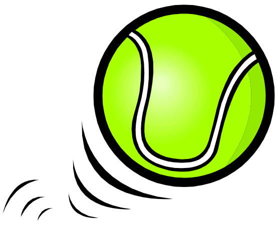
PITMAN TRAINING

Bookkeeping Transactions and Controls Part 1

Modules Section

MODULE ONE - WORK SCENARIOS

In order to create realistic scenarios when completing exercises in this course you will be working with the following companies:



I Khan, Sports Goods Dealer - trading as I K Sports

The business has a retail outlet in the High Street for individual customers but also operates a wholesale side to the business delivering sports goods to clubs and associations on a credit basis. Mr Khan is a sole-trader, however, the same principles and techniques that you will be covering in this scenario could equally apply in the case of limited companies and partnerships.

R Jones Security Installations

A company, providing security systems to commercial customers, as well as private individuals. You are employed by a local accountancy practice and visit on a monthly basis in order to maintain their accounting records.

Sound & Vision is a small company trading in DVDs and CDs – this company will be used for a consolidation exercise at the end of the course.

MODULE ONE – LEARNING OUTCOMES

By the end of this module you should be able to:

- Understand the role of the bookkeeper
- Know the difference between capital, assets and liabilities
- Understand both effects of simple transactions
- Understand the accounting equation
- Prepare a variety of balance sheets
- Distinguish between “cash” and “credit” transactions
- Identify transactions in “T” accounts

MODULE ONE – THE ROLE OF THE BOOKKEEPER

The role of a bookkeeper is to record **each and every** financial transaction entered into by a business.

In a large organisation the bookkeeper may specialise, for example only be involved with money coming in. In a small organisation, however, there may be only one person recording the flow of money **in** and **out** of the business.

Many people have an interest in the accounting records of a business, both **internally** and **externally** and this information is provided by the bookkeeper.

Internally, the bookkeeper will advise the owner how much is owed to the business, whether there are sufficient funds to pay staff wages, if the business is spending more this year than last.

Externally, HM Revenue and Customs (HMRC) need accurate bookkeeping to ensure the owner is paying the right amount of tax. Suppliers or potential investors may be making decisions based on the financial state of the business as recorded in the accounts.

The main purpose of being in business is to make a profit. Accurate bookkeeping is the first step to calculating if a profit has been made and whether the business is financially secure.

It would be impossible to see whether a profit has been made without recording any transactions. The types of transaction a business might make are:

- Buying goods (stock) to resell
- Selling goods for cash or on credit
- Buying a vehicle for use in the business
- Buying machinery for the production of goods
- Paying wages
- Borrowing money
- Paying tax to HMRC

Businesses of all sizes must prepare accounts to a common format easily understood by a variety of users. Accounting practices are duty bound by a code of professional ethics to present financial statements that give a “true and fair” view of that client’s business.

Bookkeeping is the first step towards this.

MODULE ONE - CAPITAL, ASSETS AND LIABILITIES

Capital is the amount of money owed by a business to the owner. It is often a lump sum introduced to start the business and will increase when the business makes a profit (which is owed to the owner) and decrease when the owner withdraws money.

An **asset** is something **owned** by the business.

Common examples are premises, machinery, motor vehicles, cash in the bank, money that is owed to the business by customers. In the case of a business trading in goods, unsold stock is looked upon as an asset.

Assets are traditionally analysed into two distinct types:

Fixed Assets - items that tend **not** to change in value frequently, for example, premises, machinery and motor vehicles devalue over time but on a day-to-day basis remain stable.

Current Assets - items that **can and do** vary in value frequently, for example, money in the bank and cash on the premises. The value of stock held may change from hour to hour.

A **liability** is an amount **owed** by the business

If a business buys goods from a supplier on the understanding that the debt will be settled at the end of the month, then the amount owed is treated as a liability in the accounting records of the business until the amount due is paid.

The business may have borrowed money to buy one of the assets mentioned above. The liability of the loan will be recorded and will decrease over time as each instalment of the loan is paid.

Liabilities are traditionally analysed into two distinct types:

Current Liabilities are those liabilities that the business is due to settle within the following 12 months

Long Term Liabilities are those liabilities that fall due after more than one year

The Business Entity

It is an accounting principle that the
owner and **business** are treated as **separate** entities

MODULE ONE - THE DUAL EFFECT AND DOUBLE ENTRY SYSTEM

The principle of the **double entry** system is that each transaction will be recorded **twice**; each transaction therefore has **two** separate effects on the business records.

On 1 January Mr Khan opened a business bank account and deposited £50,000

The effects of this were:

An i**ncrease** in **assets** (cash)

An **increase** in **liabilities** (owner's capital)

On 2 January Mr Khan paid a business cheque to purchase shop premises for £25,000

The effects of this were:

An **increase** in **assets** (premises)

A **decrease** in **assets** (cash)

On 3 January Mr Khan took out a loan from the bank of £12,000 over 3 years to buy a delivery van.

The effects of this were:

An **increase** in **assets** (van)

An **increase** in **liabilities** (loan)

The Accounting Equation

Assets = Liabilities + Capital

MODULE ONE - THE BALANCE SHEET

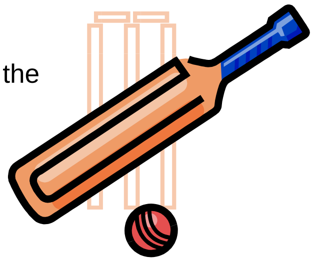
A balance sheet is a statement of the assets and the liabilities of a business at a particular time. It comes from the accounting term **'To Balance'** which means **'To Make Equal'.**

On 1 January the first transaction was the input of money by Mr Khan to start the business.

BALANCE SHEET	**1 Jan**
	£
CURRENT ASSETS	
Bank	50,000
	50,000
LIABILITIES	
CAPITAL	50,000
	50,000

When preparing the balance sheet, **assets** are analysed into two distinct sections:

Fixed Assets - items normally of a long life bought to be used in the business and not for the purpose of resale to a customer, for example, buildings, machinery, fixtures and fittings, motor vehicles. Fixed assets are listed by their life, ie the longer the life the higher it is listed in the fixed assets.



Current assets - cash, items held for resale or items that have a short life, for example, petty cash, money in the bank (bank balance), stock. Current assets are listed in order of liquidity, ie the longer an asset takes to convert into cash, the higher it is listed in the current assets.

- On 2 January **premises** were bought for £25,000

BALANCE SHEET	**2 Jan**	
	£	
FIXED ASSETS		Enter 25,000 here
Premises		
		Figure for premises is 'brought down' and entered again here
CURRENT ASSETS		
Bank		
		Total the fixed **and** current assets and enter the result
LIABILITIES		
CAPITAL		

MODULE ONE - THE BALANCE SHEET

On 3 January Mr Khan took out a loan of £12,000 over 3 years to buy a delivery van.
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BALANCE SHEET	3 Jan
FIXED ASSETS	**£**
Premises	25,000
Motor Vehicle	
CURRENT ASSETS	
Bank	25,000
CURRENT LIABILITIES	
Loan	
LONG TERM LIABILITIES	
Loan	
CAPITAL	50,000

Enter the cost of the motor vehicle here

Total both fixed assets and key in the result here

Total the fixed and current assets here

Enter the loan amounts as instructed

Current Liabilities are those liabilities that the business is due to settle within the following 12 months

Long Term Liabilities are those liabilities that fall due after more than one year

MODULE ONE - KEY TO BALANCE SHEET AS AT 3 JANUARY

BALANCE SHEET	**3 Jan**
FIXED ASSETS	**£**
Premises	25,000
Motor Vehicle	12,000
	37,000
CURRENT ASSETS	
Bank	25,000
	62,000
CURRENT LIABILITIES	
Loan	4,000
LONG TERM LIABILITIES	
Loan	8,000
CAPITAL	50,000
	62,000

Assets and Liabilities are in balance

The Accounting Equation

Assets =	62,000
Liabilities + Capital	12,000 50,000
	62,000

MODULE ONE – CASH AND CREDIT TRANSACTIONS

In a **cash transaction** the payment is made at the same time as the goods are handed over to the customer.

The term 'cash transaction' does not necessarily relate to payment in notes and coins. It is also used when immediate payment is made by cheque, debit card or other means.

In a **credit transaction** there is a period of time between the date when the goods are received and the date when payment is made. Depending on the terms of the sale this could be between 7 and 30 days. The term 'credit' or 'on credit' in this respect relates to a credit transaction.

A business buys **goods** and **services** for a number of reasons. The term **goods** includes items such as:

- Purchase of goods for resale (retail business)
- Purchase of raw materials for production of finished goods (manufacturing business)
- Purchase of items used in the running of the business, eg stationery, machinery, vans or cars

Services mainly represent items which are bought for a period of time such as:

- Insurance costs
- Electricity charges
- Telephone and internet charges

Goods purchased for later resale are known as **stock**

MODULE ONE - FURTHER TRANSACTIONS AND THE DUAL EFFECT

On 4 January Mr Khan bought goods to the value of £5,000 for re-sale from West Country Trainers, a manufacturer of trainers, on the understanding that the invoice would be paid at the end of January.
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The effects of this were:

An i**ncrease** in **assets** (stock)

An **increase** in **liabilities** (creditor)

On 5 January Mr Khan was at a sporting goods exhibition and bought 100 hockey sticks for £500 using a cheque from the business cheque book.

The effects of this were:

An i**ncrease** in **assets** (stock)

A **decrease** in **assets** (cash)

A **Creditor** (or Trade Creditor) is a supplier owed money by the business

MODULE ONE - EXERCISE ONE

On 4 January Mr Khan bought goods (stock) from West Country Trainers to the value of £5,000 **on credit.**

Complete the balance sheet to record the effect of this transaction on the business.

BALANCE SHEET	**4 Jan**
FIXED ASSETS	**£**
Premises	25,000
Motor Vehicle	12,000
	37,000
CURRENT ASSETS	
Stock	
Bank	25,000
CURRENT LIABILITIES	
Trade Creditors	
Loan	4,000
LONG TERM LIABILITIES	
Loan	8,000
CAPITAL	50,000

- Use the model answer provided in order to check your work

When **stock** is sold it will become cash
It is therefore a **current asset**

MODULE ONE - EXERCISE TWO

On 5 January Mr Khan's next transaction was to make a **cash** purchase of **stock** to the value of £500.

Using the model answer for exercise one as a guide, complete the balance sheet to show the effect of this.

BALANCE SHEET	**5 Jan**
FIXED ASSETS	**£**
Premises	
Motor Vehicle	
CURRENT ASSETS	
Stock	
Bank	
CURRENT LIABILITIES	
Trade Creditors	
Loan	
LONG TERM LIABILITIES	
Loan	
CAPITAL	

MODULE ONE - SELLING STOCK AND MAKING A PROFIT

- On 6 January Mr Khan sold stock, originally bought for £1,500, for £2,250.
- Two thirds of the total sales figure, that is £1,500, is sold for cash - **cash sales**
- One third, that is the remaining £750, is sold to Jim's Leisure Centre on credit – **credit sales**.

BALANCE SHEET	**6 Jan**
FIXED ASSETS	**£**
Premises	25,000
Motor Vehicle	12,000
	37,000
CURRENT ASSETS	
Stock	4,000
Bank	26,000
Trade Debtors	750
	67,750
CURRENT LIABILITIES	
Trade Creditors	5,000
Loan	4,000
LONG TERM LIABILITIES	
Loan	8,000
CAPITAL	50,000
Profit	750
	67,750

Profit is an amount owed to the owner of the business by the business and is a liability

A **Debtor** (or Trade Debtor) is a customer who owes money to the business

MODULE ONE - GENERAL (NOMINAL) LEDGER ACCOUNTS

- When using the double entry system each transaction will be **posted,** that is recorded, with a left hand or Debit (DR) entry to a suitable account and a corresponding entry of equal monetary value to the right hand or Credit (CR) side of another suitable account.

DR — Capital — CR

	Details	**£**	**20XX**	**Details**	**£**
			1/1	Bank	50,000

DR — Bank — CR

20XX	**Details**	**£**	**20XX**	**Details**	**£**
1/1	Capital	50,000	2/1	Premises	25,000
6/1	Sales (Cash)	1,500	5/1	Purchases (Cash)	500

DR — Premises — CR

20XX	**Details**	**£**	**20XX**	**Details**	**£**
	Bank	25,000			

DR — Motor Vehicle (Van) — CR

20XX	**Details**	**£**		**Details**	**£**
3/1	Loan	12,000			

DR — Bank Loan — CR

	Details	**£**	**20XX**	**Details**	**£**
			3/1	Van	12,000

MODULE ONE – GENERAL (NOMINAL) LEDGER ACCOUNTS

Stock purchased during the year is posted to the Purchases Account

DR — Purchases — CR

20XX	Details	£	20XX	Details	£
4/1	West Country Trainers	5,000			
5/1	Bank	500			

DR — West Country Trainers (a Creditor) — CR

	Details	£	20XX	Details	£
			4/1	Purchases	5,000

DR — Sales — CR

	Details	£	20XX	Details	£
			6/1	Bank	1,500
			6/1	Jim's Leisure Centre	750

DR — Jim's Leisure Centre (a Debtor) — CR

20XX	Details	£		Details	£
6/1	Sales	750			

MODULE ONE EXERCISE THREE - Enter your answers below:

1.	What is a **Balance Sheet**?
2.	What is the difference between a **Current Asset** and a **Fixed Asset**?
3.	A business is opened by the owner depositing £50,000 at the bank. In the accounting records what is the dual of this:
4.	What type of asset is **stock**?
5.	What is the difference between **Current Liabilities** and **Long Term Liabilities**?
6.	What is the **Accounting Equation**?
7.	Briefly describe the difference between a **cash transaction** and a **credit transaction**.
8.	What does the term **Creditor** mean?
9.	What is a **Liability**?
10.	**Stock** is bought for resale at a later date using a cheque. What is the dual effect of this?
11.	What does the term **double entry** mean?
12.	What is **Capital**?