

BOOKKEEPING TRANSACTIONS

STUDY TEXT

Qualifications and Credit Framework

AQ2016

This Study Text supports study for the following AAT qualifications:

AAT Foundation Certificate in Accounting – Level 2

AAT Foundation Diploma in Accounting and Business – Level 2

AAT Foundation Certificate in Bookkeeping – Level 2

AAT Foundation Award in Accounting Software – Level 2

AAT Level 2 Award in Accounting Skills to Run Your Business

AAT Foundation Certificate in Accounting at SCQF Level 5

British Library Cataloguing-in-Publication Data

A catalogue record for this book is available from the British Library.

Published by
Kaplan Publishing UK
Unit 2, The Business Centre
Molly Millars Lane
Wokingham
Berkshire
RG41 2QZ

ISBN: 978-1-78415-619-0

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CONTENTS

	<i>Page number</i>
Introduction	P.5
Unit guide	P.7
The assessment	P.16
Unit link to the synoptic assessment	P.17
Study skills	P.18

STUDY TEXT

Chapter

1	Business documents	1
2	Books of prime entry	41
3	Double entry bookkeeping – introduction	65
4	Ledger accounting	95
5	Accounting for credit sales, VAT and discounts	145
6	Accounting for credit purchases, VAT and discounts	165
7	Control accounts and subsidiary ledgers	183
8	Payments and receipts	231
	Mock Assessment Questions	325
	Mock Assessment Answers	345
	Index	I.1

INTRODUCTION

HOW TO USE THESE MATERIALS

These Kaplan Publishing learning materials have been carefully designed to make your learning experience as easy as possible and to give you the best chance of success in your AAT assessments.

They contain a number of features to help you in the study process.

The sections on the Unit Guide, the Assessment and Study Skills should be read before you commence your studies.

They are designed to familiarise you with the nature and content of the assessment and to give you tips on how best to approach your studies.

STUDY TEXT

This study text has been specially prepared for the revised AAT qualification introduced in September 2016.

It is written in a practical and interactive style:

- key terms and concepts are clearly defined
- all topics are illustrated with practical examples with clearly worked solutions based on sample tasks provided by the AAT in the new examining style
- frequent activities throughout the chapters ensure that what you have learnt is regularly reinforced
- 'pitfalls' and 'examination tips' help you avoid commonly made mistakes and help you focus on what is required to perform well in your examination
- 'Test your understanding' activities are included within each chapter to apply your learning and develop your understanding.

ICONS

The chapters include the following icons throughout.

They are designed to assist you in your studies by identifying key definitions and the points at which you can test yourself on the knowledge gained.



Definition

These sections explain important areas of Knowledge which must be understood and reproduced in an assessment.



Example

The illustrative examples can be used to help develop an understanding of topics before attempting the activity exercises.



Test your understanding

These are exercises which give the opportunity to assess your understanding of all the assessment areas.

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Our Quality Co-ordinator will work with our technical team to verify the error and take action to ensure it is corrected in future editions.

UNIT GUIDE

Introduction

Bookkeeping Transactions introduces students to the double-entry bookkeeping system and the associated documents and processes. Students will reach the stage of extracting an initial trial balance, before any adjustments are made. This unit provides students with the skills necessary to operate a manual double-entry bookkeeping system and provides a strong foundation for progression to more advanced manual and computerised activities.

On completion of this unit, students will be able to check the accuracy of invoices, credit notes, remittance advices, statements of account and petty cash vouchers. They will know how to use these documents to make entries in sales and purchases daybooks, sales and purchases returns daybooks, and discounts allowed and received daybooks using account codes, as well as how to transfer those totals to the sales, purchases and general ledgers.

The UK government department responsible for collecting taxes (HMRC) offers more than one method of accounting treatment when prompt payment discount (PPD) is allowed and received. However, students at Foundation level are only required to use credit notes to adjust for PPD. Using this approach, credit notes are recorded in separate daybooks, a discounts allowed daybook and/or a discounts received daybook, removing the need for discount columns in the cash book. There is no requirement at this level for learners to understand how to account for PPD by any other method.

The cash book and petty cash book are also covered in this unit, including making entries into both and transferring totals to the ledgers. Students will make appropriate checks on the accuracy of supplier invoices and credit notes, reconcile supplier statements with the purchases ledger account and calculate payments due to suppliers. They will also calculate sales invoice and credit note amounts and check receipts from customers.

This unit refers to value added tax or VAT. This is an indirect tax operating in the UK but this type of tax may also operate and be known by another name in other countries.

Bookkeeping Transactions is a mandatory unit in this qualification.

Learning outcomes

On completion of this unit the learner will be able to:

- understand financial transactions within a bookkeeping system
- process customer transactions
- process supplier transactions
- process receipts and payments
- process transactions through the ledgers to the trial balance

Scope of content

To perform this unit effectively you will need to know and understand the following:

	Chapter
1 Understand financial transactions within a bookkeeping system	
1.1 Indicate the purpose of business documents	1,8
Students need to know:	
<ul style="list-style-type: none"> • the purpose of business documents: petty cash voucher, invoice, credit note (including for PPD), remittance advice, statement of account. 	
1.2 Distinguish between prompt payment, trade and bulk discounts	1, 5, 6, 8
Students need to know:	
<ul style="list-style-type: none"> • the difference between discounts offered: prompt payment, trade and bulk • how discounts are shown on invoices: prompt payment, trade and bulk • how to use credit notes to adjust for PPD and how PPD is recorded once taken: discounts allowed or discounts received daybook, sales or purchases ledger account, general ledger discounts allowed or received account as income or expenditure, sales or purchases ledger control account, value added tax (VAT) account. 	

1.3	Demonstrate an understanding of a coding system	1
	<p>Students need to know:</p> <ul style="list-style-type: none"> • The different types of code: customer account, supplier account, product • where to use codes: sales, sales returns and discounts allowed daybooks and purchases, purchase returns and discounts received daybooks, sales and purchases ledgers • how to create codes: alphabetical, numerical, alphanumeric. 	
1.4	Demonstrate an understanding of the process of recording financial transactions	2, 3, 4, 5, 6, 7, 8,
	<p>Students need to know:</p> <ul style="list-style-type: none"> • the role of the books of prime entry: sales and sales returns daybooks, purchases and purchases returns daybooks, discounts allowed and discounts received daybooks • the role of the cash book and petty cash book: as a book of prime entry only, as a book of prime entry and as part of the double-entry bookkeeping system • the ledgers: sales, purchases and general • the accounting equation: calculation of assets, liabilities and capital, dual effect of transactions • the classification of items: assets and liabilities • the classification of income and expenditure: capital income, capital expenditure, revenue income, revenue expenditure • the purpose of the trial balance. 	

2 Process customer transactions

2.1 Calculate invoice and credit note amounts

1

Students need to know:

- the documents to be used: quotations, discount policy, customer order, delivery note, price list.

Students need to be able to:

- calculate invoice amounts: item price, net, VAT and total amounts, trade and bulk discounts
- calculate credit note amounts: item price, net, VAT and total amounts, trade, bulk and prompt payment discounts.

2.2 Enter sales invoices and credit notes into books of prime entry

2, 5

Students need to know:

- the books of prime entry: sales, sales returns and discounts allowed daybooks
- the columns within books of prime entry: customer name, customer account code, total, VAT, net, analysis (including product codes).

Students need to be able to:

- calculate VAT amounts from net and total figures
- calculate total and net amounts from the VAT figure
- make entries in books of prime entry
- total columns in books of prime entry.

2.3 Check the accuracy of receipts from customers**8**

Students need to know:

- the records and documents to use: sales ledger account, sales invoice, sales credit note, remittance advice, discount policy.

Students need to be able to:

- identify discrepancies: under- or over-payment, incorrect discount taken, incorrect amounts
- calculate amounts due from customers, including PPD.

3 Process supplier transactions**3.1 Check the accuracy of supplier invoices and credit notes****6, 8**

Students need to know:

- the documents to use: quotations including discounts, purchase orders, goods received notes, delivery notes, goods returned notes.

Students need to be able to:

- identify discrepancies that may be found: non-delivery of goods, incorrect type or quantity of goods, incorrect calculations, incorrect discounts (trade, bulk and prompt payment), date and terms of payment.

3.2 Enter supplier invoices and credit notes into books of prime entry

Students need to know:

- the books of prime entry: purchases, purchases returns and discounts received daybooks
- the columns within books of prime entry: supplier name, supplier account code, total, VAT, net, analysis (including product code).

Students need to be able to:

- calculate VAT amounts from net and total figures
- calculate total and net amounts from the VAT figure
- make entries in books of prime entry
- total columns in books of prime entry.

3.3 Prepare payments to suppliers

Students need to know:

- the records and documents to use: purchases ledger account, invoices and credit notes (including discounts and VAT), statement of account
- the information to take into account: agreed payment terms.

Students need to be able to:

- identify discrepancies between the supplier's statement of account and the purchases ledger account: timing differences, wrong amounts, missing transactions, duplicated transactions
- calculate payments due to suppliers, including PPD.

4 Process receipts and payments

4.1 Enter receipts and payments into a two column analysed cash book 2, 8

Students need to know:

- the format of the cash book: date, details, cash, bank, analysis columns (including VAT)
- the documents to use: direct debit/standing order schedule, remittance advice (including BACS), paying in slip, cheque stub, cash receipt, receipts and payments listing.

Students need to be able to:

- calculate VAT amounts from net and total figures
- make entries in the cash book.

4.2 Enter receipts and payments into an analysed petty cash book 2, 8

Students need to know:

- the format of the petty cash book: date, details, amount, analysis columns (including VAT)
- the documents to use: cash receipt, petty cash voucher.

Students need to be able to:

- calculate VAT amounts from net and total figures
- make entries in the petty cash book, including reimbursement, using the imprest and non-imprest systems.

4.3 Total and balance the cash book and petty cash book 8

Students need to be able to:

- present totals and balances: column totals, balance carried down, balance brought down, debit balance, credit balance, date and details.

5 Process transactions through the ledgers to the trial balance

5.1 Transfer data from the books of prime entry to the ledgers 5, 6, 7, 8

Students need to know:

- the books of prime entry: sales and sales returns daybooks, purchases and purchases returns daybooks, discounts allowed and discounts received daybooks, cash book, petty cash book
- the ledgers: sales, purchases, general
- that the sales and purchases ledger control accounts are part of the double-entry system.

Student need to be able to:

- transfer data from books of prime entry to the relevant accounts in the ledgers.

5.2 Total and balance ledger accounts 4

Student need to be able to:

- total and balance ledger accounts: balance carried down, balance brought down, debit balance, credit balance.

5.3 Extract an initial trial balance 4

Students need to know:

- to use the general ledger to extract balances
- the column to use in the trial balance: debit, credit.

Students need to be able to:

- transfer balances to the initial trial balance
- total and balance the initial trial balance.

Delivering this unit

Unit name	Content links	Suggested order of delivery
Bookkeeping Controls	Bookkeeping Transactions is the first of two bookkeeping units at Foundation level. With Bookkeeping Controls, it is the foundation for financial accounting at Advanced level.	It is recommended that Bookkeeping Transactions is delivered either before or at the same time as Bookkeeping Controls.
Elements of Costing	The use of codes in this unit links with Elements of Costing.	Elements of Costing might be delivered before, at the same time as or after Bookkeeping Controls.
Using Accounting Software	Bookkeeping Transactions gives students underlying knowledge that may support their study of Using Accounting Software.	It is recommended that Bookkeeping Transactions is delivered either before or at the same time as Using Accounting Software.

THE ASSESSMENT

Test specification for this unit assessment

Assessment type	Marking type	Duration of exam
Computer based unit assessment	Computer marked	2 hours

The assessment for this unit consists of 10 compulsory, independent, tasks.

The competency level for AAT assessment is 70%.

Learning outcomes		Weighting
1	Understand financial transactions within a bookkeeping system	10%
2	Process customer transactions	10%
3	Process supplier transactions	15%
4	Process receipts and payments	25%
5	Process transactions through the ledgers to the trial balance	40%
Total		100%

UNIT LINK TO SYNOPTIC ASSESSMENT

AAT AQ16 introduced a Synoptic Assessment, which students must complete if they are to achieve the appropriate qualification upon completion of a qualification. In the case of the Foundation Certificate in Accounting, students must pass all of the mandatory assessments and the Synoptic Assessment to achieve the qualification.

As a Synoptic Assessment is attempted following completion of individual units, it draws upon knowledge and understanding from those units. It may be appropriate for students to retain their study materials for individual units until they have successfully completed the Synoptic Assessment for that qualification.

With specific reference to this unit, the following learning objectives are also relevant to the Foundation Certificate in Accounting Synoptic Assessment

LO1 Understand financial transactions within a bookkeeping system

LO2 Process customer transactions

LO3 Process supplier transactions

LO4 Process receipts and payments

LO5 Process transactions through the ledgers to the trial balance.

STUDY SKILLS

Preparing to study

Devise a study plan

Determine which times of the week you will study.

Split these times into sessions of at least one hour for study of new material. Any shorter periods could be used for revision or practice.

Put the times you plan to study onto a study plan for the weeks from now until the assessment and set yourself targets for each period of study – in your sessions make sure you cover the whole course, activities and the associated Test your understanding activities.

If you are studying more than one unit at a time, try to vary your subjects as this can help to keep you interested and see subjects as part of wider knowledge.

When working through your course, compare your progress with your plan and, if necessary, re-plan your work (perhaps including extra sessions) or, if you are ahead, do some extra revision/practice questions.

Effective studying

Active reading

You are not expected to learn the text by rote, rather, you must understand what you are reading and be able to use it to pass the assessment and develop good practice.

A good technique is to use SQ3Rs – Survey, Question, Read, Recall, Review:

1 Survey the chapter

Look at the headings and read the introduction, knowledge, skills and content, so as to get an overview of what the chapter deals with.

2 Question

Whilst undertaking the survey ask yourself the questions you hope the chapter will answer for you.

3 Read

Read through the chapter thoroughly working through the activities and, at the end, making sure that you can meet the learning objectives highlighted on the first page.

4 Recall

At the end of each section and at the end of the chapter, try to recall the main ideas of the section/chapter without referring to the text. This is best done after short break of a couple of minutes after the reading stage.

5 Review

Check that your recall notes are correct.

You may also find it helpful to re-read the chapter to try and see the topic(s) it deals with as a whole.

Note taking

Taking notes is a useful way of learning, but do not simply copy out the text.

The notes must:

- be in your own words
- be concise
- cover the key points
- be well organised
- be modified as you study further chapters in this text or in related ones.

Trying to summarise a chapter without referring to the text can be a useful way of determining which areas you know and which you don't.

Three ways of taking notes:**1 Summarise the key points of a chapter****2 Make linear notes**

A list of headings, subdivided with sub-headings, listing the key points.

If you use linear notes, you can use different colours to highlight key points and keep topic areas together.

Use plenty of space to make your notes easy to use.

3 Try a diagrammatic form

The most common of which is a mind map.

To make a mind map, put the main heading in the centre of the paper and put a circle around it.

Draw lines radiating from this to the main sub-headings which again have circles around them.

Continue the process from the sub-headings to sub-sub-headings.

Annotating the text

You may find it useful to underline or highlight key points in your study text – but do be selective.

You may also wish to make notes in the margins.

Revision phase

Kaplan has produced material specifically designed for your final examination preparation for this unit.

These include pocket revision notes and an exam kit that includes a bank of revision questions specifically in the style of the new syllabus.

Further guidance on how to approach the final stage of your studies is given in these materials.

Further reading

In addition to this text, you should also read the 'Accounting Technician' magazine every month to keep abreast of any guidance from the examiners.

Business documents

Introduction

The purpose of accounting is to record and classify business transactions. There are many transactions that a business may undertake; credit sales, credit purchases, cash sales, cash purchases, other expenses either paid from the bank or by cash, paying cash into the bank, withdrawing cash from the bank and owner's drawings.

Various documents may be used when dealing with business transactions. This chapter reviews the flow of a transaction through the accounting system paying particular attention to the business documents involved.

The name of a transaction or document will depend on whether we are looking at it from the point of view of the seller or the purchaser. Thus an invoice may be called a 'sales invoice' for the seller but a 'purchase invoice' for the purchaser, it is the same invoice. Similarly, the seller makes a 'sale' and the purchaser makes a 'purchase', it is the same transaction.

ASSESSMENT CRITERIA

Indicate the purpose of business documents (1.1)

Distinguish between prompt payment, trade and bulk discounts (1.2)

Demonstrate an understanding of a coding system (1.3)

Calculate invoice and credit note amounts (2.1)

CONTENTS

- 1 Business transactions
- 2 The accounting system
- 3 Business documents for a credit transaction
- 4 Quotation
- 5 Purchase order
- 6 Sales order
- 7 Delivery note
- 8 Invoice
- 9 Operation of VAT
- 10 Discounts
- 11 Preparing an invoice
- 12 Credit note
- 13 Coding

1

Business transactions

1.1 Introduction

Businesses may undertake many different financial transactions every day; credit sales, credit purchases, cash sales, cash purchases, other expenses either paid from the bank or by cash, paying cash into the bank, withdrawing cash from the bank and owner's drawings. These transactions are recorded on different business documents and are entered into an accounting system.

The Bookkeeping Transactions unit introduces the double-entry bookkeeping system and associated documents and processes.

1.2 Sales, purchases and expenses

Sales of goods or services and payment for purchases and expenses can be made on a cash or credit basis. Cash sales and purchases are relatively straightforward but credit sales and purchases require more accounting knowledge. Dependent upon whether we are the seller or the buyer dictates whether we view the transaction as a sale or purchase. The details of all aspects covered here will be dealt with in greater depth in later chapters.

1.3 Cash sales and purchases

A cash sale or purchase will normally be made in a retail environment. A customer will enter the shop, choose the goods they wish to buy then pay for them at the till or counter. The seller will tell the customer the price of the goods and the customer then offers payment for them, in the form of notes and coins. Alternatively, the customer may offer to pay for the goods by debit or credit card.

Finally, when the customer has paid for the goods, a receipt of some sort will be given to the customer. This may be printed automatically by the till or may be a handwritten receipt. The transaction is now complete.

1.4 Credit sales and purchases

The procedure for a sale or purchase on credit can be a bit more involved. The sale or purchase process will normally be initiated by a seller receiving an order from a customer. The purchase order from the customer may be in writing, over the telephone, by email, by fax or via a website. When your business receives the order, the first decision to be made is whether or not to allow the customer credit for this sale i.e. the period of time they can take before paying the invoice.

1.5 Offering credit

Selling goods on credit always involves an element of risk. The goods are taken away or delivered to the customer now with the promise of payment in the future. Therefore your business must be confident that the payment will be received. The decision process as to whether or not to make the sale on credit will be different depending upon whether this is a sale to an existing credit customer or a new customer.

1.6 Existing customers

If an existing credit customer wishes to make a further purchase on credit, it would be normal practice to carry out some basic checks. When the customer was originally accepted as a credit customer, a credit limit will have been set which should not be exceeded. Checks should be made to ensure that the new sale, when added to the amount currently owing, does not take the customer over their credit limit.

It would also be sensible to check that there have been no problems recently with receiving payment from this customer. If the checks are satisfactory then the credit sale can go ahead.

1.7 New customer

If a new customer asks for credit from your business then it would be normal practice to ask the customer to supply some trade references – names of other businesses that they trade with on credit that can vouch for their creditworthiness. Your business may also wish to check the customer's creditworthiness through an agency, or by asking for references from the customer's bank.

If the references and checks are satisfactory then a credit limit will be set for this customer and the sale can go ahead.

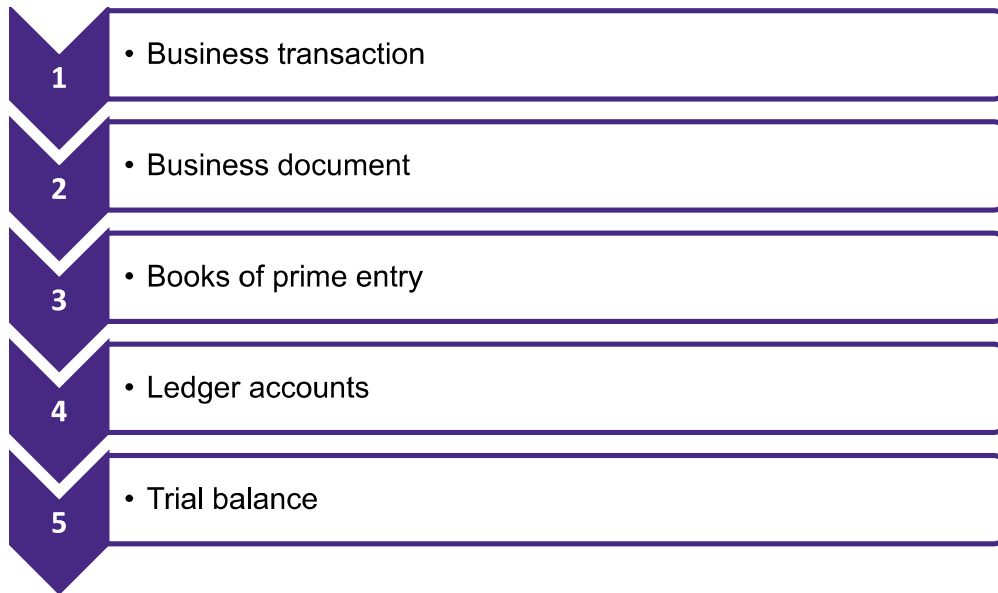
2 The accounting system

2.1 Introduction

A business may enter into a large number of transactions on a daily basis. It is quite clear that keeping track of all these transactions can be a detailed process.

To ensure that a business does keep track of all sales earned, purchases and expenses incurred, the transactions are recorded in an accounting system.

2.2 Overview of the accounting system

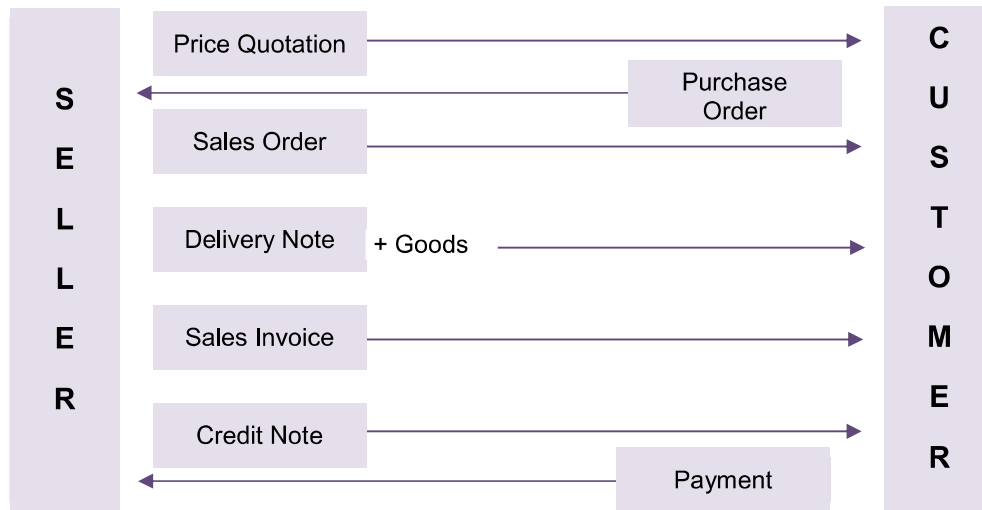


- (1) Initially a **business transaction** will take place; a credit sale, a credit purchase, a cash sale, a cash purchase, another expense either paid from the bank or by cash, cash paid into the bank, withdrawal of cash from the bank and owner's drawings.
- (2) A **business document** will be produced e.g. an invoice.
- (3) The transaction and details from the business document will be entered into the **books of prime entry**. A book of prime entry is where a transaction is first recorded. There are several books of prime entry which may also be referred to as 'day books'. These are reviewed in chapter 2 of this text.
- (4) The transactions that have been recorded in the books of prime entry are transferred into **ledger accounts** on a regular basis. Ledger accounts are used as part of the double entry accounting system. Double entry bookkeeping is introduced in chapter 3.
- (5) A **trial balance** is a list of all of the ledger accounts in the accounting system and is used as a control to check that transactions have been recorded correctly in the double entry system prior to the preparation of the financial statements. The trial balance is studied as part of ledger accounting in chapter 4.

3 Business documents for a credit transaction

3.1 Overview

The main document flows for a credit transaction are illustrated below. The various documents are described in the sections that follow.



4 Quotation

4.1 Price enquiry

The first stage of the process for a credit sale may be the receipt of a price enquiry from a customer.

The price enquiry may be a formal written document, an email enquiry or a telephone call. When responding to a price enquiry it is important that you make sure that the price you quote is the correct one as if it is incorrect you may find that you are contracted to sell the goods at that price under contract law.

4.2 Price quotation

It is common practice to quote prices on a website if there is a standard price list from which there are no variations. However, some businesses will be prepared to offer certain customers goods at different prices or offer a discount. Therefore it is often the case that a price quotation is sent out to a customer showing the price at which the goods that they want can be bought.

Different types of discounts given or offered to customers will be considered in section 10 of this chapter.

A typical price quotation is shown:

City Woods Suppliers

192 Old Kent Road
London
SE1 8QT

Tel: 020 7248 7009 – Email: sales@citywoodssuppliers.co.uk



QUOTATION

TO: Alpha Limited
Mountjoy Street
London W12 6RS

Date: 14 Sept 20X3

Thank you for your telephone enquiry of 10 September. We are pleased to quote the following price:

Chipboard sheeting 6' × 4' Code CB0351

J Kramer
Sales Manager

£23.00 per unit, excluding VAT

The price quotation is an important document as this is the price that your organisation is now contracted to sell the goods at. Therefore it is important that it is authorised by an appropriate person in the organisation.

5 Purchase order

5.1 The purchase order



Definition – Purchase order

A buyer generated document that authorises a purchase transaction.

If the customer is happy with the price quotation that they have received from your business then they will place a firm order with you. The order may be by telephone, email, fax or it may be in writing. Whichever method is used for the purchase order, it is important to check all of the details carefully.

- Does the price agree to what was quoted to the customer?
- Are the delivery terms acceptable?
- Are any discounts applicable?

A typical purchase order follows. Note that the purchase order has been authorised by an appropriate person in the customer's organisation.

PURCHASE ORDER				
<div style="display: flex; justify-content: space-between;"> <div style="width: 40%;"> <p>ALPHA LTD</p> <p>Mountjoy Street Shepherd's Bush LONDON W12 6RS</p> <p>Tel: 0208 741 2962 Email: enquiries@alpha.co.uk Date: 17 September 20X3 Purchase order no: P01562 VAT Reg no: 413 2790 04</p> </div> <div style="width: 55%;"> <p><i>Name and address of business placing the order</i></p> <p><i>Order date</i></p> <p><i>Sequential order number</i></p> <p><i>VAT registration number of business placing the order</i></p> <p><i>Name and address of business the order is being placed with</i></p> </div> </div> <div style="display: flex; justify-content: space-between; margin-top: 20px;"> <div style="width: 45%; border: 1px solid black; padding: 5px;"> <p>To: City Woods Suppliers 192 Old Kent Road London SE1 8QT</p> </div> <div style="width: 45%; border: 1px solid black; padding: 5px;"> <p>Delivery address (if different from above) 26 New Road Milton Keynes MK25 2BA</p> </div> </div>				
<i>Product</i>	<i>Ref</i>	<i>Quantity</i>	<i>Price per unit (ex VAT) £</i>	<i>Total (ex VAT) £</i>
Chipboard sheeting 6' × 4'	CB0351	10	23.00	230
<p>Signed: <u>J Rowlands</u></p> <p style="text-align: right;"><i>Authorisation signature</i></p> <p style="text-align: center;">Purchasing Manager</p>				

6 Sales order

6.1 Confirming sales orders



Definition – Sales order


A seller generated document that authorises a sale to a customer, issued after the receipt of a purchase order.

To avoid misunderstandings, a supplier will normally confirm a customer's order by completing a **sales order**, even if the customer has already sent a written purchase order.

A **sales order** confirms the terms on which goods will be sold including:

- quantity/type of goods or service
- date of supply
- delivery address
- price and payment terms including any discounts given or offered.

City Woods Suppliers



192 Old Kent Road
London
SE1 8QT

Name and address of business making the sale

Tel: 020 7248 7009 – Email: sales@citywoodssuppliers.co.uk

SALES ORDER

To:
Alpha Limited
Mountjoy St
London W12 6RS

Name and address of customer

Delivery:
26 New Road
Milton Keynes
MK25 2BA

Delivery address and date

Delivery date:
25 September 20X3

Sales order number

Date: 20 September 20X3

Sales order number: 41161

We confirm the following order to be delivered as above.
Please note our credit terms are strictly 30 days net.

Code	Quantity	Description	Unit price (excl VAT)	Discount
CB0351	10	Chipboard sheeting 6' × 4'	£23.00	NIL

Details of goods

Authorised: P. Anders

Authorisation signature

Price of goods

Date: 20 September 20X3

7 Delivery note

7.1 Introduction

When negotiations over the price and terms of the credit sale have been completed, then the goods will be delivered.

7.2 Delivery notes



Definition – Delivery note

A document accompanying goods despatched to a customer explaining what the delivery contains.

Delivery notes should have **sequential numbers** that are either pre-printed for a manual system or computer generated in a computer system, and should be used in order. Spoiled or scrapped delivery notes should be cancelled and retained.

There will normally be three parts to a delivery note:

- Part one – This is kept by the **customer** in order to compare to the purchase order and then to the sales invoice.
- Part two – This is signed and returned to the **supplier** of the goods as evidence that the goods have been received by the customer in good condition.
- Part three – This is signed and kept by the **delivery organisation** such as a courier, as evidence that they have delivered the goods and that the customer has received them.

City Woods Suppliers 192 Old Kent Road London SE1 8QT		
Tel: 020 7248 7009 – Email: sales@citywoodssuppliers.co.uk DN 005673		
DELIVERY NOTE		
To: Alpha Limited Mountjoy St London W12 6RS Date: 25 September 20X3	Delivery: 26 New Road Milton Keynes MK25 2BA	Delivery date: 25 September 20X3 Sales order number: 41161
We confirm the following order to be delivered as above.		
<i>Product</i>	<i>Code</i>	<i>Quantity</i>
Chipboard 6' × 4'	CB0351	10
Received in good condition: <i>A Patel</i>		

8

Invoice

8.1 The sales invoice



Definition – Sales invoice

An invoice is a document that itemises a transaction between a buyer and a seller. A sales invoice can be simply defined as the request for payment by the purchaser for goods sold or services provided by the seller.

When the goods have been delivered the seller must prepare and send out the sales invoice.

In a manual system, sales invoices must be prepared from the details shown on delivery notes. Delivery notes do not normally show details of prices, discounts or VAT. (This is because the purchaser might mistake the delivery note for a sales invoice.) Price, discounts and VAT are shown on the sales invoice.

Sales invoices should have pre-printed sequential numbers and should be used in order. Spoiled or scrapped sales invoices should be cancelled and retained.

In a computerised system, the sales invoice will normally be produced at the same time as the delivery note and will be identical except that the delivery note may not have details of price, etc, and they are usually a different colour to distinguish them easily.

If the business is VAT registered (the operation of VAT is reviewed in section 9) the VAT registration number must be detailed on the sales invoice.

City Woods Suppliers

192 Old Kent Road
London
SE1 8QT

Tel: 020 7248 7009
Email: sales@citywoodssuppliers.co.uk

Invoice no: 1005673
Tax point: 25 September 20X3
VAT reg no: 618 2201 63
Delivery note: DN005673
Account no: AL6215

SALES INVOICE**To:**

Alpha Limited
Mountjoy St
London W12 6RS

Delivery:

26 New Road
Milton Keynes
MK25 2BA

Delivery date:

25 September 20X3

Date: 25 September 20X3

Sales order number: 41161

We confirm the following order to be delivered as above.

Product	Code	Quantity	Price per unit £	Total £
Chipboard 6' × 4'	CB0351	10	23.00	230.00
			VAT (20%)	46.00
			Total	276.00

8.2 Pricing goods and services

Unit prices for goods or services are kept in master files which must be updated regularly. If a price quotation has been sent to a customer then this must be used to determine the price to use on the invoice.

Prices will normally be quoted exclusive of value added tax (VAT), as this is the true selling price to the business. We will now review the operation of VAT.

9 Operation of VAT

9.1 Introduction



Definition – VAT (sales tax)

VAT (sales tax) is a consumption tax added to a product's selling price. It represents a tax on the 'value added' to the product at each stage of a production or supply process.



Definitions – Output and input tax

VAT is charged on the **taxable supply of goods and services** in the United Kingdom by a **taxable person** in the course of a business carried on by him.

Output tax is the tax charged on the sale of goods and services

Input tax is the tax paid on the purchase of goods and services

Sales tax (VAT) is a tax levied on **consumer** expenditure. However the procedure is that it is collected at each stage in the production and distribution chain. Most businesses (being **taxable persons** as defined later) avoid having to treat VAT as an expense as they may deduct the VAT they have paid on their purchases (**input tax**) from the VAT they charge to customers on their sales (**output tax**) and pay only the net output tax to the tax authorities (HM Revenue and Customs).

9.2 How VAT works

Let us examine a simple illustration. We will assume a standard rate of 20%, and follow one article, a wooden table, through the production and distribution chain.

- A private individual cuts down a tree and sells it to a timber mill for £10. **Tax effect** – none. The individual is not a 'taxable person' in this case.
- The timber mill saws the log into planks and sells the timber to a furniture manufacturer for £100 + VAT.

Tax effect – Being a taxable person, the mill is obliged to charge its customers VAT at 20% on the selling price (output tax). There is no VAT paid on the purchase cost (input tax) available for offset.

Cash effect – The mill collected £120 from the customer (or has a receivable for this sum). Of this, £20 will be paid to HMRC and therefore only £100 would be recognised as sales.

- The manufacturer makes a table from the wood, and sells this to a retailer for £400 + VAT.

Tax effect – The manufacturer is obliged to charge VAT at 20% on the selling price (i.e. £80), but in this instance would be allowed to reduce this amount by setting off the input tax of £20 charged on the purchase of wood from the mill.

Cash effect – Tax of £60 is paid to the tax authorities (HM Revenue and Customs) (output less input tax = £80 - £20). £400 is recognised as sales and £100 as purchases in the accounts of the manufacturer.

- The retailer sells the table to a private customer for £1,000 plus VAT of £200. **Tax effect** – The retailer charges £200 of VAT to the customer but against this output tax may be set off the input tax of £80 charged on the purchase from the manufacturer.

Cash effect – £120 (£200 – £80) is paid to HMRC. Purchases would be shown in the books at £400 and sales at £1,000.

- **The private customer** – VAT is a tax levied on consumer expenditure and the chain ends here. The customer is not a taxable person, and cannot recover the tax paid.

You will note that everybody else has passed the sales tax on and, though the customer has paid his £200 to the retailer, HMRC has received its tax by contributions from each link in the chain, as shown below:

	£
Timber mill	20.00
Manufacturer	60.00
Retailer	120.00
	<hr/>
	200.00
	<hr/>

9.3 Taxable supply of goods and services

Taxable supply is the supply of all items except those which are **exempt**. Examples of exempt items are as follows:

- certain land and buildings, where sold, leased or hired
- insurance
- Post Office postal services
- Admission charges to museums, art galleries etc.
- betting, gaming and lotteries.

Input tax cannot be reclaimed where the trader's supplies are all exempt.

9.4 Rates of VAT

In the UK, there are three rates of VAT on taxable supplies. Some items are 'zero-rated' (similar to exempt except that input tax can be reclaimed), there is a special rate of 5% for domestic fuel and power, and all other items are rated at the standard rate of 20%. Examples of 'zero-rated' supplies include:

- water and most types of food stuffs (i.e. not hot food and not eating in as service is also provided which is taxable)
- books and newspapers
- drugs and medicines
- children's clothing and footwear.

9.5 Non-deductible VAT

VAT on some items is non-deductible. This means that VAT on any purchases of these items can never be deducted from the amount of tax payable to HMRC. The business has to bear the VAT as an expense.

Non-deductible items include:

- motor cars
- business entertaining.

For our purposes you will normally be dealing with taxable supplies at the standard rate of 20%.

9.6 Taxable person

A taxable person is any individual, partnership, company, etc who intends to make taxable supplies and is liable to register.

A person is liable to register if the value of his taxable supplies exceeds a specified amount in a 12-month period. Most companies and partnerships and many sole traders are liable to register.

9.7 VAT exclusive amounts



Definition – Net of VAT

A net amount excludes VAT.

If you are given the net price of goods, the price excluding VAT, then the amount of VAT is 20/100 of this price.

Note: VAT is always rounded down to the nearest penny.



Example 1

A sale is made for £360.48 plus VAT. What is the amount of VAT to be charged on this sale?

Solution

$$\text{VAT} = £360.48 \times 20/100 = £72.09$$

Remember to round down to the nearest penny.

An alternative way of calculating this would be to multiply the net amount of £360.48 by 20%:

$$\text{VAT} = £360.48 \times 20\% = £72.09$$

9.8 VAT inclusive amounts



Definition – Gross of VAT

A gross amount includes VAT.

If a price is given that already includes the VAT then calculating the VAT requires an understanding of the price structure:

	%
Selling price incl. VAT (gross)	120
VAT	20
	<hr/>
Selling price excl. VAT (net)	100
	<hr/>



Example 2

Goods have a selling price of £3,000 inclusive of VAT. What is the VAT on the goods and the net price of these goods?

Solution

	£
Net price ($£3,000 \times 100/120$)	2,500
VAT ($£3,000 \times 20/120$)	500
	<hr/>
Gross price (selling price)	3,000
	<hr/>



Test your understanding 1

What is the amount of VAT on each of the following transactions?

- (i) £100 net of VAT
- (ii) £250 net of VAT
- (iii) £480 including VAT (gross)
- (iv) £600 including VAT (gross)



Test your understanding 2

Dora Ltd ordered some goods from Swipey Ltd, the purchase order and the sales invoice are provided below. You should review these documents and identify any discrepancies.

PURCHASE ORDER				
<i>Dora Ltd</i> Leek Lane Northwich Cheshire CW7 5HU Tel: 01565 734 879 Email: enquiries@doraltd.co.uk Date: 15 April 20X5 Purchase order no: P0987 VAT Reg no: 414 7985 05				
To: Swipey Ltd, Keats Lane, Knutsford, Cheshire, WA16 7HT		Delivery address As above		
<i>Product</i>	<i>Ref</i>	<i>Quantity</i>	<i>Price per unit (ex VAT) £</i>	<i>Total (ex VAT) £</i>
Cream leather chairs	CL101	20	98.00	1,960.00
Signed: <i>Lee-Anne Rogers</i> Purchasing Manager				

Swipey Ltd

Keats Lane
Knutsford
Cheshire
WA16 7HT



Tel: 01565 879 852

Email: swipey@swipeyltd.co.uk

Invoice number: 15963

Invoice date: 20 April 20X5

VAT reg no: 687 2241 87

Delivery note: DN00154

Account no: DORA1

SALES INVOICE**To:**

Dora Ltd
Leek Lane
Northwich
Cheshire
CW7 5HU

Delivery:

Leek Lane
Northwich
Cheshire
CW7 5HU

Delivery date:

20 April 20X5

Date: 20 April 20X5

Sales order number: 1569

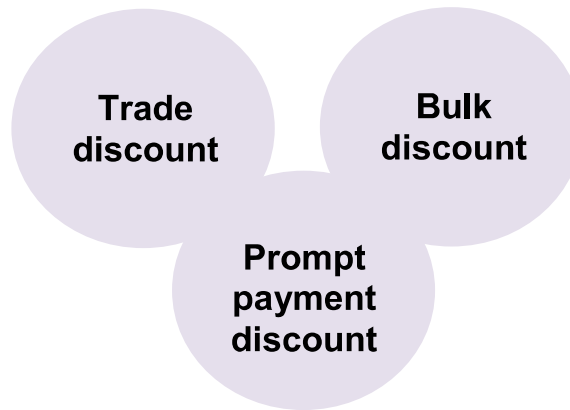
We confirm the following order to be delivered as above.

<i>Product</i>	<i>Code</i>	<i>Quantity</i>	<i>Price per unit £</i>	<i>Total £</i>
Cream leather chairs	CL100	20	100.00	2,000.00
			VAT	400.00
			Total	2,400.00

10 Discounts

10.1 Introduction

A discount is a reduction to the price of the sales of goods or services. There are different types of discounts that may be given or offered for different reasons.



10.2 Trade discounts



Definition – Trade discount

A trade discount is a definite amount that is deducted from the list price of the goods for the supplies to some customers, with the intention of encouraging and rewarding customer loyalty.

A trade discount will appear on the invoice. It will be deducted from the list price of the goods before VAT is calculated.

The calculation of the trade discount on the face of the invoice should be checked and it should be agreed that the correct percentage of trade discount has been deducted.

10.3 Bulk discounts



Definition – Bulk discount

A bulk discount is similar to a trade discount in that it is deducted from the list price of the goods and disclosed on the invoice. However, a bulk discount is given by a supplier for sales orders above a certain quantity.

A bulk discount must be checked to the agreement between customer and supplier, to ensure that the correct discount has been deducted. The deduction of a bulk discount will appear on the invoice, deducted from the list price before VAT is calculated.

10.4 Prompt payment discount



Definition – Prompt payment discount

Prompt payment discounts (also known as settlement or cash discounts) are offered to customers in order to encourage early payment of invoices.

The details of the prompt payment discount will normally be shown at the bottom of the sales invoice and it is up to the customer to decide whether to pay the invoice early enough to benefit from the prompt payment discount or whether to delay payment and ignore the prompt payment discount. No deduction will occur for a prompt payment discount on the invoice, it will just be offered to the customer.

The agreement between the customer and supplier should be checked to confirm that the correct percentage of prompt payment discount according to the terms has been offered.

A trade discount or a bulk discount is a definite reduction in price from the list price whereas a prompt payment discount is only a reduction in price if the organisation decides to take advantage of it by making early payment.