Accounting

AS 1

Theory

Contents

|  |  |  |
| --- | --- | --- |
| Definitions………………………....... | …………………………………………………………………………………. | Pg 1 |
| Reasons………………………………… | …………………………………………………………………………………. | Pg 2 |
| Stakeholders…………………………. | …………………………………………………………………………………. | Pg 2 |
| Accounting Process………………… | …………………………………………………………………………………. | Pg 3 |
| Trial Balance……………….…………. | …………………………………………………………………………………. | Pg 4 |
| Control Accounts……………………. | …………………………………………………………………………………. | Pg 5  |
| Bank Reconciliation Statements…… | …………………………………………………………………………………. | Pg 6 |
| Dealing with Bad Debt……………. | …………………………………………………………………………………. | Pg 7 |

Definitions

Accrued Expenses

A liability for services that have already been ‘used but have not yet been paid’ (1) by the business at the end of the accounting period (1) will increase expenses in the income statement (1) and increase current liabilities in the balance sheet (1)

Current Asset

Resources (assets) that are intended to be turned into cash (1) within the next twelve months (1).

Depreciation

The apportionment of the cost (1) of a non-current asset over its useful economic life (1). The amount by which falls in value (1). The drop in value of a non-current asset (1) over a certain period of time (1). Fall in value of a non-current asset (1) due to wear and tear/obsolescence etc (1).

Direct Debit

Where authority is granted by the business (1) to a third party for fixed (1) or variable payments (1) to be made at the request of that third party (1).

Non-Current Asset

Resources (assets) held for more than one financial year (1) with a view to generating profits for the business (1). Resources not purchased primarily for resale (1).

Outstanding Lodgement

Funds (that have been debited) in the cash book (1) that have not yet been processed by the bank (1) and therefore not shown on the bank statement (1).

Prepaid Expenses

An expense that has been paid in advance (1) which relates to the next accounting period (1). Reduces expenses in the income statement (1) and increases current assets in the balance sheet (1).

Standing Order

Where a fixed (1) payment (1) is made at regular intervals (1) by the bank, on the instructions of the business (1).

Unpresented Cheque

A cheque drawn (and credited) in the cash book (1) that has not yet been processed by the bank (1) and therefore not shown on the bank statement (1).

Reasons to Keep Accurate Accounting Records

To record what has happened in the past (1) to enable the owner to produce an income statement (1) and balance sheet (1).

Based on what has happened in the past, it will enable the owner to forecast for the future (1) and produce forecast income statements and balance sheets (1) together with cash budgets (1).

It will enable the owner to monitor what has actually happened in the business (1) compared to what was forecast to happen (1) and take corrective action if necessary (1).

To enable HM Revenue and Customs (1) to collect the correct amount of income tax (1) and value added tax (1).

To enable fraud to be detected (1) by checking against external records (1) for example a bank statement, etc. (1)

To assess performance/to see how successful the business is (1) by reviewing profitability and liquidity (1).

To provide evidence to support application for finance (1) and that the business will be able to repay loan of £10 000 and interest (1).

To monitor amounts owed by the business (1) and amounts owed to the business (1)

Stakeholders in a Business

Bank (1): to ensure that they are repaid amounts due (1).

Suppliers (1): to check that they will be paid amounts due (1).

Customers (1): to check that they will be supplied with orders made (1).

Government (1): to confirm the amount of taxes due (1).

Local Community (1): to provide jobs in the local area (1).

Trade Unions (1): to ensure that Mark is offering his employees good terms and conditions (1).

Competitors (1): to compare the performance of their business against Mark’s (1).

Potential Investors (1): to check whether the business is worth investing in (1).

The Accounting Process

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Stage 1Source Documents | Sales invoices | Purchases invoices | Purchases credit note | Sales credit note |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Stage 2Subsidiary books | Sales day book | Purchases day book | Purchases returns day book | Sales return day book  |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Stage 3Ledger Account – Double Entry | Dr customer account (trade receivable) – Sales ledgerCr Sales account – General ledger | Dr Purchases account – General ledgerCr Supplier account – Purchases ledger | Dr Supplier account – Purchases ledgerCr Purchases returns account – General ledger | Dr Sales returns account – General ledgerCr Customers account – Sales ledger |

The Trial Balance

The trial balance only proves the arithmetical accuracy of the records (1) it does not prove that amounts have been posted to the correct accounts (1).

Errors Revealed by the Trial Balance

Error of Omission (1) – where both sides of the transaction have been omitted from the records (1).

Compensating Error (1) – where debit and credit errors cancel each other out (1).

Error of Commission (1) – where an amount is posted to an incorrect account of the correct type (1).

Error of Principle (1) – where an amount is posted to an incorrect class of account (1).

Error of Original Entry (1) – where an error is made transferring an amount from the source document into the book of original entry (1).

Error of Reversal (1) – where the account that should have been debited is credited and vice versa (1).

Errors Not Revealed by the Trial Balance

Transposition Error (1) – where the figures of an amount are transposed (1).

Addition Error (1) – in the trial balance itself or in a general ledger account (1).

Posting Error (1) – where one side of a transaction is posted to the wrong side of an account (1).

Partial Omission Error (1) – where one side of the transaction is not posted (1).

Unequal Posting Error (1) – where the debit side of the transaction does not equal the credit side (1).

Control Accounts

Benefits of Using Control Accounts

Verifies the balances in the ledger (1). The balance on the control account should agree with the totals of the individual accounts in the sales ledger (1). If these do not agree it indicates an error in either the sales ledger (1) or the control account (1) or both (1).

Provides up-to-date/instant management information (1) of total receivables (debtors) (1) aiding preparation of financial statements (1)

Acts as a check on staff (1) so makes it more difficult for fraud to be committed (1) because there is a division of responsibility/independent check (1)

Assists in the preparation of final accounts (1) saving time (1) by identifying total receivables (debtors) (1) to be recorded as a current asset on the balance sheet (1).

Limitations of Control Accounts

The purchases ledger control account verifies the arithmetical accuracy (1) of the ledger, but does not prove that each individual account balance is correct (1).

Errors Not Revealed by Control Accounts

Error of Omission (1): where a transaction has been completely omitted from the records (1).

Compensating Error (1): where equal and opposite errors cancel each other out (1).

Error of Comission (1): where an amount is posted to an incorrect account of the correct type (1).

Error of Original Entry (1): where an error is made transferring an amount from the source document into the book of original entry (1).Bank Reconciliation Statements

Key Definitions

Outstanding Lodgement

Funds (that have been debited) in the cash book (1) that have not yet been processed by the bank (1) and therefore not shown on the bank statement (1).

Unpresented Cheque

A cheque drawn (and credited) in the cash book (1) that has not yet been processed by the bank (1) and therefore not shown on the bank statement (1).

Reasons for Reconciling his Cash Book and Bank Statements

Enables missing entries in the cash book to be accounted for (1) preventing errors in the financial statements (1). For example, the direct debit payment to Shop Maintenance

Ltd, bank interest, bank charges and the dishonoured cheque from P Hunter (1)

Enables errors in the cash book to be identified (1) and corrected (1), preventing errors in the financial statements (1). For example the cheque received from Umar Alam (1)

Enables errors on the bank statement to be identified/investigated (1) and notified to the bank for correction (1)

Enables out-of-date cheques to be identified (1) and cancelled in the cash book (1) acts as a deterrent to fraud (1) due to the bank statement being an independent accounting record prepared by the bank (1).Dealing with Bad Debt

In the Ledger Accounts

The full amount should be treated as a bad debt (1) and be debited to bad debts account

(1) and transferred to the profit and loss account (1) and credited to the debtors control account (1).

The profit will reduce (1) by [mention figure for mark] (1) and debtors will be reduced by [mention figure for mark] (1), thus reducing the net assets of the business (1).

In the Financial Statements

The bad debt written off will appear as an expense (1) in the income statement (1).

The effect on the Page of

income statement will be that the profit for the year will be reduced (1) by

[mention figure for mark] (1).