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AS-Level Accounting Unit 1 Revision Notes

Mrs Carpenter- Unit 1 Accounting Revision Notes:

Purpose of Preparing Accounts:

Accounting records all financial transactions that occur during a period of time, for example the financial year. This is necessary so that the owner can control their business and control how it is performing and use the accounts to make good business decisions. It also means that the owner can:

- Provide records of information that is required by HM Revenue and Customers for tax purposes and VAT returns
- Provide records required by suppliers of additional finance, e.g. banks

Accounting Records: Subsidiary Books and Ledger Accounts:

- **Invoices-**
 - **Sales Invoices-**records sales made by the business
 - **Purchase Invoices-** record the purchases made by the business
- **Bank Statement-**Records all transactions made to or from the businesses bank account
- **Cash Book Counterfoil-**Records any payments the business had made via check

- **Paying-in Slip Counterfoil**-records any payments of cash that the business has paid into their bank account
- **Till Receipts**-Records any sales that the business has made
- **Bank Statement**-Evidence of standing orders (when a fixed payment is made each month by the business bank account under their authority), direct debits (when either a fixed or variable amount is paid by the business through their bank account) and bank charges.
- **Credit Notes**-either received by the business to keep a track of what they owe or sent out to credit customers to remind them of their balance.

Subsidiary Books-

- **General Journal**-This is used when there isn't another appropriate book of prime entry. This has six main uses: when fixed assets are purchased on a credit basis, when fixed assets are sold on credit, when a business first comes into existence, when a business finally closes, for the correction of errors and for recording inter-ledger transfers. The source documents used would be the purchase invoices for capital expenditure and sales invoices for sales of capital items.

Four Day Books:

- **Purchase Day Book**-is a list of all credit purchases made. The source documents are the purchase invoices received
- **Sales Day Book**-A list of all credit sales made. The source documents are the copy sales invoice that has been sent out to credit customers
- **Purchase Returns Day Book**-A list of all the credit notes received from suppliers. The credit notes are the source documents.
- **The Sales Returns Day Book**-This is a list of all of the goods returned to the business and a copy of their credit notes.

Verification of Accounting Records:

Creating Trial Balances:

<u>Debit</u>	<u>Credit</u>
○ Cash	○ Capital
○ Bank	○ Sales
○ Rent	○ Returns out
○ Wages	○ Trade Payables
○ Purchases	○ Loans
○ Fixed Assets	○ Discount Received
○ Returns in	○ Payments to suppliers

<ul style="list-style-type: none"> ○ Trade Receivables ○ Opening Stock ○ Discount Allowed ○ Payments by customers 	
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Preparation of Bank Reconciliation Statements:

1. Put closing balance in the new cash book
2. Put all things that appear in the bank statement but not yet in the cash book in the new cash book (on the opposite side to what it appeared in the Bank Statement)
3. Check for any errors and messed up numbers e.g. 163 instead of 136, and if there are any adjust the cash book
4. Balance up the new cash book
5. Use the new cash book balance to start the bank reconciliation statement
6. Add cheques that have gone out of cash book but not yet the bank statement (un-presented cheques)
7. Deduct cheques that have come into the cash book but not yet the bank (Lodgements)
8. Total up the Bank reconciliation statement. The balance should be the same as the original bank balance

Example of the layout of the bank reconciliation statement:

Cash book balance	100	
<u>+ Un-presented cheque</u>		
K Hill	(50)	
<u>-Un-presented Lodgements</u>		
M Burns	40	
<u>Balance</u>	<u>90</u>	-this should equal the old bank balance

Control Accounts:

Control accounts are a check for errors.

They are a summary of all of the individual accounts in the sale/purchase ledger.

Sales Ledger Control Accounts:

Opening balance always starts on debit side along with any further credit sale. Anything offsetting these amounts is on the credit side.

Example of a sales ledger control account:

Opening balance of money owed Credit Sales	Cash Payments from Customer Discounts Allowed Returns In Bad Debts Contra to Purchase Ledger Balance b/f
Balance c/d	

Purchase Ledger Control Accounts:

Opening balance always starts on the credit side along with any further credit purchases. Anything offsetting this amount goes on the debit side

Example:

Cash Payments to suppliers Discounts received Returns out Contra to sales ledger Balance b/f	Opening balance of money owed to suppliers Credit purchases
	Balance c/d

Making Entries to Eliminate Errors:

Suspense Accounts:

Suspense accounts can be used to eliminate errors. The side on the trial balance with the least should be topped up with a suspense entry.

This amount should then be entered in the suspense account on the same side that it appeared in the trial balance to allow you to see how much it is out by.

From here the suspense account will be used to correct errors in all the other accounts by debiting or crediting the incorrect amounts and doing the opposite in the suspense account. Eventually, the suspense account will balance and will no longer be needed as the trial balance will balance.

You should also make journal entries to record the corrections made, showing the changes made in each account.

Example-

Question-

1. Rent of £200 has been entered in the rates account
 2. The wages account has been under cast by £400
 3. Payment made to Tom £146 entered in cash book but not in Tom's account
 4. Payment for insurance £273 debited in cash book and credited to insurance account.
- a) Prepare journal entries to show the necessary corrections
 - b) Prepare a suspend account to correct the errors
 - c) State which side of the trial balance was larger before the discovery of the errors

Journal Entries:

1. Credit rates £200 to remove entry
Debit suspense £200
Debit Rent £200
Credit Suspense £200
2. Debit wages £400 to top it up
Credit suspense £400
3. Debit Tom £146 to pay him
Credit suspense £146
4. No effect on trial balance but
Credit cash book (double the amount of remove error) £546
Debit insurance in the same way-£546

Suspense Account

Rates	200	Rent	200
		Wages	400
Balance	546	Tom	146

Original error on trial balance. Debit side had 546 LESS or credit side had 546 MORE.

Effect of Errors on Profit Calculations:**Income Statement**

- Sales** → **if this reduces, Gross profit reduces**
- (Less returns in)** → **if this increases, Profit reduces**

Less costs of goods sold

→ this gets taken away from sales. Anything added in this section reduces profit. Anything Taken Away in this section increases profit.

Opening Inventory

+purchases

+carriage in

- Returns out

- closing stock

Gross Profit

Less Expenses

→ if these increase Net profit decreases.

Net profit

Things that don't affect profit:

- Purchase of asset-Fixed Asset
- The cash Book
- Capital
- Creditor + Debtors

Limitations of Trial Balances and Control Accounts:Trial Balances-

- The six invisible errors
- Only gives condensed information about each account
- It doesn't give information about whether a profit or loss has been made, or about the financial situation of the business at the end of the financial period.
- it does allow checking for errors in total and can allow the cash book and other ledgers to be checked.

Control Accounts-

- Lack of details as it is only a summary account but it does allow checking for errors in total and can allow the cash book and other ledgers to be checked.
- The six invisible errors cannot be identified
- If there are errors in any of the documents or accounts used to make this account, the information in the account will also be wrong.

Errors Not Visible on the Trial Balance:

COPROC

Compensating Errors-these cancel each other out if there is the same wrong amount on each side of two different accounts, it will not be visible. Example- if rent was overstated by £100, but it was also recorded in the Cash book as £100 too much.

Omission- when a transaction is completely missed from the ledgers. £100 of sales was completely missed from the ledgers.

Principle-Same as commission but completely the wrong class of account. This will affect profit. A vehicle costing £23,500 is posted to the motor expenses account. Both profit and fixed assets will be understated by £23,500.

Reversal of Entries-when the correct amount figures and accounts are used but both entries are on the wrong side of each account meaning that they balance. £70 of goods were purchased from P Smith and P Smith was debited with £70 and the purchase account was credited with £70.

Original Entry-When the wrong amount is entered to start with. For example, £167 instead of £176.

Commission-when the correct amount is entered on the correct side of a wrong, but similar account. This type of error will not affect profit. If £600 Rent was paid, and the Rates account was debited with £600.

Trading and profit and loss accounts and balance sheets including simple adjustments:

The Business Equation:

$$\text{Capital (Total money invested)} + \text{-Liabilities} = \text{Assets}$$

Credit Sales:

1. Enter Details in Sales Day Book
2. **Debit** individual Customer's Account
3. **Credit** Sales account

Later when they pay:

4. **Debit** Cash Book
5. **Credit** Customer's account to offset what they owe.

Credit Purchases:

1. Enter details in purchase day book
2. **Credit** Suppliers Account
3. **Debit** purchases account

Later when you pay

4. **Credit** Cash Book
5. **Debit** Suppliers Account

Example of an Income Statement Layout:**Income Statement for X for the year ending XXXX**

	£	£
Sales		
Less Returns In		
Less Costs of Goods Sold		
Opening Inventory		
+ Purchases		
- Returns Out		
- Closing Inventory		
Gross Profit		

	XXXXXXX
	(XX)
	XXXXX
XX	
XXX	
(X)	
(XX)	
	(XX)
	XXX
(X)	
	(X)
	XX

Balance Sheet Example

Balance Sheet for X as at 31st March XXXX

	£	£	£
Fixed Assets:			
Van	XXXXX	(XX)	XXX
Current assets:			
Trade Receivables	XX		
Prepayment	X		
Bank	XX		
		XXXXX	
Current Liabilities:			
Trade Payables	XX		
Accruals		(XXX)	
			XX
			XXXXX
Long Term Liabilities			(XXX)
Bank Loan			XX
Balancing Figure-			
Represented By:	XXX		
Capital	XX		
+Profit	(XXX)		
- Drawings			XX
Balancing Figure-			

- Returns In-Deducted from Sales at the very top

- Returns Out-Show Returns Out Deducted From Purchases Under Costs of Goods Sold
- Carriage In-Add to purchases in costs of goods sold section
- Carriage Out-Include as an expense
- Discount Received-Add to Gross Profit
- Discount Allowed-Include as an expense
- If the owner takes stock for their own use-deduct from purchases under costs of goods sold
- Provision for Bad Debts-Add decrease for this year to Gross Profit or include increase for this year as an Expense
- Accrual-add to Relevant expense
- Prepayment-Deduct from relevant expense
- Depreciation-include this year's amount as an expense
- For bad debt written off, include as an expense

Balance Sheet Adjustments:

- Accrual-Include as a current liability
- Prepayment-include as a current asset
- Depreciation-take all years depreciation including this years away from cost value of the relevant fixed asset, showing it across the 3 columns
- Provision for bad debts-show the whole new provision deducted from trade receivables in current assets.

Depreciation:

The loss of value of fixed assets due to:

- Usage/wear and tear
- Passage of time
- Depletion (Not-Complete)
- Obsolescence (Out of Date)

There are two main methods of depreciation:

1. Straight line method-when you take off the same amount every year from your asset. Usually a % of the original cost
2. When you deduct as % of the latest value each year. This method is more realistic as it properly reflects the way assets lose value.

Provision for Depreciation Account:

Used to record the amount written off each year and shows the total depreciation to date.

Credit provision for depreciation with New Year's amounts

Debit income statement as an expense.

Selling a Fixed Asset:

If a profit is made on the sale:

Debit disposals account to make it balance

Credit income statement- add to Gross Profit

Is a Loss is made on the Sales:

Credit disposals to make it balance

Debit income statement- add as an expense