CHAPTER 1
RECORDING TRANSACTION

LEARNING OBJECTIVE

I. ACCOUNTING AND EQUATION
II. ASSETS, LIABILITIES, REVENUE AND EXPENSES
III. THE BASIS OF DOUBLE ENTRY BOOKKEEPING
IV. CREDIT TRANSACTION
V. ACCOUNTING FOR SALE TAX/VALUE ADDED TAX (VAT

I. ACCOUNTING AND EQUATION

Accounting:

Accounting records a business's transactions to produce financial statements such as income statement (IS) and statement of financial position (SFP).

Accounting Equation:

Asset = Capital + Liabilities

Or Capital = Asset – liabilities

e.g.

Bank + Inventory = Capital + Liability

3,000$ + $2,000= $5,000 + 0

II. ASSETS, LIABILITIES, REVENUE AND EXPENSES

Assets:

An asset is a resource controlled by the entity as a result of past events and from which economic benefits are expected to flow to the entity (an inflow cash or other assets).

There are two kinds of asset, current assets and non-current assets.

Current assets are assets that will be sold or consumed within the business's operating cycle. Normally this means that they will turned into cash within 12 months.For example, inventory, trade receivable, cash, bank…

Non-current assets are assets that are not current assets. For example, property or machinery used by a business over many accounting periods.

II. ASSETS, LIABILITIES, REVENUE AND EXPENSES

Liabilities:

A liability is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.

There are two kind of liabilities.

Current liabilities are liabilities that must be settled within 12 months. These include trade payable, bank overdraft…

Non-current liabilities are liabilities that do not need to be settled for a least one year.

Capital:

Capital represents the owner’s net investment in the business.

Capital = capital introduced + profit – drawing

Drawing:

Drawings are any amounts taken out of the business by the owner for their own personal use. Drawing can include money taken out, goods for personal use or personal expenses.

II. ASSETS, LIABILITIES, REVENUE AND EXPENSES

Revenue:

Revenue normally consists of sales (less sales returns).

Sales are the proceeds from the sale of goods and services. It is reported net of sales tax.

Expenses:

Expenses are the costs incurred by the business in the course of trading.

The following expenses.

- ✓ Cost of sale/cost of goods sold
- ✓ Overheads or expenses: all administration, selling and distribution costs
- ✓ Finance cost on loans and overdrafts.

III. THE BASIS OF DOUBLE ENTRY BOOKKEEPING

Debit entries record	Credit entries record
Increases in assets	Increases in capital
Expenses	Increases in liabilities
Drawings	Sales and other income
Decreases in liabilities	Decreases in assets

III. THE BASIS OF DOUBLE ENTRY BOOKKEEPING

Journal Entries as follows

Setting up a business (Day1)

Debit:	Bank	5,000
Credit:	Capital	5,000

Buying inventory for bank (Day2)

Debit:	Purchases	2,000
Credit:	Bank	2,000

Borrowing Money and buy van (Day3)

Debit:	Bank	4,000
Credit:	Loan	4,000
Debit:	Non-current assets	4,000
Credit:	Bank	4,000

Sold goods and expense (Day 4)

Debit:	Cash in hand	3,500
Credit:	Sales	3,500
Debit:	Expenses	480
Credit:	Cash in hand	480

Drawing(Day5)

Debit:	Drawing	350
Credit:	Bank	350

III. THE BASIS OF DOUBLE ENTRY BOOKKEEPING

Individual Ledger Accounts and general ledger:

Part B Ledger accounts

Capital (SFP)

		$			$
			Day 1	Bank	5,000

Bank (SFP)

		$			$
Day 1	New capital	5,000	Day 2	Purchases	2,000
Day 3	Loan	4,000	Day 3	Van	4,000
			Day 5	Drawings	350

Purchases (IS)

		$			$
Day 2	Purchases	2,000			

Loan (SFP)

		$			$
			Day 3	Bank	4,000

Motor van (SFP)

		$			$
Day 3	Bank	4,000			

III. THE BASIS OF DOUBLE ENTRY BOOKKEEPING

Sales (IS)

		$			$
			Day 4	Cash in hand	3,500

Cash in Hand (SFP)

		$			$
Day 4	Sales	3,500	Day 4	Expenses	480

Expenses (IS)

		$			$
Day 4	Cash in Hand	480			

Drawings (SFP)

		$			$
Day 5	Bank	350			

III. THE BASIS OF DOUBLE ENTRY BOOKKEEPING

Balancing the ledger accounts:

Bank (SFP)

		$			$
Day 1	*New capital*	5,000	*Day 2*	*Purchases*	2,000
Day 3	*Loan*	4,000	*Day 3*	*Non-current assets*	4,000
			Day 5	*Drawings*	350
Step 1	Sub-total	9,000	Step 1	Sub-total	6,350
			Step 2	Balance carried down	2,650
Step 3	Total	9,000	Step 3	Total	9,000
Step 4	Balance brought forward	2,650			

IV. CREDIT TRANSACTION

Credit Purchases:

Debit: Purchase…………………10,000

Credit: Trade payable…………10,000

(Buy goods on credit)

Debit: Trade payable…………. 10,000

Credit: Bank/Cash……………… 10,000

(Goods are paid)

Credit Sales:

Debit: Trade receivable………..14,000

Credit: Sales……………………… 14,000

(sold goods on credit)

Debit: Bank/Cash………………….14,000

Credit: Trade receivable………… 14,000

(customer pays up)

V. ACCOUNTING FOR SALE TAX/VALUE ADDED TAX (VAT)

Sale tax in this lesson applies only for UK.

Taxable suppliers are goods sold subject to sales tax

Sales charged on sales to customers is referred to as **output tax**

Sales tax paid on purchases is referred to as **input tax**

Sales Tax Rates:

- ✓ Standard rate: 20%, the default rate
- ✓ Reduced rate: 5% on e.g. domestic fuel
- ✓ Zero rate: On e.g. food, books, newspapers and children's clothes.

Some items are exempt or outside the scope of sales tax for example, banking and exports. Businesses carrying on exempt activities can not charge sales tax on their sales and cannot reclaim sales tax on their purchases.

V. ACCOUNTING FOR SALE TAX/VALUE ADDED TAX (VAT)

E.g assume that the net selling price is $200, and tax rate is 20%.

Net amount………………200

Add tax @20%............<u>..40</u>

Gross amount……………240

Assume that the gross selling price is $750.

Gross amount…………….750

Less tax @ 20/120……<u>…(125)</u>

Net amount………………..625

Credit Sales and Sales Tax:

Dr. Trade receivable ………………7,200

Cr. Sales……………………………6,000

Cr. Sales tax………………………1,200

When customer pays the gross amount:

Dr. Cash at bank………………………7,200

Cr. Trade receivable …………………..7,200

V. ACCOUNTING FOR SALE TAX/VALUE ADDED TAX (VAT)

Credit purchases and sales tax:

Dr. Purchase ……………………….4,000

Dr. Sale tax…………………………..800

Cr. Trade payables……………….4,800

We pay total invoice amount.

Dr. Trade payables……………….4,800

Cr. Cash at bank………………….4,800