# 4

Ledger Accounting and Double-Entry Bookkeeping

Chapter learning objectives

When you have completed this chapter, you should be able to:

- apply and explain the principles of double-entry bookkeeping
- prepare nominal ledger accounts
- prepare bookkeeping entries for income and expenditure
- prepare bookkeeping entries for assets, liabilities and capital.

1 Introduction

> Principles of double-entry bookkeeping
>
> Preparation of nominal ledger accounts
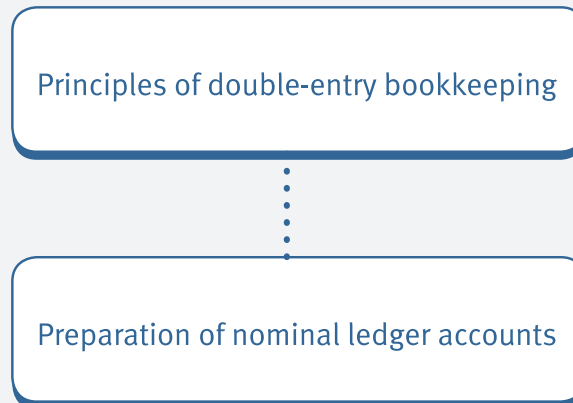
In this chapter we develop an understanding of:

- the principles of double-entry bookkeeping
- the preparation of nominal ledger accounts.

2 Ledger accounts and the division of the ledger

In most business entities each class of transaction and their associated assets and liabilities are given their own account. For example, there will be separate accounts for sales, purchases, rent, liabilities to pay suppliers (payables), amounts due from customers (receivables) etc. There is no rule as to how many accounts an entity should have but the system should facilitate effective and efficient accounting and control. Each account in the system is referred to as a 'ledger.'
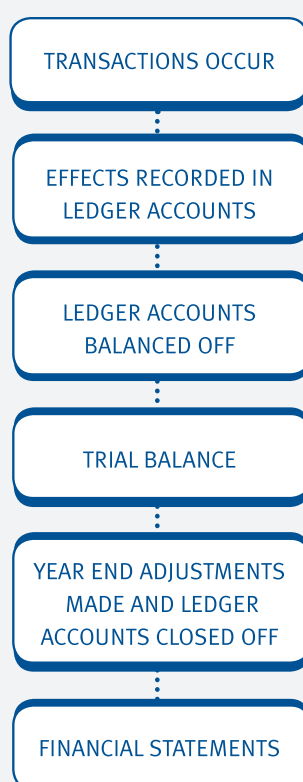
Ledger accounts – a definition
In simple terms the ledger accounts are where the double entry records of all transactions and events are made. They are the principal books or files for recording and totalling monetary transactions by account. An entity's financial statements are generated from summary totals in the ledgers.

The term 'nominal ledger' or 'general ledger' is used to refer to the overall system of ledger accounts used within an entity. It houses all the separate ledgers required to produce a complete trial balance and, consequently, set of financial statements.

As stated above, each class of transaction, asset, liability and item of equity will have its own ledger account. The summary of these ledger balances will eventually be transferred into the corresponding caption in the primary financial statements. For a summary of the main classifications please refer to the earlier chapters which explained the elements of the financial statements and the classification of assets, liabilities, capital, income and expense in a set of financial statements. Note also that books of prime entry were covered in more detail in an earlier chapter. In this chapter we will focus on the entries made in the ledger accounts. In particular we will look at the nature of 'double-entry' bookkeeping.

3 Duality, double entry and the accounting equation

TRANSACTIONS OCCUR

EFFECTS RECORDED IN
LEDGER ACCOUNTS

LEDGER ACCOUNTS
BALANCED OFF

TRIAL BALANCE

YEAR END ADJUSTMENTS
MADE AND LEDGER
ACCOUNTS CLOSED OFF

FINANCIAL STATEMENTS

Each transaction that an entity enters into affects the financial statements in two ways.

For example, an entity may buy a vehicle for cash. The two effects on the entity are:

(1) it has increased the vehicle assets it has at its disposal for generating income, and

(2) there is a decrease in cash available to the entity.

To follow the rules of double entry bookkeeping, each time a transaction is recorded, both effects must be taken into account. These two effects are equal and opposite and, as such, the accounting equation will always be maintained.

The accounting equation

ASSETS = EQUITY + LIABILITIES

ASSETS - LIABILITIES = EQUITY

Note that the image above used the term 'equity' which is an alternative term to 'capital' when dealing with the accounting equation.

The statement of financial position shows the position of an entity at one point in time. A statement of financial position will always satisfy the accounting equation as shown above.

The accounting equation is a simple expression of the fact that at any point in time the assets of the entity will be equal to its liabilities plus its equity.

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e.g

Illustration 1 – The accounting equation

The transactions of a new business entity in its first five days are as follows:

Day 1	AVO commenced business introducing $1,000 cash.
Day 2	Bought a motor car for $400 cash.
Day 3	Obtained a $1,000 loan.
Day 4	Purchased goods for $300 cash.
Day 5	Sold goods for $400 on credit.

Required:

Use the accounting equation to illustrate the position of the entity at the end of each day. (Ignore inventory for this example).

Solution

Day 1: AVO commenced business introducing $1,000 cash

The dual effect of this transaction is:

(a) the entity has $1,000 of cash

(b) the entity owes the owner $1,000 – this is capital/equity.

Assets	=	Equity	+	Liabilities
1,000		1,000		0

Day 2: Bought a motor car for $400 cash

The dual effect of this transaction is:

(a) the entity has an asset (a motor car) of $400

(b) the entity has spent $400 in cash

This transaction changes the form in which the assets are held.

Assets	=	Equity	+	Liabilities
1,000		1,000		0
400 – 400		0		0
_____		_____		_____
1,000		1,000		0

Note that the acquiring of an asset must lead to one of the following:

- reducing another asset by a corresponding amount (as above)
- incurring a corresponding liability
- increasing the equity of the owner (either capital invested or profits made and owed to the owners).

Day 3: Obtained a $1,000 loan from the bank

The dual effect of this transaction is:

(a) the entity has $1,000 of cash

(b) the entity owes $1,000 to the bank.

Assets	=	Equity	+	Liabilities
1,000		1,000		0
1,000		0		1,000
–––––		–––––		–––––
2,000		1,000		1,000

Day 4: Purchased goods for $300 cash

The purchase represents a cost (or an expense) to the entity. This cost will reduce the profits of the entity, which will in turn reduce equity.

The dual effect of is:

(a) The entity has an expense of $300 (expenses reduce the amount due to the owners, i.e. they reduce equity)

(b) The entity has reduced cash by $300.

Assets	=	Equity	+	Liabilities
2,000		1,000		1,000
(300)		(300)		0
–––––		–––––		–––––
1,700		700		1,000

Day 5: Sold goods for $400 on credit

The dual effect of this transaction is:

(a) The entity has earned sales revenue of $400.

(b) The entity has a new asset to receive payment of $400 from their customer.

The sales revenue will increase profits and will therefore increase equity in the business entity.

Assets	=	Equity	+	Liabilities
1,700		700		1,000
400		400		0
————		————		————
2,100		1,100		1,000

4 Ledger accounts, debits and credits

An **account** is a record of the transactions involving a particular item.

A ledger account may be thought of as a record kept as a page in a book. The book contains many pages – many accounts – and is referred to as a ledger.

In this chapter we are concerned with the **nominal ledger**, which is the ledger containing all of the accounts necessary to summarise an entity's transactions and prepare a statement of financial position and statement of profit or loss.

Each account comprises two sides: the left-hand side is referred to as the **debit** side, and the right-hand side is referred to as the **credit** side. The format is shown below:

Debit (Dr)					Credit (Cr)
Date	Details	$	Date	Details	$

Summary of steps to record a transaction

(1) Identify the items that are affected.

(2) Consider whether they are being increased or decreased.

(3) Decide whether each account should be debited or credited.

(4) Check that a debit entry and a credit entry have been made and they are both for the same amount.

- Transactions and events are eventually recorded in the relevant ledger accounts using a double entry to reflect the duality concept explained previously. There is a ledger account for each asset, liability, equity, income and expense item

- Traditionally each account was drawn as an enlarged 'T' that has two sides – a debit and a credit side as illustrated

- The duality concept means that each transaction will affect at least two ledger accounts

- One account will be debited and the other credited.

- Whether an entry is to the debit or credit side of an account depends on the type of account and the transaction:

Debit	Credit
Increase in:	Increase in:
Purchases	**R**evenues
Expenses	**L**iabilities
Assets	**S**hareholder's equity

You can use the mnemonic 'PEARLS' to help you remember this vitally important double entry rule.

It is important to note that the opposite is also true; for example, a reduction in assets would constitute a credit entry into the ledgers.

5 What is a ledger account?

A **ledger account** is a record of the transactions involving a particular item.

A ledger account may be thought of as a record kept as a page in a book. The book contains many pages – many accounts – and is referred to as a ledger.

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Debit (Dr)			Credit (Cr)		
Date	Details	$	Date	Details	$

6 What is double-entry bookkeeping?

According to the **CIMA Official Terminology:**

Double-entry bookkeeping: The most commonly used system of bookkeeping based on the principle that every financial transaction involves the simultaneous receiving and giving of value, and is therefore recorded twice.

Duality concept

Earlier in this text we saw how some transactions affected the accounting equation and the statement of financial position. We saw that each transaction had two effects: this is referred to as the **dual aspect** or **duality** concept. For example, receiving payment from a receivable increases the asset 'cash', whilst also reducing the asset 'receivables'; paying a supplier reduces the asset 'cash' whilst also reducing the liability 'payables'; In both cases, the accounting equation remains intact. The fact that every transaction has two effects – equal and opposite – means that each transaction must be recorded in two ledger accounts. This is double-entry bookkeeping.

Bookkeeping is the technique of recording financial transactions as they occur so that summaries may be made of the transactions and presented as a report to the users of accounts. The double-entry bookkeeping technique applies to the recording of transactions in ledger accounts.

Test your understanding 1

Explain what is meant by the term 'double-entry bookkeeping'.

In the previous chapters, you were introduced to the following terms:

- assets
- liabilities
- capital/equity
- income, and
- expenses.

These **five items** can be put into **two categories**, according to whether they appear in the **statement of financial position** or in the **statement of profit or loss**.

- Assets, liabilities and capital appear on the statement of financial position.
- Expenses and revenue appear in the statement of profit or loss.

If you compare these pairs you will see that they are, in effect, two pairs of opposites.

Each type of asset, liability, capital, expense or income is recorded separately. This is achieved by using **separate ledger** accounts for each of them.

7 Bookkeeping entries for the statement of financial position

We shall look first of all at recording assets, liabilities and capital. Transactions are recorded on either the debit or the credit side of a ledger account according to the following table:

Debit (Dr)	**Credit (Cr)**
Increases in assets	Decreases in assets
Decreases in liabilities	Increases liabilities
Decreases in capital	Increases in capital/equity

Entering transactions in ledger accounts is also called **posting** the transactions.

Examples of debit and credit entries

Examples of debit entries:

- Increase in assets, e.g. purchase of inventory, non-current assets, increase in cash/bank
- Decreases in liabilities, e.g. payment of suppliers/loans
- Decreases in capital, e.g. drawings

Examples of credit entries:

- Decrease in assets, e.g. sale of non-current assets, payment of receivables, decreases in cash/bank

- Increases in liabilities, e.g. purchase of goods on credit, new loans obtained

- Increase in capital, e.g. introduce new capital into the entity

In chapter 2, we saw how transactions would affect the accounting equation and the statement of financial position. Worked Example 2.B from chapter 2 which required you to determine the balance on Nadim's capital account at 1 January is reproduced here as Worked Example 4.A of this chapter so that the double-entry bookkeeping entries (or postings) may be compared with the solution given in chapter 2.

Worked Example 4.A

Nadim had the following assets and liabilities on 1 January:

	$
Land	200,000
Buildings	60,000
Inventory	10,000
Receivables	15,000
Bank balance	32,000
Cash in hand	5,000
	———
	322,000
	———
Payables	17,000
Bank loan	240,000
	———
	257,000
	———

Required:

What was the balance of Nadim's capital account at 1 January?

Solution:

First of all, we enter the opening balances into the ledger accounts. **Assets have debit balances**, and **liabilities and capital have credit balances.** These balances are referred to as 'brought down' or 'brought forward' and are usually abbreviated to be shown as 'b/d', 'b/f' or 'b/fwd' on the appropriate side of the ledger.

Land

Dr	$	Cr	$
1 Jan Balance b/d	200,000		

Buildings

Dr	$	Cr	$
1 Jan Balance b/d	60,000		

Inventory

Dr	$	Cr	$
1 Jan Balance b/d	10,000		

Receivables

Dr	$	Cr	$
1 Jan Balance b/d	15,000		

Cash in hand

Dr	$	Cr	$
1 Jan Balance b/d	5,000		

Bank balance

Dr	$	Cr	$
1 Jan Balance b/d	32,000		

Payables

Dr	$	Cr	$
		1 Jan Balance b/d	17,000

Bank loan

Dr	$	Cr	$
		1 Jan Balance b/d	240,000

Capital

Dr	$	Cr	$
		1 Jan Balance b/d	65,000

Note:

(1) The capital account balance is the difference between assets and liabilities ($322,000 – $257,000).

Assume that Nadim had the following transactions during the first week of January:

(1) Bought office equipment costing $7,000, paying $2,000 deposit by cheque, the balance to be paid at the end of March.

(2) Returned some office equipment to his supplier because it was faulty. Nadim had originally been charged $3,000 for it.

(3) Received $8,000 from his receivables. They all paid him by cheque.

We now want to enter the January transactions into the ledger accounts. First, though, let us look at each transaction to determine how we are going to record it.

(1) Office equipment is an asset, and has increased. Therefore we want to **debit the office equipment** account.

A cheque for $2,000 has been paid. The bank account, an asset, has decreased, so we want to credit the bank account with $2,000. Note that $5,000 is still owing to the supplier (payable), so liabilities need to be increased, leading us to **credit payables**.

(2) Office equipment has been returned, so the asset of office equipment has decreased. Therefore we want to **credit the office equipment** account.

As Nadim has not yet paid for the goods, this amount will be included in the payables figure. If we return goods, the amount owed to payables decreases and, as payables are liabilities, we therefore want to **debit the payables** account.

(3) Receivables are assets. If they pay their debts, the amount owed decreases, so we want to **credit receivables**.

Bank is an asset. Paying money in increases the balance, so we want to **debit bank**.

These transactions can now be entered into the ledger accounts, as follows:

Land

Dr	$	Cr	$
1 Jan Balance b/d	200,000		

Buildings

Dr	$	Cr	$
1 Jan Balance b/d	60,000		

Inventory

Dr	$	Cr	$
1 Jan Balance b/d	10,000		

Receivables

Dr	$	Cr	$
1 Jan Balance b/d	15,000	Jan Bank	8,000

Cash in hand

Dr		$	Cr		$
1 Jan	Balance b/d	5,000			

Bank balance

Dr		$	Cr		$
1 Jan	Balance b/d	32,000	Jan	Office equip't	2,000
Jan	Receivables	8,000			

Payables

Dr		$	Cr		$
Jan	Office equip't	3,000	1 Jan	Balance b/d	17,000
			Jan	Office equip't	5,000

Bank loan

Dr		$	Cr		$
			1 Jan	Balance b/d	240,000

Capital

Dr		$	Cr		$
			1 Jan	Balance b/d	65,000

Office equipment

Dr		$	Cr		$
Jan	Bank	2,000	Jan	Payables	3,000
	Payables	5,000			

8 Bookkeeping entries for expenses and income

An expense is a cost connected with the day-to-day activities of the entity. Examples of expenses include rent, local business tax, light and heat, wages and salaries, postage, telephone i.e. costs of operating the business entity, along with the cost of items bought for resale.

Income is the term used to describe the activities that will eventually lead to the entity receiving money. The most common source of income is that derived from the sale of its goods or services, but others include the receipt of interest on bank deposits.

Transactions are recorded on either the debit or the credit side of a ledger account according to the following table:

Debit	**Credit**
Increases in expenses	Decreases in expenses
Decreases in income	Increases in income

Examples of debit and credit entries

Examples of debit entries:

- Increases in expenses, e.g. purchase of materials, rent, wages, electricity costs
- Decreases in income, e.g. sales returns

Examples of credit entries:

- Decreases in expenses, e.g. purchase returns
- Increases in income, e.g. sales of goods for cash or credit

9 Summary of bookkeeping entries

You may find it easier to remember the mnemonic **PEARLS** to remember the debit and credit rule for transactions.

Debit (Dr)		Credit (Cr)	
Increase in	$	Increase in	$
Purchases		**R**evenue (income)	
Expenses		**L**iabilities	
Assets		**S**hareholders' equity (capital)	

Summary of steps to record a transaction:

(1) Identify the items that are affected.

(2) Consider whether they are being increased or decreased.

(3) Decide whether each account should be debited or credited.

(4) Check that a debit entry and a credit entry have been made and they are both for the same amount.

Bookkeeping entries for purchases and sales

We keep separate ledger accounts for the different types of inventory movement. Purchases and sales of inventory must always be kept in separate accounts, because one is at cost price and the other at selling price. You might have difficulty in determining how to classify purchases and sales. You could regard purchases as being assets, or you could regard them as being expenses. It all depends on whether they are consumed during the period, and that is unknown at the time they are bought. Similarly, sales could be regarded as decreases in inventory or as revenues. The fact is that it does not matter how you regard them. Both will result in the correct entry being made. For example, if you regard the purchase of inventory as an increase in an asset, you will make a debit entry; if you regard it as an increase in an expense, you will still make a debit entry. The same applies to sales – a decrease in inventory results in a credit entry, as does an increase in revenue. So, you will choose the right side for the entry, whichever way you classify these. The most important thing is to use the correct account – and never use the inventory account for purchases and/or sales as the inventory account is used only at the beginning and end of the accounting period.

Also note that you should **never** use either the purchases account or the sales account for anything other than the goods in which the business entity trades. Purchases of non-current assets, stationery and so on should all be recorded in their own ledger accounts.

Test your understanding 2

Tick the correct box for each of the following:

		Debit	Credit
1	Increases in assets	....	....
2	Increases in liabilities	....	....
3	Increases in income	....	....
4	Decreases in liabilities	....	....
5	Increases in expenses	....	....
6	Decreases in assets	....	....
7	Increases in capital	....	....
8	Decreases in income	....	....

Illustration 2

BR started a business on 1 May and, during the first month, entered into the following transactions:

1 May	BR starts business as a sole proprietor with $20,000 in cash
2 May	Pays $15,000 cash into a business bank account
4 May	Purchases goods on credit from JM for $2,000
6 May	Purchases goods from ERD on credit for $3,000
7 May	Pays wages in cash $60
10 May	Pays rent by cheque $80
12 May	Sells goods for cash $210
16 May	Buys furniture for $1,500 paying by cheque
19 May	Sells goods on credit to SP for $580
22 May	Buys goods for cash $3,900
24 May	Buys fittings for cash $600
	Pays carriage outwards costs by cheque $25
25 May	Pays wages by cash $110
	Sells goods for cash $430
27 May	Receives part payment from SP of $330 by cheque
	Pays carriage inwards costs by cheque $20
28 May	Pays advertising by cheque $25
	Sells goods for cash $890
29 May	Sells goods on credit to KM for $8,090
30 May	Withdraws $100 cash for his personal use

Required:

Prepare ledger account entries to record the transactions.

Note: When you draw up your accounts, you may want to leave extra lines after the bank account (approx 10), and after all other ledger accounts (approx 4 per account) – this exercise is continued in chapter 5.

Note: It might help you to determine the correct ledger entries by completing a table before you start, like this (the first item is done for you):

Date	Names of accounts involved	Type of accounts	Increase/decrease	Debit/credit
1 May	Cash	Asset	Increase	Debit
	Capital	Capital	Increase	Credit

Solution

Capital

Dr	$	Cr	$
		1 May Cash	20,000

Cash

Dr		$	Cr		$
1 May	Capital	20,000	2 May	Bank	15,000
12 May	Sales	210	7 May	Wages	60
25 May	Sales	430	22 May	Purchases	3,900
28 May	Sales	890	24 May	Fittings	600
			25 May	Wages	110
			30 May	Drawings	100

Bank

Dr		$	Cr		$
2 May	Cash	15,000	10 May	Rent	80
27 May	SP	330	16 May	Furniture	1,500
			24 May	Carriage out	25
			27 May	Carriage in	20
			28 May	Advertising	25

Purchases

Dr		$	Cr
4 May	JM	2,000	
6 May	ERD	3,000	
22 May	Cash	3,900	

JM

Dr		Cr		$
		4 May	Purchases	2,000

ERD

Dr		Cr		$
		6 May	Purchases	3,000

Wages

Dr		$	Cr
7 May	Cash	60	
25 May	Cash	110	

Rent

Dr		$	Cr
10 May	Bank	80	

Sales

Dr		Cr		$
		12 May	Cash	210
		19 May	SP	580
		25 May	Cash	430
		28 May	Cash	890
		29 May	KM	8,090

Furniture

Dr		$	Cr
16 May	Bank	1,500	

SP

Dr		$	Cr		$
19 May	Sales	580	27 May	Bank	330

Fittings

Dr		$	Cr
24 May	Cash	600	

Advertising

Dr		$	Cr
28 May	Bank	25	

KM

Dr		$	Cr
29 May	Sales	8,090	

Drawings

Dr		$	Cr
30 May	Cash	100	

Carriage Outwards

Dr		$	Cr
24 May	Bank	25	

Carriage Inwards

Dr		$	Cr
27 May	Bank	20	

Test your understanding 3

ATH commenced business on 1 February 20X1, paying $500 into a business bank account.

During the next month the following transactions took place. All payments are made by cheque and all receipts are banked.

		$
1 Feb	Bought goods for resale	150
5 Feb	Paid rent	50
10 Feb	Sales receipts	290
22 Feb	Paid for advertising	25
26 Feb	ATH's drawings	100
27 Feb	Sales receipts	240

Required:

(a) write up the bank account

(b) write up all the other accounts.

Note: When you draw up your accounts, leave ten extra lines after the bank account, and four extra lines after all other ledger accounts – this exercise is continued in chapter 5.

Ledger account entries from day books

Making the ledger account entries from day books

Examples within this chapter have recorded the double-entries required to record individual transactions. Chapter 3 dealt with the recording or listing of transactions in day books so that they can be periodically totalled and summarised for posting into the nominal ledger.

Here, the accounting entries required to record transactions listed in the day books from Worked Example 3.A in chapter 3 are stated. You should note that, whether individual transactions are posted, or whether transactions are first listed and totalled in a book of prime entry prior to posting in the nominal ledger, exactly the same principles of double-entry apply.

Purchase day book		$
Debit	Purchases account	1,600
Debit	Sales tax	
Credit	Purchase ledger control account	1,600

Sales day book		$
Debit	Sales ledger control account	1,520
Credit	Sales tax	
Credit	Sales account	1,520

Returns in day book		$
Debit	Returns inwards account	320
Credit	Sales ledger control account	320

Returns out day book		$
Debit	Purchase ledger control account	200
Credit	Returns outwards account	200

Note that the sales and purchases control accounts only show the total of transactions relevant for each control account. They will not identify separate amounts due to each credit supplier or due from each credit customer. Therefore there is a need to maintain a separate set of ledger account balances for individual credit suppliers (in a purchase ledger) and individual credit customers (in a sales ledger). Note that the sales ledger and purchase ledger balances are not part of the double-entry accounting system - they are memorandum accounts only to help the entity manage and control its accounting transactions.

Consequently, the recording of accounting transactions can be divided up and allocated between a number of employees, each having distinct responsibilities. This is particularly important in larger entities where, for example, a different person may have sole responsibility for each of the following:

- cash receipts book
- cash payments book
- sales ledger
- purchase ledger
- general or nominal ledger

Nominal ledger accounts

At this stage in your studies, all your ledger accounts are kept in a single 'book'. In later chapters you will see how the ledger accounts can be divided into several books. The main book used is called the **nominal ledger.**

10 Chapter summary

In this chapter you have studied:

- how financial transactions are recorded in ledger accounts, using double-entry principles.

Double entry is the cornerstone of the entire accounting process. You will not get far in your studies of this subject unless you have a thorough grasp of its principles. Make sure you can follow the steps involved in the examples given in this chapter, and memorise the table:

It is important that you fully understand the double-entry system, as it will enable you to understand how to record more complex transactions later on in your studies.

Try not to analyse the reason for the 'left and right' system for recording transactions. It is simply a rule that, if everyone abides by it, leads to a common system. It can be likened to the rule for driving a car. If the rule in a country is to drive on the left, then the system works as long as everyone abides by the rule.

Practise the examples in the chapter several times until you feel competent in them.

Principles of double-entry bookkeeping

Debit	Credit
Increases in assets	Decreases in assets
Decreases in liabilities	Increases in liabilities
Decreases in capital	Increases in capital
Increases in expenses	Decreases in expenses
Decreases in revenue	Increases in revenue

Preparation of nominal ledger accounts
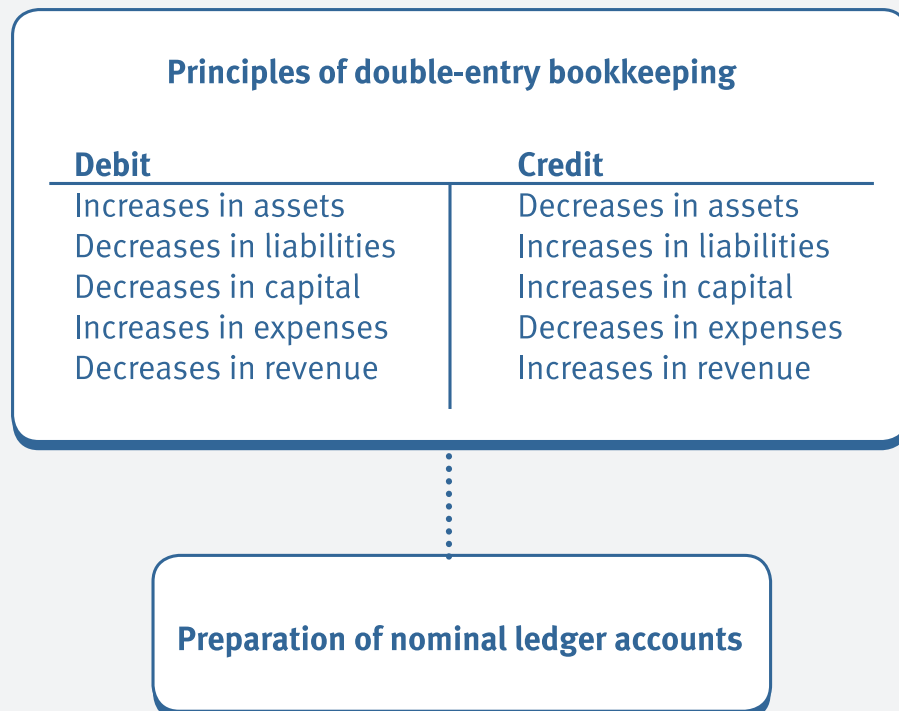
Test your understanding questions

Test your understanding 4

Which one of the following statements is correct?

A   Assets and liabilities have credit balances

B   Liabilities and revenues have debit balances

C   Assets and revenues have credit balances

D   Assets and expenses have debit balances

Test your understanding 5

ALC had the following assets and liabilities at 1 January:

	$
Inventory	350
Payables	700
Receivables	400
Bank overdraft	125
Motor vehicles	880

Required:

What was the capital account balance at 1 January?

$...............

Test your understanding 6

The correct entries needed to record the return of office equipment that had been bought on credit from PYO, and not yet paid for, are:

	Debit	Credit
A	Office equipment	Sales
B	Office equipment	PYO
C	PYO	Office equipment
D	Cash	Office equipment

Test your understanding 7

Which of the following is the correct entry to record the purchase on credit of inventory intended for resale?

	Debit	**Credit**
A	Inventory	Receivable
B	Inventory	Payable
C	Purchases	Payable
D	Payable	Purchases

Test your understanding 8

A receives goods from B on credit terms and A subsequently pays by cheque. A then discovers that the goods are faulty and cancels the cheque before it is cashed by B. How should A record the cancellation of the cheque in his books.

	Debit	**Credit**
A	Payables	Returns outwards
B	Payables	Bank
C	Bank	Payables
D	Returns outwards	Payables

Test your understanding 9

The table below shows a selection of financial transactions. Complete the columns to identify the accounts and the debit/credit entries to be made in the ledger to record each of the transactions.

Transaction description	Account to be debited	Account to be credited
1 Sold goods on credit to BAS		
2 Bought goods for sale on credit from PWA		
3 Returned goods to PWA		
4 Bought office machinery on credit from WPR		
5 Returned office machinery to WPR		
6 Received cash from PWR		
7 Received payment from TWI by cheque		
8 Owner's private car brought into the business		
9 Cheque received from PWR dishonoured		

Test your understanding 10

The double entry system of bookkeeping normally results in which of the following balances in the ledger accounts?

	Debit	Credit
A	Assets and income	Liabilities, capital and expenses
B	Income, capital and liabilities	Assets and expenses
C	Assets and expenses	Liabilities, capital and income
D	Assets, expenses and capital	Liabilities and income

Test your understanding 11

What double-entry should be made with the totals from the sales returns day book?

A	Dr	Receivables
	Cr	Returns inwards
B	Dr	Returns inwards
	Cr	Receivables
C	Dr	Returns inwards
	Cr	Payables
D	Dr	Returns outwards
	Cr	Payables

Test your understanding 12

The cash payments book

The following is the cash payments book of a small printing business.

Date	Detail	Bank	Discount	Payables	Rent
		$	$	$	$
18.7.X6	MRA	1,400	100	1,400	
18.7.X6	Office	3,000			3,000
18.7.X6	MRB	210		210	
18.7.X6	MRC	1,600	80	1,600	
18.7.X6	Shop	400			400
		_____	____	_____	_____
		6,610	180	3,210	3,400

Required:

What are the accounting entries arising from the totals in the cash book at the end of the day, assuming control accounts are kept?

Test your understanding 13

The following is the cash receipts book of the SMA art gallery.

Date	Detail	Bank received	Discount	Receiv-ables	Bank interest
		$	$	$	$
18.7.X6	C Monet	10,000	500	10,000	
18.7.X6	Interest Acc # 1	20			20
18.7.X6	V V Gogh	25,000		25,000	
18.7.X6	Interest Acc # 2	100			100
18.7.X6	P Picasso	13,700	300	13,700	
		48,820	800	48,700	120

Required:

What are the accounting entries arising from the totals in the cash book at the end of the day, assuming that individual accounts for each customer and supplier are maintained?

Test your understanding 14

NRA keeps cash and bank records. At the close of business on 29 May 20X1 he reached the bottom of a page and carried forward the following:

	Discount ($)	Cash ($)	Bank ($)	
Total b/f	27.40	114.10	214.30	Debit side
Total b/f	40.10	74.50	210.00	Credit side

The following sums were received on 30 May 20X1:

Cheque from JCC for $120 in settlement of an account for $125

Cash from NGR $40

Cheque from XYZ for $75 in settlement of an account for $76.50

The following payments were made on 30 May 20X1:

Cheque to MBR for $140.40

Cheque to local council in payment of local business tax for the half-year $150.40

NRA cashed a cheque for private drawings of $50 and took an additional $50 from the office cash for the same purpose.

Required:

Write up NRA's cash and bank records on 30 May 20X1.

Test your understanding 15

SMA commenced in business as a decorator on 1 January.

1 Jan	Commenced business by paying $1,000 into a business bank account.
3 Jan	Bought a motor van on credit from ABG for $3,000.
4 Jan	Bought decorating tools and equipment on credit from BAP for $650.
8 Jan	Bought paint for $250, paying by cheque.
10 Jan	Received $400 cash from a customer for work done.
12 Jan	Bought paint for $150, paying in cash.
14 Jan	Issued an invoice to a customer, KOR, for $750 for work done.
18 Jan	Returned some of the decorating tools, value $80, to BAP.
23 Jan	Took $50 of the cash to buy a birthday present for his son.
28 Jan	KOR paid $250 by cheque towards his bill.

Required:

Write up the transactions on each account for the month of January, by completing the ledger accounts provided below:

Capital

	$		$

Bank

	$		$

Motor van

	$		$

ABG

	$		$

Tools and equipment

	$		$

BAP

$		$

Purchases

$		$

Sales

$		$

Cash

$		$

KOR

$		$

Drawings

$		$

Test your understanding 16

BBA commenced in business as a market gardener on 1 March. Record the following transactions in the ledger accounts:

1 Mar   Paid $70 rent for land for the month of March, from his own funds.

3 Mar   Bought equipment on credit for $400 from JKL

4 Mar   Bought plants for $2,000, paying from his own funds.

8 Mar   Received $100 cash for a talk to the local horticultural society.

10 Mar Sold plants for $1,200, being paid by cheque. A business bank account was opened with this amount.

12 Mar Paid wages of $50 in cash.

14 Mar Bought plants for $800 on credit from BHH

18 Mar Sold Plants for $500 on Credit to PB.

23 Mar Paid $100 local business tax by cheque.

28 Mar Paid wages of $20 in cash.

31 Mar Sold plants for $240, being paid in cash.

Required:

Record the above transactions in the ledger accounts provided below.

Rent expense

$	$

Capital

$	$

JKL

$	$

Equipment

$		$

Purchases

$		$

Sales

$		$

Cash

$		$

Bank

$		$

Wages

$		$

BHH

$		$

PB

	$		$

Local business tax

	$		$

Test your understanding 17

On 1 January, P Roberts started a business with $2,500 in the bank and $500 cash. The following transactions occurred:

2 Jan	He bought raw materials on credit for $700 from J Martin.
3 Jan	He sold goods for $300 on credit to G Goddard.
7 Jan	He sold goods for $1,100 to K Lemon on credit.
12 Jan	He bought equipment for $3,000, paying by cheque.
18 Jan	He paid wages of $50 by cheque.
20 Jan	He bought raw materials for $350, paying by cheque.
	He took $80 from the cash box for himself.
28 Jan	He paid J Martin $250 by cheque.
30 Jan	He transferred $200 cash into the bank from his cash box.

Required:

Record the above transactions in the ledger accounts provided below.

Capital

		$			$
31 Jan	Drawings		1 Jan	Bank	
				Cash	

Bank

		$			$
1 Jan	Capital		12 Jan	Equipment	
30 Jan	Cash		18 Jan	Wages	
			20 Jan	Purchases	
			28 Jan	J Martin	

Cash

		$			$
1 Jan	Capital		20 Jan	Drawings	
			30 Jan	Bank	

Purchases

		$			$
2 Jan	J Martin				
20 Jan	Bank				

J Martin

		$			$
28 Jan	Bank		2 Jan	Purchases	

Sales

		$			$
			3 Jan	G Goddard	
			7 Jan	K Lemon	

G Goddard

		$			$
3 Jan	Sales				.....

K Lemon

		$		$
7 Jan	Sales			

Equipment

		$		$
12 Jan	Bank			

Wages

		$		$
18 Jan	Bank			

Drawings

		$		$
20 Jan	Cash			

Test your understanding answers

Test your understanding 1

Double-entry bookkeeping is a system of keeping records of transactions in ledger accounts such that every transaction requires debit and credit entries of equal value. For example, there might be a debit entry of $100 equalled by two credit entries of $90 and $10, respectively. The result of this method is that the total of debit balances on ledger accounts equals the total of credit balances.

Test your understanding 2

The order of boxes should be debit; credit; credit; debit; debit; credit; credit; debit.

Test your understanding 3

Bank

20X1		$	20X1		$
1 Feb	Capital	500	1 Feb	Purchases	150
10 Feb	Sales	290	5 Feb	Rent	50
27 Feb	Sales	240	22 Feb	Advertising	25
			26 Feb	Drawings	100

Capital

			20X1		$
			1 Feb	Bank	500

Purchases

20X1		$			
1 Feb	Bank	150			

Rent

20X1		$	
5 Feb	Bank	50	

Advertising

20X1		$	
22 Feb	Bank	25	

Drawings

20X1		$	
26 Feb	Bank	100	

Sales

		20X1		$
		10 Feb	Bank	290
		27 Feb	Bank	240

Test your understanding 4

D

Test your understanding 5

Capital	= Assets	– Liabilities
	= ($350 + $400 + $880)	– ($700 + $125)
	= $805	

Test your understanding 6

C

Test your understanding 7

C

The inventory account is never used to record purchases.

Test your understanding 8

C

Test your understanding 9

- This question tests your ability to determine the debit and credit entries of a range of simple transactions.

- It is common for students to reverse the entries at this stage in their studies. Keep referring to the table until you are sure of your accuracy.

Debit	Credit
Increases in assets	Decreases in assets
Decreases in liabilities	Increases liabilities
Decreases in capital/equity	Increases in capital/equity
Increases in expenses	Decreases in expenses
Decreases in income	Increases in income

	Account to be debited	Account to be credited
1	BAS	Sales
2	Purchases	PWA
3	PWA	Returns outwards
4	Office machinery	WPR
5	WPR	Office machinery
6	Cash	PWR
7	Bank	TWI
8	Car	Capital
9	PWR	Bank

Test your understanding 10

C

Test your understanding 11

B

Test your understanding 12

The cash transactions are recorded in total as follows:

Dr Purchase ledger control account $3,210

Dr Rent expense $3,400

Cr Bank $6,610

The discount is recorded as follows:

Dr Purchase ledger control account $180

Cr Discounts received $180

Entries must also be made to MRA, MRB and MRC's individual purchase ledger accounts in the purchase ledger in order to reflect the payments made and discounts received.

Test your understanding 13

The cash transactions are recorded in total as follows:

Dr Bank $48,820

Cr Receivables $48,700

Cr Interest income $120

The discount is recorded as follows in relation to each customer:

Dr Discounts allowed $800 (an expense in the statement of profit or loss)

Cr Receivables $800

Remember that, even though it is not part of the double-entry accounting system, we still need to update the individual accounts in the payables' ledger to reflect these transactions.

Test your understanding 14

Date	Details	Disc. all'd ($)	Cash ($)	Bank ($)	Date	Details	Disc. rec'd ($)	Cash ($)	Bank ($)
29 May	Balance b/d	27.40	114.10	214.30	29 May	Balance b/d	40.10	74.50	210.00
30 May	JCC	5.00		120.00	30 May	MBR			140.40
	NGR		40.00			Rates			150.40
	XYZ	1.50		75.00		Drawings		50.00	50.00

Test your understanding 15

Capital

		$			$
			1 Jan	Bank	1,000

Bank

		$			$
1 Jan	Capital	1,000	8 Jan	Purchases	250
28 Jan	KOR	250			

Motor van

		$			$
3 Jan	ABG	3,000			

ABG

		$			$
			3 Jan	Motor van	3,000

Tools and equipment

		$			$
4 Jan	BAP	650	18 Jan	BAP	80

BAP

		$			$
18 Jan	Tools	80	4 Jan	Tools	650

Purchases

		$		$
8 Jan	Bank	250		
12 Jan	Cash	150		

Sales

	$			$
		10 Jan	Cash	400
		14 Jan	KOR	750

Cash

		$			$
10 Jan	Sales	400	12 Jan	Purchases	150
			23 Jan	Drawings	50

KOR

		$			$
14 Jan	Sales	750	28 Jan	Bank	250

Drawings

		$		$
23 Jan	Cash	50		

Test your understanding 16

Rent expense

		$			$
1 Mar	Capital	70			

Capital

		$			$
			1 Mar	Rent	70
			4 Mar	Purchases	2,000

JKL

		$			$
			3 Mar	Equipment	400

Equipment

		$			$
3 Mar	JKL	400			

Purchases

		$			$
4 Mar	Capital	2,000			
14 Mar	BHH	800			

Sales

		$			$
			8 Mar	Cash	100
			10 Mar	Bank	1,200
			18 Mar	PB	500
			31 Mar	Cash	240

Cash

		$			$
8 Mar	Sales	100	12 Mar	Wages	50
31 Mar	Sales	240	28 Mar	Wages	20

Cash

		$			$
8 Mar	Sales	100	12 Mar	Wages	50
31 Mar	Sales	240	28 Mar	Wages	20

BHH

		$			$
			14 Mar	Purchases	800

PB

		$			$
18 Mar	Sales	500			

Local business tax

		$			$
23 Mar	Bank	100			

Test your understanding 17

(a)

Capital

		$			$
31 Jan	Drawings	80	1 Jan	Bank	2,500
				Cash	500

Bank

		$			$
1 Jan	Capital	2,500	12 Jan	Equipment	3,000
30 Jan	Cash	200	18 Jan	Wages	50
			20 Jan	Purchases	350
			28 Jan	J Martin	250

Cash

		$			$
1 Jan	Capital	500	20 Jan	Drawings	80
			30 Jan	Bank	200

Purchases

		$			$
2 Jan	J Martin	700			
20 Jan	Bank	350			

J Martin

		$			$
28 Jan	Bank	250	2 Jan	Purchases	700

Sales

		$			$
			3 Jan	G Goddard	300
			7 Jan	K Lemon	1,100

G Goddard

		$			$
3 Jan	Sales	300			

K Lemon

		$			$
7 Jan	Sales	1,100			

Equipment

		$			$
12 Jan	Bank	3,000			

Wages

		$			$
18 Jan	Bank	50			

Drawings

		$			$
20 Jan	Cash	80			