………………………**(ii)**

2.2 Components of accounting equations

Assets: An asset is a resource controlled by a business entity/firm as a result of past events for which economic benefits are expected to flow to the firm.
An example is if a business sells goods on credit then it has an asset called a debtor. The past event is the sale on credit and the resource is a debtor. This debtor is expected to pay so that economic benefits will flow towards the firm i.e. in form of cash once the customers pays.
Assets are classified into two main types:

i) Non current assets (formerly called fixed assets).
ii) Current assets.

Non current assets are acquired by the business to assist in earning revenues and not for resale. They are normally expected to be in business for a period of more than one year. Major examples include

- Land and buildings
- Plant and machinery
- Fixtures, furniture, fittings and equipment
- Motor vehicles

Current assets are not expected to last for more than one year. They are in most cases directly related to the trading activities of the firm. Examples include:

- Stock of goods – for purpose of selling.
- Trade debtors/accounts receivables – owe the business amounts as a resort of trading.
- Other debtors – owe the firm amounts other than for trading.
- Cash at bank.
- Cash in hand.

Liabilities: These are obligations of a business as a result of past events settlement of which is expected to result to an economic outflow of amounts from the firm. An example is when a business buys goods on credit, then the firm has a liability called creditor. The past event is the credit purchase and the liability being the creditor the firm will pay cash to the creditor and therefore there is an out flow of cash from the business.

Liabilities are also classified into two main classes.

i) Non-current liabilities (or long term liabilities)
ii) Current liabilities.

Non-current liabilities are expected to last or be paid after one year. This includes long-term loans from banks or other financial institutions. Current liabilities last for a period of less than one year and therefore will be paid within one year.

Major examples:

- Trade creditors or accounts payable – owed amounts as a result of business buying goods on credit.
- Other creditors - owed amounts for services supplied to the firm other than goods.
- Bank overdraft - amounts advanced by the bank for a short-term period.

Capital: This is the residual amount on the owner's interest in the firm after deducting liabilities from the assets.

2.3 Double Entry Aspects

The Accounting equation forms the basis of double entry and therefore it should always be maintained. Any change in assets, liabilities or capital will have a double effect such that assets will always be equal to liabilities plus capital. If the owners put in additional capital then this will increase the cash at bank and the capital amount therefore the equation is still maintained.

Name

Debit Credit

Date	Detail	Folio	Amount	Date		Detail	Folio	Amount

In this account the date will show the opening period of the asset, liability or capital i.e. the balance brought forward. It will also show the date when a transaction took place (i.e. either an asset was bought or liability incurred).

The detail column (also called the particulars column) shows the nature of the transaction and reference to the corresponding account. The Folio Column for purposes of detailed recording shows the reference number of the corresponding account. The amount column shows the amount of the asset, liability or capital.

The left side of the account is called the debit side and the right side is called the credit side. All assets are shown or recorded on the debit side while all the liabilities and capital are recorded on the credit side. Each type of asset or liability must have its own account whereby all transactions affecting them are recorded in this account. Therefore there should be an account for Premises, Plant and Machinery, Stock, Debtors, Creditors etc.

Under the accounting equation if all assets are represented by liabilities and capital therefore all debits should be the same as credits.

For the double entry to be reflected in the accounts, every debit entry must have a corresponding credit entry. The transactions affecting these accounts are posted in the account as debit entry and credit entry to complete the double entry.

When we make a debit entry we are either:

i. Increasing the value of an asset.
ii. Reducing the value of a liability.
iii. Reducing the value of capital.

When we make a credit entry we are either:

i. Reducing the value of an asset.
ii. Increasing the value of a liability.
iii. Increasing the value of capital.

Example 4.2
H Jumps has the following assets and liabilities as on 30 November 2002:
Creditors Sh.39,500; Equipment Sh.115,000; Motor vehicle Sh.62,900; Stock Sh.61,500; Debtors Sh.57,700;Cash at bank Sh.72,800 and Cash in hand Sh.400.

Compute the balance on the capital account as at 30 November 2002.

During the first week of December 2002, Jump:

a. Bought extra equipment on credit for Sh.13,800.
b. Bought extra stock by cheque Sh.5,700.
c. Paid creditors by cheque Sh.7,900.
d. Received from debtors Sh.8,400 by cheque and Sh.600 by cash.
e. Put in an extra Sh.2,500 cash as capital.

You are to record the above transactions in respective accounts.

Answer:
Capital = Assets – Liabilities

Assets	Sh.	Liabilities	Sh.
Equipment	115,000	Creditors	39,500
Motor vehicle	62,900		
Stock	61,500		
Debtors	57,700		
Cash at bank	72,800		
Cash in hand	400		
	371,300		

Capital = Sh.371, 300 - Sh.39, 500 = Sh.330, 800

Creditors A/C
a/c

2002	Sh.B	2002		Sh.
Bank	7900	1.12	Bal b/d	39,500
1.12 Bal c/d	31,600			
	39,500			39,500

Motor Vehicles

2002		Sh.	2002		Sh.
1.12	Bal b/d	62,900	1.12	Bal c/d	62,900
		62,900			62,900

Equipment a/c

2002		2002	Sh.
Sh.			
1.12 Bal b\d	115,000		
Creditors	13,800	7.12 Bal c\d	
		128,800	
128,800		128,800	

Stock a/c

2002		2002	Sh.
Sh.			
1.12 Bal b\d	61,500		
Bank	5700	7.12 Bal c\d	67,200
67,200		67,200	

Debtors a/c

2002		2002	Sh.
Sh.			
1.12 Bal b\d	57,700	Bank	8,400
		Cash	600
Bank	570	7.12 Bal c\d	48,700
57,700		57,700	

Cash at Bank a/c

2002		2002	
Sh.		Sh.	
1.12 Bal b\d	72,800	Stock	5,700
		Creditors	7,900
Debtors	8,400	7.12 Bal c\d	67,600
81,200		81,200	

Cash in hand a/c

2002		2002	
Sh.		Sh.	
1.12 Bal	b\d		
400			
Debtors	600		
Capital	2500	7.12 Bal c\d	3500
3500		3500	

Capital

2002		Sh.	2002		Sh.
			1.12	Bal b\d	330800
7.12	Bal b\d	333300		Cash	2500
		128,800			128,800

Creditors Of Equipment

2002		Sh.	2002		Sh.
7.12	Bal b\d	13800		Equipment	13800
		13,800			13,800

Example 5.2

Write up the asset, capital and liability accounts in the books of M Crash to record the following transactions:

2002		
June	1	Started business with Sh.50,000 in the bank.
–	2	Bought motor van paying by cheque Sh.12,000.
–	5	Bought Fixtures Sh.4,000 on credit from Office Masters Ltd.
–	8	Bought a van on credit from Motor Cars Ltd Sh.8,000.
–	12	Took Sh.1,000 out of the bank and put it into the cash till.
–	15	Bought Fixtures paying by cash Sh.600.
–	19	Paid Motor Cars Ltd by cheque Sh.8000.
–	21	A loan of Sh.10,000 cash is received from J Marcus.
–	25	Paid Sh.8,000 of the cash in hand into the bank account.
–	30	Bought more Fixtures paying by cheque Sh.3,000.

Capital a/c

2002		Sh.	2002		Sh.
30/6	Bal c/f	50,000	1/6	Bank	50,000
		50,000			50,000

Cash at bank a/c

2002		Sh.	2002		Sh.
1/6	Capital	50,000	2/6	Van	12,000
12/6	Cash	8,000	12/6	Cash	1,000
			19/6	Motor ltd	8,000
			30/6	Fixtures	3,000
			30/6	Bal c/f	34,000
		58,000			58,000

Motor Van

2002	Sh.	Sh.	
2/6	Bank		
12,000			
8/6	Super M	30/6	Bal c/f
8,000		20,000	
20000		20000	

Fixtures

2002	Sh.	2002	Sh.
5/6young			
4,000			
15/6	Cash		
600			
30/6	Bank	Bal c/f	7,600
3000			
7,600		7,600	

Motor Car Ltd – Creditors

2002	Sh.	2002	Sh.
19/6	Bank	8/6 Van	8000
8000			
8000		8000	

Office Masters Ltd - Creditor

2002	Sh.	2002	Sh.
30/6 B\f	4000	8/6 Fixtures	4000
4000		4000	

Cash in hand

2002	Sh.	2002	Sh.
12/6	Cash	15/6	Cash
1,000		600	
		25/6 Bank	800
21/6 J. Marcus	10000	30/6 Bal c/f	2400
11000		11000	

J. Marcus - Loaner

2002	Sh.	2002	Sh.
30/6 c\f	10000	21/6 Cash	10000

Note that the difference between the debit side and the credit side is the balancing figure. Most assets will have a balance on the credit side and most liabilities and capital accounts will have a balance on the debit side.

2.6 Accounting for Sales, Purchases, Incomes and Expenses.

Sales: This is the sell of goods that were bought by a firm (the goods must have been bought with the purpose of resale). Sales are divided into cash sales and credit sales. When a cash sale is made, the following entries are to be made.

i. Debit cash either at bank or in hand.
ii. Credit sales account.

For a credit sale:

i. Debit debtors/ Accounts receivable account.
ii. Credit sales account.

A new account for sales is opened and credited with cash or credit sales.

Buying (*Purchases:)* of goods meant for resale. Purchases can also be for cash or on credit. For cash purchases:

i. Debit purchases.
ii. Credit cash at bank/cash in hand

For credit purchases, we:

i. Debit purchases.
ii. Credit creditors for goods.

A new account is also opened for purchases where both cash and credit purchases are posted. *Note*: no entry is made into the stocks account.

Incomes:

A firm may have other incomes apart from that generated from trading (sales). Such incomes include:

- Rent
- Bank interest
- Discounts received.

When the firm receives cash, from these incomes, the following entries are made:

- Debit cash in hand/at bank.
- Credit income account.

Each type of income should have its own account e.g. rent income, interest income.

Incomes increase the value of capital and that is the reason why they are posted on the credit side of their respective accounts.

Expenses: These are amounts paid out for services rendered other than those paid for purchases. Examples include:

- Postage and stationery
- Salaries and wages
- Telephone bills

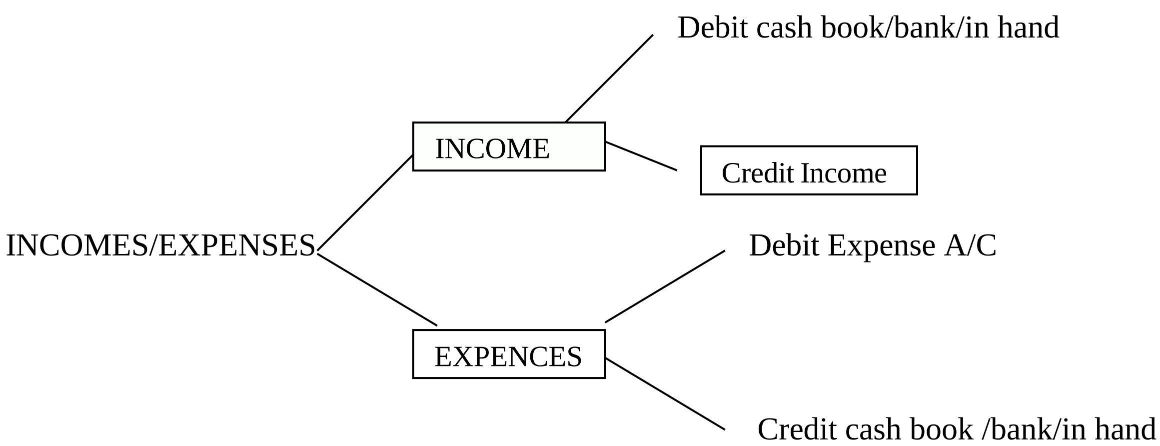
- Motor vehicle running expenses.
- Bank charges.

When a firm pays for an expense, we:

i. Debit the expense account.
ii. Credit cash at bank/in hand.

Each expense should also have its own account where the corresponding entry will be posted. Expenses decrease the value of capital and thus the posting is made on the debit side of their accounts.

The following diagram is a simple summary of the entries made for incomes and expenses.



2.7 Returns Inwards and Returns Outwards.

Returns Inwards: These are goods that have been returned by customers due to various reasons e.g.

i. They may be defective/damaged,
ii. Being of the wrong type.
iii. Excess goods being delivered.

Goods returned may relate to cash sales or credit sales. For the goods returned in relation to cash sales and cash is refunded to the customer the following entries are made:

i. Debit returns – inwards
ii. Credit cashbook.

For goods returned that relate to credit sales; no cash has been given to customer, the following entry is to be made.

i. Debit returns inwards.
ii. Credit debtors.

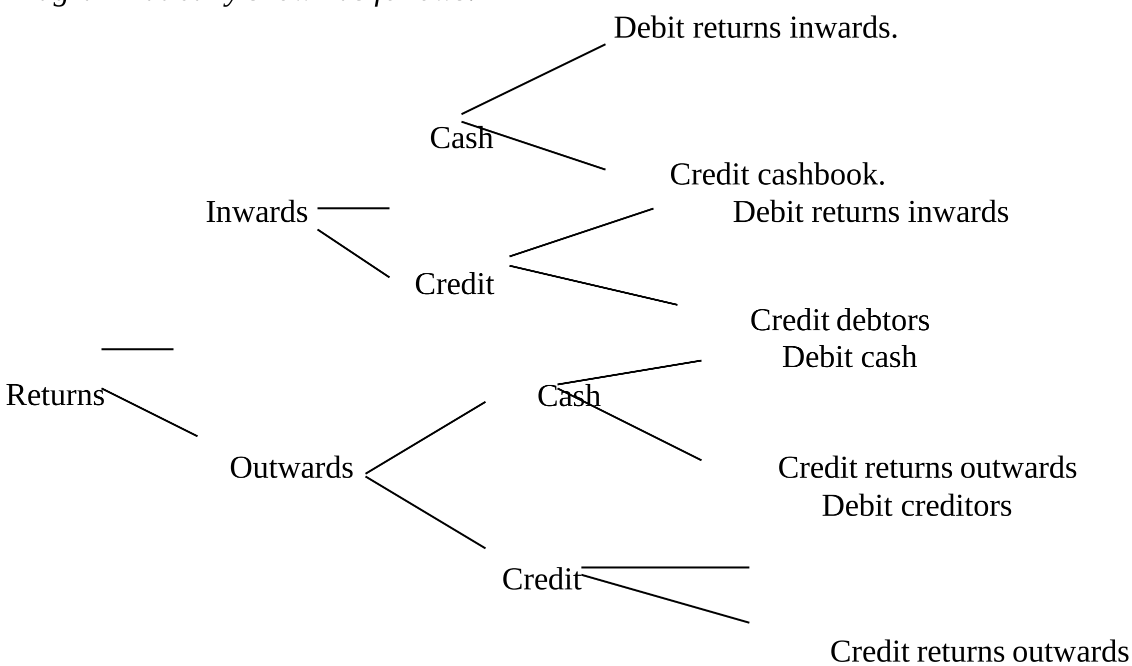
Returns Outwards: These are goods returned to suppliers/creditors. They may be for cash purchases or for credit purchases. For cash purchases a cash refund given to the firm by the supplier,

i. Debit the cashbook (cash at bank/hand).
ii. Credit returns outwards.

For credit purchases and no refund has been made:

i. Debit creditors.
ii. Credit returns outwards.

Diagrammatically shown as follows:



Now lets us take one example that includes most of the above transactions.

Example 6.2

You are to enter the following transactions, completing the double entry in the books for the month of May 2002.

2002		
May	1	Started business with Sh.2,000 in the bank.
–	2	Purchased goods Sh.175 on credit from M Rooks.
–	3	Bought furniture and fittings Sh.150 paying by cheque.
–	5	Sold goods for cash Sh.275.
–	6	Bought goods on credit Sh.114 from P Scot.
–	10	Paid rent by cash Sh.15.
–	12	Bought stationery Sh.27, paying in cash.
–	18	Goods returned to M Rooks Sh.23.
–	21	Let off part of the premises receiving rent by cheque Sh.5.
–	23	Sold goods on credit to U Foot for Sh.77.
–	24	Bought a motor van paying by cheque Sh.300.

— 30 Paid the month‘s wages by cash Sh.117.
— 31 The proprietor took cash for himself Sh.44.

Solution

Bank a/c

2002		Sh.	2002		Sh.
1/5	Capital	2,000	3/5	Furn& fitting	150
			24/5	Motor vehicle	300
21/5	Rent	5	31/5	Bal c/f	1,555
		2,005			2,005

Capital a/c

31/5	Bal c/f	2,000	1/5	Bank	2,000

Purchases a/c

2002		Sh.	2002		Sh.
2/5	M Rooks	175			
6/5	P Scot	114	31/5	Bal c/f	289
		289			289

Creditor – M Rooks a/c

2002		Sh.	2002		Sh.
18/5	Returns in	23	2/5	Purchases	175
31/5	Bal c/f	152			
		175			175

Furniture & Fittings a/c

2002		Sh.	2002		Sh.
3/5	Bank	150	31/5	Bal c/f	150
		150			150

Sales a/c

2002			Sh.	2002			
31/5	Bal c/f	352	5/5	Cash	275		
			23/5	U. Foot	77		
		352			352		

Cash in hand a/c

2002		Sh.	2002		Sh.
5/5	Sales	275	10/5	Rent	15
Sh.					
			12/5	Stationery	27
			30/5	Wages	117
			31/5	Bal c/f	116
		275			275

P Scot a/c

2002		Sh.			2002
31/5	Bal c/f	114	6/5	Purchases	114
		114			114

Expenses – Rent a/c

2002		Sh.	2002		Sh.
Sh.					
1/5	Bal c/f	15	10/5	Cash	15

Expenses – Stationery a/c

2002			Sh.	2002	
12/5	Cash	27	31/5	Bal c/f	27
		27			27

Returns – Out a/c

2002		Sh.	2002		Sh.
Sh.					
31/5	Bal c/f	23	18/5	M Rooks	23
5					

Income – Rent a/c

2002		Sh.		2002
21/5	Bal c/f	5	31/5	Bank

Debtors – U Foot a/c

2002		Sh.	2002		Sh.
23/5	Sales		31/5	Bal c/f	77

Motor vehicle a/c

2002		Sh.	2002		Sh.
24/5	Bank	300	31/5	Bal c/f	300

Expenses – Wages a/c

2002		Sh.	2002		Sh.
30/5	Cash	117	31/5	Bal c/f	117

Drawings a/c

2002		Sh.	200		Sh.
31/5	Cash	44	31/5	Bal c/f	44

2.8 Accounting for Drawings, Discounts Allowed and Discounts Received.

Drawings The owner makes drawings from the firm in various ways:

i) Cash or bank withdrawals
When the owner withdraws money from the business we debit drawings and credit cashbook (cash in hand or cash at bank).

ii) Taking goods for own use and
When the owner takes out some of the goods for his own use, we debit drawings and credit purchases.

iii) Personal expenses, paid by the business
Here we debit the drawings and credit expense account

Taking some of the other assets from the business e.g. motor vehicles or using part of the premises.
Sometimes the owner may take over some of the assets of the business e.g. vehicle or converting business premises into living quarters or not paying into the business cash collected personally from the customers. When this happens we debit drawings and credit the relevant asset e.g. motor vehicles, premises or some building or even debtors.

Discounts
Discounts received.
A discount received is an allowance by the creditors to the firm to encourage the firm to pay the amount dues within the agreed time. It is an amount deducted from the invoice price.
When a discount is given by the supplier then we debit creditor's account and credit discounts received e.g. A. Ltd sells some goods on credit to B Ltd.Sh.1,000 under the terms of sale, B Ltd, will receive a discount of 5% if they pay the amount due within one month. B decides to take up the offer and pays the amount within the given time. B will record the transaction as follows.

Debit: Creditor – A Ltd
Credit: Discounts Received

Creditor A. Ltd a/c

2002	Sh.	2002	Sh.
Bank	950	Purchases	1,000
Disc received	50		
	1000		1000

Purchases a/c

2002	Sh.	2002	Sh.
A Ltd	1,000		

Discounts Received a/c

200	Sh.	2002	Sh.
Bal c/f	50	A Ltd	50

Bank a/c

2002	Sh.	2002	Sh.
		A Ltd	950

Discounts Allowed

These are the allowances made by a firm on the amounts receivable from the customers to encourage prompt payment. The amounts deducted from the sales invoice. In the previous example when A Ltd issued the discount and was taken up by B the entries will be:

i. Debit - discount allowed
ii. Credit - debtors - B Ltd.

Debtors B Ltd a/c

2002	Sh.	2002	Sh.
Sales	1,000	Bank	950
		Discount	50
	1,000		1,000

Sales a/c

2002	Sh.	2002	Sh.
		Debtor	1,000

Discount allowed a/c

2002	sh.	2002	Sh.
Debtor	50	Bal c/f	50

Bank a/c

2002	Sh.		Sh.
Debtor	950		

2.9 Trial Balance

The trial balance is a simple report that shows the list of account balances classified as per the debits and credits. The purpose of the trial balance is to show the *accuracy of the double entries* made and to *facilitate the preparation of final accounts* i.e. the trading, profit & loss account and a statement of financial position.

The debits of the trial balance should be the same as the credits; if not then there is an error in one or more of the accounts.

The trial balance in example 1.8 would be extracted as follows:

Name

Trial balance as at 31 May 2002		
	Debit	Credit
	Sh.	*Sh.*
Rent – income		5
Debtor – U Foot	7	
Motor vehicle	300	
Bank	1555	
Purchases	289	
Wages	117	
Capital		2000
Creditor – M Rooks		152
Furniture & Fittings	150	
Sales		352
Cash in hand	72	
Creditor – P Scot		114
Expenses – Rent	15	
Expenses – Stationery	27	
Returns Outwards		23
Drawings	44	.
	2464	2464

From the trial balance please note that assets and expenses are on the debit side. Capital, liabilities and incomes are normally listed on the credit side.
The next example is a detailed one that shows extracting of trial balance once all the postings have been made in the relevant accounts.

Example7.2
Write up the following transactions in the books of S Pink:
2003

March	1	Started business with cash Sh.1,000.
–	2	Bought goods on credit from A Cliks Sh.296.
–	3	Paid rent by cash Sh.28.
–	4	Paid Sh.1,000 of the cash of the firm into a bank account.
–	5	Sold goods on credit to J Simpson Sh.54.
–	7	Bought stationery Sh.15 paying by cheque.
–	11	Cash sales Sh.49.
–	14	Goods returned by us to A Cliks Sh.17.
–	17	Sold goods on credit to P Lutz Sh.29.
–	20	Paid for repairs to the building by cash Sh.18.

– 22 J Simpson returned goods to us Sh.14.
– 27 Paid A Cliks by cheque Sh.279.
– 28 Cash purchases Sh.125.
– 29 Bought a motor vehicle paying by cheque Sh.395.
– 30 Paid motor expenses in cash Sh.15.
– 31 Bought fixtures Sh.120 on credit from R west.

Solutions

Capital a/c

2003	Sh.	2003	Sh.
31/3 bal c/d	1,500	1/3 Cash	1,500

Cash in hand a/c

2003	Sh.	2003	Sh.
1/3 Capital	1,500	3/3 Rent	28
1/3 Sales	49	4/3 Bank	1,000
		20/3 Repairs	18
		28/3 Purchases	125
		30/3 Motor exp.	15
		31/3 Bal c/d	363
	1,549		1,549

Purchases a/c

2003	Sh.	2003	Sh.
2/3 Hanson	296	31/3 Bal c/d	421
28/3 Cash	125		
	421		421

Creditors – A Cliks ac

2003	Sh.	2003	Sh.
14/3 Returns out	17	2/3 Purchases	296
27/3 Bank	279		
	296		296

Rent –Expenses a/c

2003	Sh.	2003	Sh.
3/3 Cash	28	31/3 Bal c/d	28

Bank a/c

2003	Sh.	2003	Sh.
3 Cash	1,000	5/3 Stationery	15
		27/3 A. Hanson	279
		29/3 Motor van	395
		31/3 Bal c/d	311
	1,000		1,000

Debtor – J Simpson a/c

2003		Sh.	2003		Sh.
3/3	sales	54	22/3	Returns in	14
			31/3	Bal c/d	40
		54			54

Sales a/c

2003		Sh.	2002		Sh.
31/3	Bal c/d	132	5/3	JSimpson	54
			11/3	Sales	49
			17/3	P Lutz	29
		132			132

Stationery a/c

2003		Sh.	2003		Sh.
7/3	Bank	15	31/3	Bal c/d	15

Returns outwards a/c

2003		Sh.	2003		Sh.
/3	Bal c/d	17	14/3	A Cliks	17

P Lutz – Debtor a

2003		Sh.	2003		Sh.
17/3	Sales	29	21/3	Bal c/d	29

Building repairs - expenses

2003		Sh.	2003		Sh.
20/3	Cash	18	31/3	Bal c/d	18

Returns - Inwards

2003		Sh.	2003		Sh.
22/3	J Simpson	14	31/3	Bal c/d	14

Motor vehicle

2003		Sh.	2003		Sh.
29/3	Bank	395	31/3	Bal c/d	395

R West – Creditor (others)

2003		Sh.	2003		Sh.
31/3	Bal c/d	120	31/3	Fixtures	120

Motor expenses

2003		Sh.	2003		Sh.
30/3	Cash	15	31/3	Bal c/d	15

Fixtures

2003	Sh.	2003	Sh.
31/3 A. Webster	120	31/3 Bal c/d	120

Pinks
Trial Balance As At 31 March 2003

	Debit (Sh.)	Credit (Sh.)
Capital		1500
Purchases	421	
Cash in hand	363	
Bank	311	
Rent expense	28	
Sales		132
Fixtures	120	
Debtor – J Simpson	40	
Debtor – P Lutz	29	
Motor vehicle	395	
Creditors	-	-
Motor expenses	15	
Returns inwards	14	
Creditors others – R West		120
Stationery	15	
Returns outwards		17
Building repairs	18	-
	1769	1769

question
The following transactions took place during the month of May:

2003
May1 Started firm with capital in cash of Sh.250.
— 2 Bought goods on credit from the following persons: R Kelly Sh.54; Pcombs Sh.87;
J Role Sh.25; D Mobile Sh.76; I. Sims Sh.64.
— 4 Sold goods on credit to: C Blanes Sh.43; B Long Sh.62; F Skin Sh.176.
— 6 Paid rent by cash Sh.12.
— 9 C Blanes paid us his account by cheque Sh.43.
— 10 F Skin paid us Sh.150 by cheque.
— 12 We paid the following by cheque: J Role Sh.25; R Kelley Sh.54.
— 15 Paid carriage by cash Sh.23.

- 18 Bought goods on credit from P Combs Sh.43; Mobile Sh.110.
- 21 Sold goods on credit to B Long Sh.67.
- 31 Paid rent by cheque Sh.18.

Question Three

Brian Barmouth is a sole trader. At 30 June 2000 the following balances have been extracted from his books:

	Sh.
Sales	47,600.00
Purchases	22,850.00
Office expenses	1,900.00
Insurance	700.00
Wages	7,900.00
Rates	2,800.00
Heating and Lighting	1,200.00
Telephone	650.00
Discounts allowed	1,150.00
Opening stock	500.00
Returns inwards	200.00
Returns outwards	150.00
Premises	40,000.00
Plant and Machinery	5,000.00
Motor Vehicles	12,000.00
Debtors	12,500.00
Bank balance	7,800.00
Creditors	3,400.00
Loan-long term loan	10,000.00
Capital	60,000.00
Drawings for the year	4,000.00
Closing stock	550.00

Required: Prepare a trial balance, from the above li t of balances.

TOPIC 3: SOURCE DOCUMENTS AND BOOKS OF ORGINAL ENTRY

Learning Objectives:

Upon completion of this chapter you will be able to

- Identify the main data sources and records in an accounting system
- Describe the content and purpose of different types of business documentation
- Record transactions using the day books
- Post day books totals to the ledgers accounts
- Explain division of the ledger accounts

3.1 Definition and Purpose

A book of original entry is a book of record in which transactions are recorded as they occur on a daily basis and in a chronological order, before they are posted to the relevant accounts in the ledger. These books are also known as books of prime entry as transactions are first recorded in them before they are posted to the accounts in the ledger.

Information from source documents is first recorded in such books before being posted to the ledger. These books act as aid to the ledger in respect of certain transactions which cannot be posted directly to the ledger. They are minor or subsidiary to the ledger which remains the main book of account.

3.2 Source Documents

This shows the evidence transactions. They are collected, filed and posted in the books of prime entry. Example, if a firm sells goods on credit, then an invoice is raised. The source documents as shown in the above include:

- Sales invoice
- Purchases invoice
- Credit note
- Debit note
- Receipts, cheques and petty cash vouchers
- Other correspondences.

(i) Sales Invoice

The sales invoice is raised by the firm and sent to the debtor/customer when the firm makes a credit sale.

The sales invoice contains the following:

i. Name and address of the firm
ii. Name and address of the buying firm
iii. Date of making the sale – invoice date.
iv. Invoice number
v. Amount due (net of trade discount)
vi. Description of goods sold

vii. Terms of sale

(ii) Purchases Invoice

A purchase invoice is raised by the creditor and sent to the firm when the firm makes a credit purchase. It shows the following:

i. Name and the address of the creditor/seller
ii. Name and address of the firm
iii. Date of the purchase (invoice date)
iv. Invoice number
v. Amount due
vi. Description of goods sold
vii. Terms of sale

(iii) Credit note

A credit note is raised by the firm and issued to the debtor when the debtor returns some goods back to the firm. It‘s contents include:

i. Name and address of the firm
ii. Name and address of the debtor
iii. Amount of credit
iv. Credit note number
v. Reason for credit e.g. if goods sent but of the wrong type.

The purpose of the credit note is to inform the debtor or customer that the debtor‘s account with the firm has been credited i.e. the amount due to the firm has been reduced or cancelled.

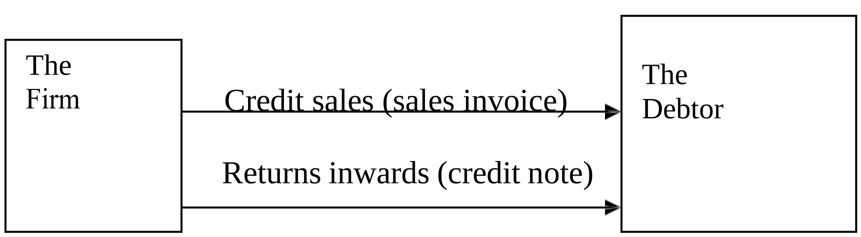
The credit note may also be issued when the firm gives an allowance of the amounts due from the debtors. From the context we can assume that all credit notes are issued when goods are returned.

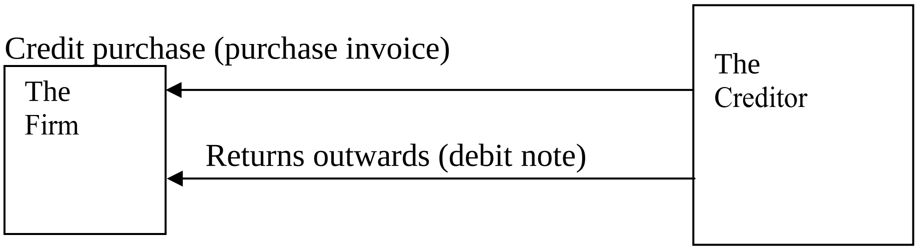
(iv) Debit note

This is raised by the creditor and issued to the firm when the firm returns some goods to the creditor. It includes the following items:

i. Name and address of the firm
ii. Name and address of the creditor
iii. Amount of debit
iv. Debit Note number
v. Reason for the debit

The purpose of the debit note is to inform the firm that the amount due to the creditor has been reduced or cancelled.





(vi) Receipts

A receipt is raised by the firm and issued to customers or debtors when they make payments in the form of cash or cheques. It shows:

i. The name and address of the firm
ii. The date of the receipt
iii. Amount received (cash or cheque or other means of payment)
iv. Receipt number.

Cheques

When a firm opens a current account with the bank, a chequebook containing cheques issued. The cheques allow the firm to make payments against the account with the bank. When a firm issues a cheque to its creditors for payments, it authorizes the bank to honour payments against the firm‘s account with the bank. The cheque contains the following information:

i. Name and account number of the firm (account holder)
ii. The date of the cheque
iii. Name of the payee (creditor)
iv. Name of the firm‘s bank
v. Amount payable in words and figures
vi. The cheque number
vii. The authorized signature(s)

Petty cash vouchers

A petty cash voucher is raised by a cashier to seek authority for payments (payments of small value in the firm which require cash payments e.g. fuel, bus-fare, office snacks), which is approved by a senior manager and filed for record purpose. It shows:

i. Date of payment
ii. Amount paid
iii. Reason for payment
iv. Authorized signature(s):
v. Person approving
vi. Person receiving

The person receiving the money must then return a document supporting how the money was utilized e.g. fuel receipt, bus ticket e.t.c.

(vii) Other correspondence

These include information received within or outside the firm that has a financial implication in the accounts.

Examples are:

i. Letters from the firm's lawyers about a debtors balance.
ii. Hire-purchase/credit sale or credit purchase agreements that relate to non-current assets.
iii. Memorandum from a senior manager requiring changes to be made in the accounts.
iv. Bank statement from the bank, e.g. bank charges.

3.3 Books of Prime Entry

They record the source documents.

Sales Journal

It is also called a Sales Day Book. It records all the sales invoices issued by the firm during a particular financial period. The format is as follows (with simple records of invoice).

Sales Journal			Page 5
Date 19x 8	Detail	Folio	Amount Sh.
1st March	S.Spikes	SL.10	200
3rd March	T.Binns	SL.19	350.00
5th March	L.Thompson	SL.8	150.00
Total			700.00

The individual entries in the sales journal are posted to the debit side of the debtor's accounts in the sales ledger and the total is posted on the credit side of the sales account in the general ledger.

This is shown below:

Sales Ledger **General Ledger**

S Spikes

19x8		Sh.	19x8	Sh.
1/3	Sales	200		

General Account

19x8	Sh.	19x8		Sh.
		5/3	Credit sales for period	700

Sales Ledger

T Binus

19x8		Sh.	19x8
3/3	Sales	350	

L Thompson

19x8		Sh.	19x8	Sh.
3/3	Sales	150		

Example 1.3

You are to enter up the sales journal from the following details. Post the items to the relevant accounts in the sales ledger and then show the transfer to the sales account in the general ledger.

2003			
Mar	1	Credit sales to J Gordon	Sh.1,870
–	3	Credit sales to G Abrahams	Sh.1,660
–	6	Credit sales to V White	Sh.120
–	10	Credit sales to J Gordon	Sh.550
–	17	Credit sales to F Williams	Sh.2,890
–	19	Credit sales to U Richards	Sh.660
–	27	Credit sales to V Wood	Sh.280
–	31	Credit sales to L Simes	Sh.780

Answer

Sales Journal			Page 10
Date (2003)	Detail	Folio	Amount
1st March	J. Gordon		1,870.00
3rd March	G.Abrahams		1,6660.00
6th March	V.White		120.00
10th March	J. Gordon		550.00
17th March	F.Williams		2,890.00
19 March	U. Richards		660.00
27th March	V.Wood		280.00
31st March	L.Simes		780.00
			8,810.00

Sales Ledger

J Gordon

2003		**Sh.**	**2003**		**Sh.**
1/3		1570			
10/3		550			

U Richards

2003		**Sh.**	**2003**		**Sh.**
19/3	Sales	660			

G Abrahams

2003		Sh.	2003		Sh.
3/3	Sales	1,660			

V Wood

2003		Sh.	2003		Sh.
27/3	Sales	280			

U White

2003		Sh.	2003		Sh.
6/3	Sales	120			

L Simes

2003		Sh.	2003		Sh.
31/3	Sales	750			

F Williams

2003		Sh.	2003		Sh.
17/3	Sales	2890			

Sales a/c

2003		Sh.	2003		Sh.
				Credit Sales	

Purchases Journal

Purchases journal is also called a purchases day-book. It records all the purchase invoices received by the firm during a particular financial period. It has the following format (including records of invoices).

Purchase Journal			**Page 15**
DATE 19x 6	Description/Detail	Folio	Amount
1st May	C.Kelly	PL.10	400
2nd May	L.Smailes	PL.20	350
Total			750

The individual entries in the purchases journal are posted to the credit side of the creditor's accounts in the purchases ledger and the total is posted to the debit side of purchases account of the general ledger. This is shown below:

C Kelly

19x6	Sh.	19x6		Sh.
		1/5	Purchases	400

Purchases a/c

19x6		Sh.	19x6	Sh.
31/5	Sundry Creditors	750		

L Smailes

19x6	Sh.	19x6		Sh.
		2/5	Purchases	250

Returns Inwards Journal

It is also called the returns inwards day-book. It records all the credit notes raised by the firm and sent to customers during a particular financial period, it has the following format.

Returns Inwards Journal		Page 10	
Date	Detail	Folio	Amount Sh.)
1st March	S.Spikes	SL.22	20
2nd March	C.Kelly	SL.18	18
5th March	T.Bills	SL.9	15
Total			15

Individual entries in a return inwards journal are posted to the credit of the debtors accounts in the sales ledger and the total is posted to the debit side of the return-inwards account of the general ledger

Sales Ledger **General Ledger**

S. Spikes a/c

Sh.			Sh.
	1/3	Returns In	20

Returns Inwards a/c

		Sh.			Sh.
31/3	Sundry Debtors	53			

C Kelly a/c

Sh.			Sh.
	2/3	Returns In	18

T. Bills a/c

		Sh.			Sh.
			5/3	Returns In	15

Returns Outwards Journal

It is also called the returns outwards daybook. It records all the debit notes received by the firm from the creditors during a particular financial period. It has the following format.

Returns outwards journal			
Date	Detail	Folio	Ampunt(Sh)
2nd May	L.Thompson	PL.15	14
3rd May	M.Hyatt	PL.10	12
4th May	T.Bills	PL.7	19
Total			35

Individual entries are posted on the debit side of the creditors account in the purchases ledger and on the total to credit side of the returns outwards account in the general ledger.

Purchases Ledger **General Ledger**

L. Thompson a/c

		Sh.			Sh.
2/5	Returns out	14			

Returns Outwards a/c

		Sh.			Sh.
			31/5	sundry creditors	35

M. Hyatt a/c

		Sh.			Sh.
3/5	Returns out	12			

T. Bills a/c

		Sh.			Sh.
4/5	Returns Out	19			

question

You are to enter the following items in the books, post to personal accounts, and show transfers to the general ledger.

2023

July 1 Credit purchases from: K Hill Sh.3800; M Norman Sh.500; N Senior Sh.106.

– 3 Credit sales to: E Rigby Sh.510; E Phillips Sh.246; F Thompson Sh.356.

5 Credit purchases from: R Morton Sh.200; J Cook Sh.180; D Edwards Sh.410; C Davies Sh.66.

– 8 Credit sales to: A Green Sh.307; H George Sh.250; J Ferguson Sh.185.

– 12 Returns outwards to: M Norman Sh.30; N Senior Sh.16.

– 14 Returns inwards from: E Phillips Sh.18; F Thompson Sh.22.

– 20 Credit sales to: E Phillips Sh.188; F Powell Sh.310; E Lee Sh.420.

– 24 Credit purchases from: Ferguson Sh.550; K Ennevor Sh.900.

– 31 Returns inwards from: E Phillips Sh.27; E. Rigby Sh.30.

– 31 Returns outwards to: J Cook Sh.13; C Davies Sh.11.

TOPIC 5: ERRORS AND CORRECTION

Learning Objectives

Upon completion of this topic you should be able to:

- Discover and correct errors that do not affect the balancing of the trial balance
- Discover and correct errors that affect the balancing of the trial balance

5.1 Errors that do not affect the 'balancing' of Trial Balance

The trial balance produced from the accounts appears to be okay/correct, i.e the debits are the same as the credits. However, on taking a close check on the balances and transactions posted, errors may have been made and therefore the balances shown on the trial balance may be incorrect i.e. under/over stated.

There are 6 main types of errors that don‘t affect the trial balance and these are explained as follows:

a) Error of omission

Here, a transaction is completely omitted from the accounts and therefore the double entry is not made e.g. a sales invoice of Sh.400 is not posted in the sales journal therefore no entry is made in the debtor‘s account and the sales account i.e. both debit of Sh.400 in debtor‘s account and credit of Sh.400 in the sales account.

The effect of the error is understates both the debtors and the sales.

To correct this error, the transaction is posted in the books by:

Debiting debtors	Sh.400
Crediting sales	Sh.400

b) Error of Commission

This error occurs when a transaction is posted to a wrong account but the account is of the same class. Example: a credit sale to T Thompson is posted to L Thompson‘s account for an amount of Sh.200. Instead of a debit to T Thompson‘s account it is made to L Thompson‘s account and the corresponding credit in the sales account is correct.

Although the debit entry is made into the wrong account, the two accounts are of the same class i.e. debtors.

To correct this error a transfer is made from L Thompson‘s account to T Thompson by:

		Sh.
(i)	Debit T Thompson a/c	200
(ii)	Credit L Thompson a/c	200

c) Error of principle

In this type of error a transaction is posted not only to the wrong account but also of a different class e.g. Motor vehicle purchased for Sh.400 is posted to the motor vehicle expenses a/c. (Instead of debiting motor vehicles, we debited motor vehicle expenses a/c and the credit entry in the cashbook is correct)

The motor vehicles account is a non-current asset, and motor vehicles expenses a/c is an expense account. Therefore a capital expenditure has been posted as revenue expenditure.

To correct this error a transfer is made from the motor expenses account to the motor vehicles a/c by:

		Sh.
(i)	Debit Motor vehicles a/c	400
(ii)	Credit Motor expenses a/c	400

d) Complete reversal of entries

A transaction is posted to the correct accounts but to the wrong sides of the accounts i.e. a debit is posted as a credit and a credit is posted as a debit. Example: cash drawn from the bank of Sh.150 for business use is posted as a debit in the bank account and credit in cash in hand.

To correct this error, two entries are made in the relevant accounts:

(i) Correct the error
(ii) Post the transaction correctly

The entries will therefore be as follows:

(i)	Debit Cash in hand by	Sh.150
	Credit bank by	Sh.150

To correct the error of Sh.150 posted in the wrong sides of these account

(ii)	Debit cash by	Sh.150
	Credit bank by	Sh.150

To post the entries correctly

e) Error of Original entry

Here a transaction is posted to the correct accounts but the amount posted is not correct i.e. it is either under/over stated. In some cases, this is known as a transposition error e.g. cash received from a debtor of Sh.980 is credited/posted to the customer‘s account as Sh.890.

To correct this error, the amount understated or overstated is posted to these accounts to reflect the correct balance. In this case, we will:

Sh.

Debit cash book 90
Credit debtors 90

f) Compensating Errors

These are errors that tend to cancel out each other i.e. if the effect of one error is to understate the debits or credits then another error may take place to overstate the debits or credits by the same amount, hence canceling out each other. E.g. if the balance c/d of the purchases a/c is Sh.3,980 but shown in the trial balance as Sh.3,890 and another error carried to the trial balance of fixture amounting to Sh.4,540 instead of Sh.4,450:

	Sh.
Purchases	3,980
	3,890
	(90)
	Sh.
Fixtures	4,450
	(4,540)
	90

This type of error is corrected by use of a suspense account.

Example 5.1

Give the journal entries needed to record the corrections of the following. Narratives are required.

a) Extra capital of Sh.10, 000 paid into the bank had been credited to Sales account.
b) Goods taken for own use Sh.700 had been debited to General Expenses.
c) Private insurance Sh.89 had been debited to Insurance account.
d) A purchase of goods from C Kelly Sh.857 had been entered in the books as Sh.587.
e) Cash banked Sh.390 had been credited to the bank column and debited to the cash column in the cashbook.
f) Cash drawings of Sh.400 had been credited to the bank column of the cashbook.
g) Returns inwards Sh.168 from M McCarthy had been entered in error in J Charlton‘s account.
h) A sale of a motor van Sh.1, 000 had been credited to Motor Expenses.

Solution

The Journal

	Debit	Credit
Sales	10,000	
Capital		10,000
Additional capital passed into sales a/c now transferred to capital a/c		
Drawings	700	
General expenses		700
Drawings debited in general expense now transferred to drawing a/c		

Drawings	89	
Insurance		89
Private insurance transferred from insurance a/c to drawings a/c		
Purchases	270	
C Kelly		270
Purchases and creditors amount to 857 initially entered as Sh.587		
Bank	390	
Cash		390
Correct error in posting		
Bank	390	
Cash		390
To post the cash banked correctly		
Bank	400	
Cash		400
Cash drawings correctly started from bank to cash		
J Charlton	168	
M McCarthy		
Returns in from McCarthy entered in error in J Carlton now transferred to his		168
a/c	1000	
Motor expenses		1000
Motor disposal a/c		
To correct error in recording sales proceeds In expense account		

5.2 Errors that affect the 'balancing' of Trial Balance and Suspense Account

These types of errors are reflected on the trial balance because the debits will not be same as the credits. The debits may be more than the credits and vice versa.
Examples include:

1. Transaction is posted on one side of the accounts i.e. only a debit entry or a credit entry. Example cash received from a debtor is debited to the cashbook and no other entry is made in the account, i.e. no credit entry on the debtor's a/c.
2. A transaction is posted on one side of both the accounts i.e. two debits or two credits. Example a payment to a creditor of Sh.300 is credited in the cashbook and also credited in the creditor's accounts.
3. A transaction is posted correctly but different amounts i.e. debit is not the same as the credit. Example – cash received from a debtor of Sh.450 is debited in the cashbook as Sh.450 and credited as Sh.540 in the debtor's a/c.
4. Error on balances of accounts – i.e. understatement or overstatement of an account balance due to mathematical errors.

5. Balance on an account is shown on the wrong side of the account when opening the ledger accounts or when taken up to the trial balance. Example Bal c/d in the cash book for cash at bank of Sh.2000 is shown as a credit i.e. an overdraft, instead of a debit in the trial balance. The balance may also be brought down as an overdraft instead of a debit balance in the trial balance.
6. A balance is omitted from the trial balance on the accounts in total.

To correct the above errors, the appropriate or the adjusting entries are made through an account called a suspense account.
The difference in the accounts is posted to this account and the entries to correct the accounts are posted here. The balance to be shown on the suspense accounts depends on which side the error is shown on the trial balance.

If the debits > credits, then an amount is included on the credit side of the trial balance so that the debits = credits. This is a credit balance and will be taken to the suspense account on the credit side.

Example 5.2

	DR	CR
Total	240	200
Suspense	-	40
	240	240

Suspense a/c

	Sh.		Sh.
		Difference as per T/B	40

If the credits are more than the debits this is a debit balance and therefore we require an amount to be added to the total of the debits for the two side to be same. This debit balance is posted to the debit side of the suspense a/c.

	DR	CR
Total	260	300
Suspense	40	-
	300	300

Suspense a/c

	Sh.		Sh.
Difference as per T/B	40		

Posting the correct entries should eliminate the balance on the suspense account.

In some cases, after checking for all errors that can affect the trial balance, the suspense a/c has a balance. This balance depends on whether it is a credit or debit and whether it is material or not for purposes of proper accounting treatment. The following is the recommended approach:

Balance	Material	Not Material
Debit	Show as an asset (eg) other debtors	Charge in P& L as an expense
Credit	Show as a liability (eg) other creditors	Report as income in P&L

Example 5.3
A bookkeeper extracted a trial balance on 31 December 2002 that failed to agree by Sh.3, 300, a shortage on the credit side of the trial balance. A suspense account was opened for the difference.
In January 2003 the following errors made in 2003 were found:

(i) Sales daybook had been undercast by Sh.1, 000.
(ii) Sales of Sh.2, 500 to J Church had been debited in error to J Chane account.
(iii) Rent account had been undercast by Sh.700.
(iv) Discounts received account had been under cast by Sh.3, 000.
(v) The sale of a motor vehicle at book value had been credited in error to Sales account Sh.3, 600.

You are required to:

a) Show the journal entries necessary to correct the errors.
b) Draw up the suspense account after the errors described have been corrected.

Journal Entries

	Sh.	Sh.
Suspense	1,000	
Sales		,1000
Sales under cast of Sh.100 now corrected		
J Church	2,500	
J Chane		2,500
Sale to J Church posted to J Chane corrected		
Rent	700	
Suspense		700
Under cast in rent balance now corrected		
Suspense	3,000	
Discount received		3,000
Under cast in discount received balance now corrected		
Sales a/c	3,600	
Disposal		,3600
Sale of motor vehicle entered in sales a/c now corrected		

Suspense a/c

	Sh.		Sh.

Sales	1,000	Bal b/d	3,300
Discount received	3,000	Rent	700
	4,000		4,000

5.3 Review Question

Question one

The statement of financial position of N Patel, a sole trader, as at 31 March 2000 was as follows:

	Sh'000	Sh'000		Sh'000	Sh'000
Capital 1 April 1999		1,890	Land and buildings (at valuation)		1,650
Profit for the year ended 31 March 2000	450		Machinery (at cost)	1,200	
Deduct: drawings	150	300	Deduct: depreciation	750	450
Creditors		630	Stock at cost	570	
Bank overdraft		270	Debtors	420	990
		3,090			3,090

Further investigation reveals the following information:

1. The closing stock includes damaged goods which, although they had cost Sh. 10,000 have an estimated sale value of Sh.7, 500.
2. Debtors include Sh. 20,000 in respect of a customer who has gone bankrupt. A provision for doubtful debts of 2 ½% is also required on the balance of the debtors.
3. The machinery was acquired five years ago and is being depreciated to its scrap value on a straight-line basis over eight years. A more realistic estimate indicates that the life span will be 10 years.
4. Wages owing at 31 March 2000 amounted to Sh. 9,500 but this has not been reflected in the accounts.
5. Charges for the bank overdraft, amounting Sh 8,000 have not been reflected in the accounts.
6. In arriving at the profit for the period, a drawing of Sh 100,000 paid to Mr. Patel had been deducted as an expense.
7. Sh 20,000 rent owing to Mr. Patel for the letting of part of his business premises to external party had not been received and no entry had been made in the books in respect of this item.

Required:

a) Journal entries to correct errors and omissions. (10 marks)

TOPIC 6: FINAL ACCOUNTS

Learning Objectives

Upon completion of this topic you should be able to:

- Explain the importance of income statement and balance sheet
- Prepare an income statement and balance sheet
- Distinguish between capital and revenue expenditure

7.1 Income Statements

(a) Trading Account

The trading account summarises the trading activities (sale and purchase of goods/stocks) of the business and tries to determine the gross profit for the relevant financial period. The gross profit is then taken up in the profit and loss account as part of the income.

Format for the trading account:

Name

Trading Account for the year ended 31 Dec.

	Sh.		Sh.		Sh.
Sales					x
Less: Returns Inwards					(x)
					x
Less: Cost of Sales					
Opening stock	x				
Purchases	x				
Add: Carriage Inwards		x			
	x				
Less: Returns Outwards		x		x	
Cost of stock available for sale				x	
Less: Closing stock			x		(x)
Gross Profit					x

Example: 7.1

From the following details draw up the trading account of Springs for the year ended 31 December 2002, which was his first year in business.

	Sh.
Carriage inwards	6,700
Returns outwards	4,950
Returns inwards	8,900
Sales	387,420
Purchases	333,330

Stock of goods: 31 December 19x7	74,890

Springs
Trading Account for the year ended 31 Dec 2002

	Sh.	Sh.
Sales		387,420
Less: Returns Inwards		8,900
		378,520
Less cost of sales		
Purchases	333,330	
Add: Carriage Inwards	6,700	
	340,030	
Less: Returns outwards	4,950	
	335,080	
Less: Closing stock	74,890	260,190
Gross Profit		118,330

Example 7.2

The following details for the year ended 31 March 2003 are available. Draw up the trading account of R Sings for that year.

	Sh.
Stocks: 1 April 2002	16,523
Returns inwards	1,372
Returns outwards	2,896
Purchases	53,397
Carriage inwards	1,122
Sales	94,600
Stocks: 31 March 2003	14323

Solution

R Sings
Trading Account for the year ended 31 Mar 19x8

	Sh.	Sh.	Sh.
Sales			94,600
Less: Returns Inwards			(1,372)
			93,228
Less: Cost of sales			
Opening Stock		16,523	
Purchases	53,397		
Add: Carriage Inwards	1,122		
	54,519		

Less: Returns Outwards	2,896		51,623	
Cost of goods available for sale			68,146	
Less: Closing stock		18,504		(49,642)
Gross Profit				43,586

(b) Profit and Loss Account

It shows the net profit or net loss that the business has made from all the activities during a financial period.

The net profit (or loss) is determined by deducting all the expenses from all the incomes of the same financial period.

In practice, the trading account is combined together with the net profit and loss account into one report called *comprehensive statement of income (formerly, trading, profit and loss account)* . Format is as shown below:

Name

Trading, Profit and Loss Account for the year ended 31/12/19xx

	Sh.		Sh.		Sh.	
Sales					x	
Less: Returns Inwards					x	
					x	
Less: Cost of sales						
Opening stock			x			
Purchases	x					
Add: Carriage Inwards		x				
	x					
Less: Returns Outwards		x		x		
Cost of goods available for sale				x		
Less: Closing stock			x		(x)	
Gross Profit					x	
Discount received					x	
Rent received					x	
Interest received						x
Other incomes					x	
					x	
Less: Expenses						
Carriage Outwards			x			
Discounts allowed			x			
Postage & stationary			x			
Salaries & wages				x		
Rent paid			x			
Insurance & rates			x			

Bank charges	x		
Other expenses		x	(x)
Net profit/ (loss)			x/(x)

Example 7.3

From the following trial balance of P Boones draw up statement of comprehensive income for the year ended 30 September 2002, and a statement of financial position as at that date.

	Dr	Cr
	Sh.	Sh.
Stock 1 October 19x8	23,680	
Carriage outwards	2,000	
Carriage inwards		3,100
Returns inwards	2,050	
Returns outwards		3,220
Purchases	118,740	
Sales		186,000
Salaries and wages	38,620	
Rent	3,040	
Insurance	780	
Motor expenses	6,640	
Office expenses	2,160	
Lighting and heating expenses	1,660	
General expenses	3,140	
Premises	50,000	
Motor vehicles	18,000	
Fixtures and fittings	3,500	
Debtors	38,960	
Creditors		17,310
Cash at bank	4,820	
Drawings	12,000	
Capital		126,360
	332,890	332,890

Solution

P Boones

Income Statement as at 30 September 2003

	Sh.	Sh.	Sh.
Sales			186,000
Less: Returns Inwards			(2,050)
			183,950

Less: Cost of sales

Opening stock		23,680	
Purchases	118,740		
Add: Carriage inwards	3,100		
	12,1840		
Less: Returns Outwards	3,220	118,620	
Cost of goods available for sale		142,300	
Less: Closing stock		29,460	(11,2840)
Gross Profit			71,110
Less Expenses			
Salaries & wages		38,620	
Carriage outwards		2,000	
Rent		3,040	
Insurance		780	
Motor expenses		6,640	
Office expenses		2,160	
Lighting & heating		1,660	
General expenses		3,140	(58,040)
Net Profit			13,070

7.2 Statement of Financial Position/Balance Sheet

This is a simple report that shows the assets and liabilities of the business and the capital of the owner as at a certain point in time. The format is at shown below:

Name
Statement of financial position as at 31/Dec/19xx

	Sh.	Sh.	Sh.
Non Current Assets			
Land & Buildings			x
Plant & Machinery			x
Fixtures, Furniture & Fittings			x
Motor vehicles			x
			x
Current Assets			
Stock/inventories	x		
Debtors – trade	x		
Debtors – others	x		
Cash at bank	x		
Cash at hand	x		
	x		
Current Liabilities			
Bank overdraft	x		
Creditors – trade	x		

Creditors – others	x	(x)	
Net current assets		x	
Net Assets		x	
Capital			x
Add: Net profit			x
		x	
Less: Drawings			(x)
			x
Non Current Liabilities			
Loan (s)			x
			x

The statement of financial position of P Boones in example 2.3 will be produced as follows:

P Boones
Statement of financial position as at 30 Sept 2002

	Sh.	Sh.
Non Current Assets		
Premises		50,000
Fixtures & fittings		3,500
Motor vehicles		18,000
		71,500
Current Assets		
Stock	29,460	
Debtors	38,960	
Cash at bank	4,820	
	73,240	
Current Liabilities		
Creditors	(17,310)	
Net Current Assets		55,930
Net Assets		127,430
Capital		
126,360		
Add: Net Profit		
13,070		
		139,430
Less: Drawings		(12,000)
		127,430

Questions

Question One

(a) Differentiate between the following terms as used in accounting.

(i) A debit entry and credit entry (2 marks)

(ii) Return inwards and return outwards (2 marks)

(iii) An asset account and liability account (2marks)

(iv) An expense account and revenue account (2 marks)

(v) A trail balance and a balance sheet (2 marks)

b) The following is a trial balance of ABC Ltd.

	Kshs	Kshs
Stock 1 Jan 2009	2,368,000	
Carriage inwards	200,000	
Carriage outwards	310,000	
Return outwards	205,000	
Return outwards		322,000

Purchases	11,870,000	
Sales		18,600,000
Rent	3,862,000	
Salaries & Wages	304,000	
Insurance	78,000	
Motor expenses	216,000	
Lighting and heating expenses	166,000	
General expenses	314,000	
Premises	500,000	
Motor vehicles	1,800.000	
Debtors	3,896,000	
Fixture and fittings	350,000	
Creditors		1,731,000
Cash at Bank	482,000	
Drawings	1,200,000	
Capital		8,132,000
	28,785,000	28,785,000

Stock at 30 December 2009 was Sh. 2,946,000

Required:

Draw up a income statement for the year ended 31st Dec. 2009 andstatement of financial position as at 31/12/2009. (20 marks)

Question Two

Write a two-column cash book from the following detail and balance off as at the end of the month.

2009

Oct 1: Started business with capital in cash Sh. 1,000,000

Oct 2: Paid rent by cash Sh. 100,000

Oct 3: Loan from Mary- Sh. 500,000, paid by cheque.

Oct 4: Paid B. Peter by cheque Sh. 65,000

Oct 5: Cash sales made Sh. 98,000

Oct 7: Mitter, owe of debtor paid by cash Sh.62, 000

Oct 9: Paid Den (creditor) in cash 22,000

Oct 11: Cash sales paid direct into the bank Sh. 53,000

Oct 15: George (creditor) paid as by cheque Sh. 65,000

Oct 16: Repaid Mary by cheque Sh.100, 000

Oct 19: Took Sh.50, 000 out of the cash till and paid it into the bank accounts.

Oct 22: Paid motor expenses by cheque Sh. 12,000

Oct 26: Withdrew Sh. 100,000 cash from the bank for business use.

Oct 31: Paid wages in cash Sh. 97,000.

Question Three

The following transaction to Best Sales (K) Ltd for the month of March 2009.

March 1: Started business with Sh. 800,000 in the bank.

March 2: Bought goods on credit from the following persons

Ndichu- Sh. 76,000

Omolo- Sh. 27,000

Tina- Sh. 56,000

March 5: Cash sales Sh. 87,000

March 6: Paid wages in cash Sh. 14,000

March 7: Sold goods on credits to

Emma-Sh.35, 000

Jane- Sh. 42,000

Juma- Sh. 72,000

March 9: Bought goods for cash Sh. 46,000

March 10: Bought goods on Credits from

Omolo- Sh. 57,000

Ndebu-Sh. 98,000

March 12: Paid wages in cash Sh.465, 000

March 13: Sold on credit to: Jane- Sh. 32,000

Juma- Sh. 23,000

March 15: Bought fix tires on credit from Beta Ltd Sh. 50,000

March 17: Paid Omolo by cheque Sh. 84,000

March 18: Returned goods to Ndebu Sh.20, 000

March 24: Jane returned some of goods sold to her Sh.11, 000

March 31: Bought a motor van paying by cheque Sh. 400,000

Required:

Record the above transaction in the ledger of Best Sales Ltd and balance off the account; hence forth, extract a trial balance as at 31 March 2009.

Question Four

(a) Define the following terms as used in Business.

(i) Business transactions (2 marks)

(ii) Credit transaction (2 marks)

(iii) Initial capital (2 marks)

(iv) Final capital (2 marks)

(v) Drawings (2 marks)

(b) Outline 4 circumstances under which the capital of a business may change (4 marks)

(c) The following information was extracted from the book of LIMA Ltd. For the year 2006.

(i) Initial capital as at 1/01/2006 – Sh.200,000

(ii) Made a net loss of Sh. 50,000

(iii) The proprietor invested into the business from her personal saving Sh. 600,000

(iv) The proprietor withdraw in cash for her personal use Sh. 250,000

Required:

Using the final capital formula, determine the final capital as at 31/12/06 **(**4 marks)

Question Five

Write notes on any 5 basic accounting concepts (20 marks)