

The accounting system AS

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What you need to know

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

1. **Use double entry:** record every business transaction as a debit in one account and an equal credit in another.
2. **Use the accounting equation**, $\text{assets} = \text{liabilities} + \text{capital}$: work out capital, and say how a transaction changes assets, liabilities and capital.
3. **Explain what each book of prime entry is for**, and choose the right one for a transaction: the sales journal, sales returns journal, purchases journal, purchases returns journal, cash book and general journal.
4. **Prepare ledger accounts**, including balancing them off.
5. **State the purpose of a trial balance.**
6. **Give the advantages and disadvantages of keeping full accounting records** (rather than minimal ones).
7. **Name, explain and apply the twelve accounting concepts:** business entity, historic cost, money measurement, going concern, consistency, prudence, realisation, duality, materiality, objectivity, matching (accruals) and substance over form.
8. **Describe how computerised accounting systems are used** to record transactions, give the **advantages and disadvantages of introducing one**, and state **how data can be kept secure** in one. No particular software is needed.
9. **Use all of this to judge information and advise a business owner.**

Control accounts, correcting errors and suspense accounts are in "Reconciliation and verification". Accruals, prepayments, depreciation and the financial statements themselves are in "Preparation of financial statements", although the concepts behind them are examined here.

Understand it

The accounting equation

A business has **assets** (things it owns or is owed: premises, vehicles, inventory, trade receivables, money in the bank). Some of those assets were paid for by outsiders, and what the business owes them are its **liabilities** (trade payables, loans, a bank overdraft). The rest was paid for by the owner, and that is the owner's **capital**. So, always,

$$\text{assets} = \text{liabilities} + \text{capital}.$$

Every transaction changes at least two of the figures, and the equation still balances afterwards. Follow Sam, who starts a business:

Transaction	Assets	Liabilities	Capital
1. Sam pays \$20 000 of his own money into the business bank account	+20 000 (bank)		+20 000
2. Buys equipment for \$6000 on credit	+6000 (equipment)	+6000 (other payable)	

Transaction	Assets	Liabilities	Capital
3. Buys goods for \$4000, paying by cheque	+4000 inventory, –4000 bank		
4. Sells goods that cost \$1500 for \$2500 on credit	+2500 receivable, –1500 inventory		+1000 (profit)
5. Takes \$800 from the bank for himself	–800 (bank)		–800 (drawings)
After all five	26 200	6000	20 200

$26\,200 = 6000 + 20\,200$, so the equation still balances. Notice that:

- a **profit** increases capital, and a **loss** decreases it (it belongs to the owner);
- **drawings** (the owner taking money or goods out) decrease capital, and are **not** an expense;
- swapping one asset for another (transaction 3) changes nothing in total.

Over a year, capital moves like this:

$$\text{closing capital} = \text{opening capital} + \text{capital introduced} + \text{profit} - \text{drawings}.$$

Double entry

Each transaction has two sides, so it is recorded twice: a **debit** (Dr, the left side of an account) in one account and a **credit** (Cr, the right side) of the same amount in another. This is the **duality** concept, and it is why the accounting equation always balances.

Account type	An increase is a	A decrease is a	Its balance is usually
Asset (bank, inventory, equipment, receivables)	Debit	Credit	Debit
Expense (purchases, wages, rent, discount allowed)	Debit	Credit	Debit
Drawings	Debit	Credit	Debit
Liability (payables, loan, overdraft)	Credit	Debit	Credit
Income (sales, rent received, discount received)	Credit	Debit	Credit
Capital	Credit	Debit	Credit

A quick test: the account that **receives** value is debited; the account that **gives** value is credited. When a customer pays, the bank receives the money (debit bank) and the customer gives it (credit the customer).

Ledger accounts

Each account is kept in the ledger as a two-sided "T" account. The **details** column names the **other** account in the double entry, never a description like "payment" or "profit". Sam's bank account after transactions 1, 3 and 5:

Dr	Bank	\$	Cr	Bank	\$
	Capital	20 000		Purchases	4 000
				Drawings	800
				Balance c/d	15 200
		20 000			20 000
	Balance b/d	15 200			

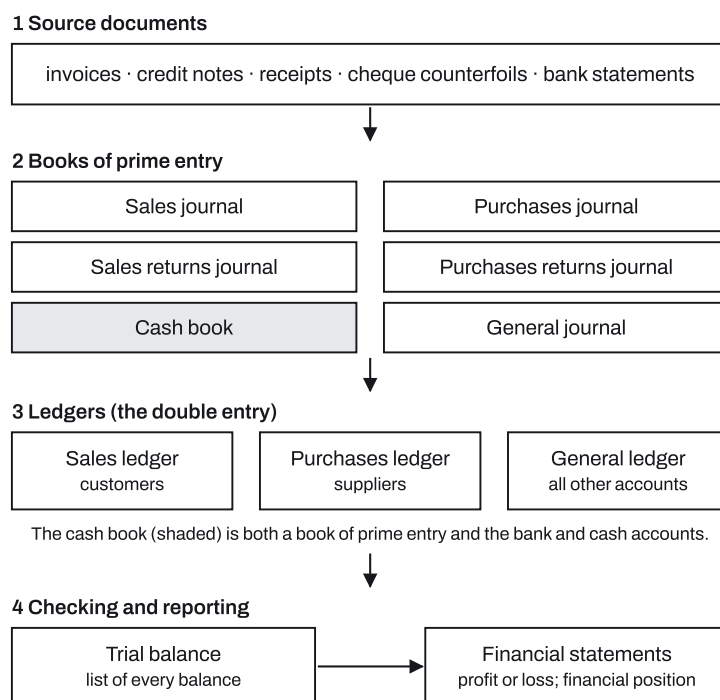
Balancing off: add up the bigger side, put the difference on the smaller side as "Balance c/d" (carried down) so both totals match, then bring it down on the other side as "Balance b/d" (brought down) to start the next period. Here the \$15 200 debit balance is money in the bank. If Sam had paid out more than he had, the balance b/d would be a **credit**, which is a bank overdraft, a liability.

The ledger is split into three parts:

- the **sales ledger**: one account for each credit customer (trade receivables);
- the **purchases ledger**: one account for each credit supplier (trade payables);
- the **general (nominal) ledger**: every other account, such as sales, purchases, expenses, assets, capital and drawings.

Books of prime entry

With hundreds of transactions a month, writing each one straight into the ledger would be slow and messy. So every transaction is first listed, from its **source document**, in a **book of prime entry** (a book of first entry). Similar transactions are kept together, the work can be shared out between clerks, and the ledger gets **totals** instead of hundreds of single entries.



Book of prime entry	What goes in it	Posted to the ledger as
Sales journal	Sales invoices for credit sales of goods	Dr each customer's account; Cr sales with the total
Sales returns journal (returns inwards)	Credit notes sent to customers for goods they return	Dr sales returns with the total; Cr each customer
Purchases journal	Invoices received for credit purchases of goods for resale	Dr purchases with the total; Cr each supplier
Purchases returns journal (returns outwards)	Credit notes received for goods sent back to suppliers	Dr each supplier; Cr purchases returns with the total
Cash book	Every receipt and payment of cash or by bank	It is the cash and bank accounts, so only the other side is posted

Book of prime entry	What goes in it	Posted to the ledger as
General journal	Everything else: non-current assets bought or sold on credit , goods taken by the owner, irrecoverable debts written off, corrections of errors, opening entries, year-end transfers	Each entry shows its debit and credit, with a short narrative

Points that come up again and again:

- Amounts go into the journals **after trade discount** (the price actually charged) and **before cash discount** (that comes later, when the bill is paid).
- **Cash** sales and purchases go only in the cash book, not the sales or purchases journal. Stationery or a non-current asset bought for cash is also a cash book item.
- The **three-column cash book** has discount, cash and bank columns on each side. The cash and bank columns are **balanced** (they are accounts); the discount columns are only **totalled** (they are lists), then posted: the debit-side total to Dr **discount allowed**, the credit-side total to Cr **discount received**.
- The books of prime entry are not part of the double entry, **except the cash book**, which is both a book of prime entry and a ledger account.

Recording the tricky transactions

Transaction	Debit	Credit
Owner takes goods for own use (at cost)	Drawings	Purchases
Owner takes cash	Drawings	Cash or bank
Owner brings in a private asset (a car, a computer, goods)	That asset (inventory , for goods)	Capital
Owner pays a business bill with her own money	The expense (or the supplier, if it was owed)	Capital
Customer returns goods	Sales returns	Customer
Goods returned to a supplier	Supplier	Purchases returns
Non-current asset bought on credit	The asset	Other payables (not trade payables)
Faulty non-current asset returned to its supplier	Supplier (other payable)	The asset (not purchases returns)
Customer pays and takes a cash discount	Bank and discount allowed	Customer (full amount)
We pay a supplier and take a cash discount	Supplier (full amount)	Bank and discount received
Customer's cheque is dishonoured (bounces)	Customer (full amount)	Bank and discount allowed
Irrecoverable debt written off	Irrecoverable debts	Customer
Written-off debt later paid	Bank	Irrecoverable debts recovered
Payment that takes the bank into overdraft	The expense or asset	Bank (the full payment)

Two of these need a closer look.

Returns are valued at the price charged. If 20 units at \$50 were sold less 10% trade discount, each unit was charged at \$45. When 4 come back, the credit note is $4 \times 50 \times 0.9 = \180 , not \$200.

A dishonoured cheque undoes the whole settlement. A customer who owed \$600 paid \$570 and took a 5% (\$30) discount. The cheque bounces, so both entries are reversed: Dr customer \$600, Cr bank \$570, Cr discount allowed \$30. The customer owes \$600 again and loses the discount.

Trade discount is never recorded. It is a reduction in the list price, so only the reduced price appears anywhere. Cash (settlement) discount is recorded, because it is decided when the bill is paid.

The trial balance

At the end of a period every ledger balance is listed, debits in one column and credits in the other. Because every transaction was entered twice, the two totals should agree.

A trial balance is prepared **to help prepare the financial statements** (it gathers every balance in one place) and **to check the arithmetic** of the double entry. Totals that agree do **not** prove the books are free from error: a transaction left out completely, or entered in the wrong account on the correct side, still balances. (Which errors it hides, and how to correct them, is in "Reconciliation and verification".)

Ledger accounts, not the trial balance, are where the double entry from the books of prime entry is recorded; checking the accuracy is the trial balance's job.

Full or minimal accounting records

Many small traders keep only a cash book or a bank statement and a few lists, and their accountant works out the profit at the year end ("incomplete records"). A **full** set means books of prime entry and a complete double-entry ledger.

Full records: advantages	Full records: disadvantages
Up-to-date balances all through the year (bank, what each customer owes, what is owed to each supplier)	Take time to keep
Better control of receivables and payables; fewer debts missed	Need bookkeeping skill, or a bookkeeper to be paid
Profit and financial position are complete and reliable, so decisions are better informed	May need accounting software or equipment
Performance can be analysed and compared	Cost may be more than the benefit for a very small business
Supports a loan application and tax returns	
Fraud is harder to hide; financial statements are easier (and cheaper) to prepare	
Full records don't guarantee error-free statements, and they increase bookkeeping costs.	

The accounting concepts

The concepts are the ground rules that make every business's accounts reliable and comparable.

Concept	What it says	Example
Business entity	The business is separate from its owner; only business transactions are recorded	Goods or cash taken by the owner are drawings, not expenses
Historic cost	Assets are recorded at what they cost	A building bought for \$200 000 stays at cost (less depreciation) even if it is now worth more
Money measurement	Only things that can be measured reliably in money are recorded	A skilled, loyal workforce is not shown as an asset

Concept	What it says	Example
Going concern	Assume the business will carry on for the foreseeable future	Non-current assets at cost less depreciation, not at what they would sell for; if it is not a going concern, they are valued at what they could be sold for
Consistency	Once a method is chosen, use it every year	The same depreciation method each year, so results can be compared
Prudence	Don't overstate profit or assets (or understate losses or liabilities); record a loss as soon as it is expected, a gain only when it is certain	Inventory at the lower of cost and net realisable value; an allowance for irrecoverable debts
Realisation	Revenue is recognised when it is earned: goods delivered or invoiced, not when the order arrives or the cash is received	An order not yet delivered is not a sale; goods on sale or return are not a sale until the customer keeps them
Duality	Every transaction has two effects	Double entry; assets = liabilities + capital
Materiality	An item is material if leaving it out or misstating it could affect the decisions of users of the statements; small items needn't be treated precisely	A \$20 waste bin is written off as an expense, not treated as a non-current asset
Objectivity	Figures should be based on evidence, not personal opinion	Use invoices and valuations, not the owner's guess
Matching (accruals)	Income and expenses are recorded in the period they belong to, whether or not cash has been paid or received	Unpaid wages are included as an expense; insurance paid in advance is carried forward; irrecoverable debts are matched against the year's sales
Substance over form	Record the economic reality, not just the legal form	An asset on a lease the business will use for most of its life is shown as its asset

Prudence does **not** mean deliberately overstating liabilities or understating profit; it means being cautious, not pessimistic.

Computerised accounting systems

Accounting software keeps the same books and ledgers. An entry is made once (for example a sales invoice), and the software posts it to the customer's account, the sales account and the control accounts, and keeps the balances and trial balance up to date.

Introducing a computerised system: advantages	Disadvantages
Fast; entries posted automatically	Cost of hardware and software
Arithmetic is always accurate; the trial balance always agrees	Staff need training; some resist the change
Up-to-date reports on demand (aged receivables, statements, invoices)	Disruption while changing over
Fewer staff hours; may save accountant's fees	Risk of hacking, viruses and data loss; system failures stop work
Information for managers, lenders and tax	Errors of input are still possible

A computer does **not** make records free from error or fraud: a wrong figure typed in is posted wrongly, and a dishonest user can still enter a false invoice. It only guarantees the **arithmetic**.

Keeping data secure:

- strong, unique passwords for each user, changed regularly, with each user's access limited to the parts they need;

- anti-virus and firewall software, and installing the software supplier's updates;
- regular **back-ups**, kept off site or in the cloud;
- encryption (including encrypted USB drives), and a secure connection (VPN) for remote access;
- automatic log-out when a computer is left idle;
- training staff to spot suspicious emails and activity, and limiting their use of other websites.

A password's purpose is to stop **other people** getting into the records. It does not stop the person who has it making mistakes or entering a fraudulent invoice.

Key facts and formulas

There is no formula list in the 9706 exam, so learn all of these.

Formula	Status
$\text{assets} = \text{liabilities} + \text{capital}$	Learn it
$\text{capital} = \text{assets} - \text{liabilities} = \text{non-current assets} + \text{current assets} - \text{non-current liabilities} - \text{current liabilities}$	Learn it
$\text{closing capital} = \text{opening capital} + \text{capital introduced} + \text{profit} - \text{drawings (subtract a loss)}$	Learn it
$\text{cash discount} = \text{amount owed} \times \text{rate}$; $\text{amount paid} = \text{amount owed} - \text{discount}$	Learn it
$\text{price charged} = \text{list price} \times (1 - \text{trade discount rate})$	Learn it
Goods for own use at cost: $\text{cost} = \text{selling price} \div (1 + \text{mark-up})$	Learn it

Key facts to learn:

- **Debit** increases assets, expenses and drawings. **Credit** increases liabilities, income and capital.
- **Six books of prime entry**: sales, sales returns, purchases, purchases returns journals; cash book; general journal.
- **General journal**: non-current assets on credit, goods for own use, irrecoverable debts, corrections, opening entries, transfers.
- **Trial balance**: to help prepare the financial statements and check the arithmetic; it doesn't prove there are no errors.
- **Twelve concepts**, with one example each (the table above).

How to do it

We have 84 tagged questions for this topic from 2021 to 2025 (three appear on two paper variants). 5 of them mix two types, so the counts add up to 89:

Question type	Questions
Record a transaction with double entry (debit and credit, journal, ledger account)	21
Identify the accounting concept being applied (multiple choice)	20
Choose the book of prime entry, or say how the books and ledgers work	13
Name and explain an accounting concept in context (written)	10
Apply the accounting equation (effect of a transaction, calculate capital)	10

Question type	Questions
Advantages and disadvantages of full accounting records	6
Computerised accounting: reasons, drawbacks and data security	6
Purpose of a trial balance or of ledger accounts	3

1. Record a transaction with double entry (21 questions)

1. **Whose books?** Read whose books the question is about. A cash discount is **discount allowed** in the seller's books and **discount received** in the buyer's books.
2. **Name the two (or three) accounts** involved.
3. **Decide debit or credit** for each, from the table in "Understand it" (receives value: debit; gives value: credit).
4. **Check the amounts:** the debits must equal the credits. Use the price after trade discount; split a settlement into bank and discount.

For example, Tom buys goods for \$500 on credit, returns \$60 of them and pays the balance less 5% cash discount. The balance is \$440; the discount is $440 \times 5\% = \$22$, so he pays \$418. In Tom's books: Dr supplier \$440, Cr bank \$418, Cr discount received \$22.

Variations you will meet:

- **Goods for own use:** Dr drawings, Cr **purchases** (not inventory, and not sales), at cost. If you are given the selling price and the mark-up, find the cost first: goods selling at \$500 with a 25% mark-up cost $500 \div 1.25 = \$400$.
- **The owner puts something in:** a private computer, goods, or paying a business bill (stationery, a supplier) from her own money. The credit is always **capital**. The debit is the asset received: goods brought in are debited to **inventory** (not purchases), a computer to equipment, a bill to the expense or the supplier.
- **Part-paid purchase of a non-current asset:** Dr the asset with the full price; Cr bank with what was paid now and Cr **other payables** with the rest.
- **Returns with a bulk or trade discount:** value the returned goods at the discounted price actually charged. 10 units at \$100 less a 5% discount come back as \$950.
- **Which account appears where?** A customer's account in the seller's books: Dr balance b/d; Cr bank and Cr discount allowed. Items **debited** to accounts in the **purchases ledger** are payments to suppliers and purchases returns (and discounts received); purchases are credited there.
- **Discount allowed is recorded** on the debit side of the cash book (discount column) and the credit side of the customer's account (and of the sales ledger control account).
- **Posting cash-book discount totals:** debit-side total \$250 goes to Dr discount allowed \$250; credit-side total \$90 goes to Cr discount received \$90.
- **Paying into an overdraft:** credit the bank with the whole payment. There is no separate "overdraft account"; the bank account simply ends up with a credit balance.
- **A running bank balance:** work through each item in order, remembering that paying makes an overdraft bigger. An overdraft of \$4800, then paying for \$3000 of materials less 20% trade and 5% cash discount ($3000 \times 0.8 \times 0.95 = \2280), then receiving \$500, leaves an overdraft of $4800 + 2280 - 500 = \$6580$.
- **Rule-check questions:** "Which entry does **not** follow double entry?" Test each against the table. For example, an expense **prepaid** at the year end is carried down as a **debit** balance (an asset), but the entry in the expense account at the year end is a **credit** (balance c/d).
- **Written (Paper 2) "State the double entry":** write "Debit: drawings \$420 / Credit: purchases \$420". One mark per correct account on the correct side. For a journal entry, use the Dr and Cr columns; no narrative is needed unless asked.
- **Prepare a ledger account:** dates, the other account's name, amounts; balance it off with c/d and b/d.

2. Identify the accounting concept being applied (20 questions)

1. **Find the key words** in the scenario and match them to a concept using the table:

- lower of cost and net realisable value, obsolete inventory, allowance for irrecoverable debts, "not overstated": **prudence**;
- sale on delivery or invoice, not on order or payment; sale or return: **realisation**;
- unpaid wages or costs incurred not yet billed; allowance matched with the year's sales: **matching**;
- skills of the workforce, staff morale: **money measurement**;
- small value items expensed; "affects users' decisions or interpretation": **materiality**;
- resale value only if the business is closing: **going concern**;
- owner's private items: **business entity**;
- same method every year: **consistency**.

2. **For numbered statements**, test each one separately and pick the option with exactly the true ones.

Variations you will meet:

- **Two concepts at once:** an allowance for irrecoverable debts applies **both** prudence and matching.
- **Statements about prudence:** "assets should not be overstated" is true; "liabilities should be overstated" and "losses are provided for only after they happen" are false.
- **"Which item wrongly applies matching?"** Putting a value on staff expertise and writing it off over their working life breaks money measurement, so it is the wrong one. Unused stationery carried forward, providing for irrecoverable debts in the year of the sales and recording telephone costs not yet billed are all correct matching.
- **The basis of a statement of profit or loss** is income earned less costs incurred in the year (matching), not cash received less cash paid.
- **Goods sent on sale or return** and not yet accepted: realisation says they are not sales, so they stay in inventory at cost.

3. Choose the book of prime entry, or say how the books and ledgers work (13 questions)

1. **Is it a cash or bank transaction?** Then it is the **cash book**, whatever was bought or sold.

2. **Is it a credit purchase or sale of goods for resale** (or a return of them)? Then it is the matching **journal**.

3. **Anything else** (credit non-current assets, goods for own use, irrecoverable debts, corrections) goes in the **general journal**.

Variations you will meet:

- **Selling a non-current asset for cash:** the cost moved into the disposal account is a general journal entry; the sales proceeds are in the cash book. Sold **on credit**: general journal.
- **Amounts in each book:** goods bought for \$100 on credit, \$20 returned, the rest paid as \$76 after a cash discount: purchases journal \$100, purchases returns journal \$20, cash book (bank column) \$76.
- **Where one sales invoice goes:** the sales journal, then the customer's account in the sales ledger. Only the journal's **total** goes to the sales account and the sales ledger control account.
- **True or false statements:** "a book of prime entry is also part of the double entry system" counts as **true**, because the cash book is both; the sales account is in the general ledger; credit notes issued go in the sales **returns** journal; the sales journal is written up from invoices, not from the ledger; only **credit** sales are in the sales ledger; trade discount never appears in the statement of profit or loss; income and liability accounts have credit balances.
- **Three-column cash book at the period end:** cash and bank columns balanced; discount columns totalled.
- **Why keep a purchases journal:** to keep similar transactions in one place, to share out bookkeeping duties, and to provide totals (for purchases and the control account). It does **not** reduce the entries in the purchases ledger; each invoice is still posted to its supplier.
- **Paper 2:** "Identify the book of prime entry for discounts allowed" (cash book) and "irrecoverable debts written off" (general journal, not the sales ledger).

4. Name and explain an accounting concept in context (10 questions)

Paper 2 gives an adjustment or an error and asks for the concept behind it: usually 1 mark for naming the concept and 1 for explaining it **for this item**.

1. **Name** the concept exactly (for example "prudence", not "being careful").
2. **Explain** what the concept requires, and **link** it to the item: "so the damaged goods are valued at \$1400, the lower of cost and net realisable value, and profit and inventory are not overstated".

Variations you will meet:

- **"Which concept has been ignored?"** for a list of errors: changing depreciation method (consistency), not recording the owner's goods (business entity), writing assets down to resale value when the business will continue (going concern), recording an order as a sale (realisation).
- **"Define the concept and give an example"**: a one-line definition, then a specific example from the table.
- **"Explain how the concept is applied"**: say what the business does because of it.
- **An asset the owner wants to show that can't be valued** (a highly skilled workforce): money measurement.
- Other valid concepts are credited when the reasoning fits (an allowance for irrecoverable debts can be prudence or matching).

5. Apply the accounting equation (10 questions)

1. Write the equation with the starting figures.
2. Take the transactions one at a time, showing the change to assets, liabilities and capital.
3. Check the equation still balances.

For example, a business with non-current assets \$90 000, current assets \$25 000, non-current liabilities \$30 000 and current liabilities \$12 000 has capital $90\,000 + 25\,000 - 30\,000 - 12\,000 = \$73\,000$.

Variations you will meet:

- **Closing capital from a list of balances**: add all assets, subtract all liabilities. Profit and drawings are not assets or liabilities; ignore them when you are already given every asset and liability, or use them with the opening capital when you are not.
- **Closing capital from the movement**: opening capital \$85 000, a private vehicle worth \$30 000 introduced, cash drawings \$15 000 and a loss of \$22 000 give $85\,000 + 30\,000 - 15\,000 - 22\,000 = \$78\,000$.
- **A sale at a profit**: goods costing \$50 sold for \$80 on credit raise current assets **and** capital by \$30.
- **Asset bought on credit**: assets up, liabilities up, capital unchanged.
- **The owner pays a business payable from her own money**: liability down, capital up.
- **Business pays the owner's private costs**: capital down (drawings). Taking out a loan: no effect on capital.
- **Drawings that overdraw the bank**: if the bank had \$1000 and \$2000 is drawn, assets fall by \$1000 (the bank is now nil) and liabilities rise by \$1000 (the overdraft).
- **Buying a used asset part-paid**: an asset of \$12 000 paid \$7500 now and \$4500 later: assets up \$4500 overall (+12 000 vehicle, -7500 bank), liabilities up \$4500, capital unchanged.

6. Advantages and disadvantages of full accounting records (6 questions)

1. For multiple choice, pick the true advantages: fuller view of performance, better-informed decisions, balances available through the year. Reject "lower bookkeeping costs", "error-free statements" and "keeps business and private assets apart" (that is the business entity concept, not full records).
2. For "State two reasons why an owner keeps only minimal records": lack of time, lack of skill, cost of a bookkeeper or software, the business is small and the owner is content with the information.

3. For "State/identify four benefits of full records": one short, different point per mark from the table (reliable profit, control of receivables and payables, decisions, loan applications, tax, less fraud, easier statements).
4. For "Advise whether to keep full records using software": points for (max about 3), points against (max about 3), then a decision with a reason.

7. Computerised accounting: reasons, drawbacks and data security (6 questions)

1. **"State three ways the security of data can be ensured"**: three different measures from the list (passwords, restricted access, anti-virus, encryption, back-ups, automatic log-out, staff training). One mark each.
2. **"State three disadvantages of introducing a computerised system"**: cost, training, disruption, hacking or viruses, loss of data.
3. **Multiple choice**: a computer ensures arithmetic accuracy only; a password limits access by others; back-ups and anti-virus protect data, while skipping updates and sharing one password for everything make it less secure.

8. Purpose of a trial balance or of ledger accounts (3 questions)

1. The trial balance's purpose is **to assist the preparation of the financial statements** (and check the arithmetic of the double entry).
2. Reject options claiming it **proves** there are no errors, that every transaction has been recorded, or that postings are accurate; and reject "to calculate profit" or "to calculate owner's equity".
3. "What is **not** a purpose of ledger accounts?": verifying the accuracy of the bookkeeping is the trial balance's job. Ledger accounts record the double entry from the books of prime entry and feed the trial balance and statements.

Worked examples

Example 1

Nadia sells goods on credit. A customer, Omar, owes her \$800. He pays by bank transfer and deducts a 2.5% cash discount.

Which entries record this in **Nadia's** books?

	Debit	\$	Credit	\$
A	Bank	780	Omar	800
	Discount allowed	20		
B	Bank	780	Omar	800
	Discount received	20		
C	Omar	800	Bank	780
			Discount allowed	20
D	Bank	800	Omar	800

[1]

The discount is $800 \times 2.5\% = \$20$, so Omar pays $800 - 20 = \$780$. In the **seller's** books, a discount she gives is **discount allowed**, an expense (debit). The bank receives \$780 (debit), and Omar's debt of \$800 is cleared (credit). The answer is **A** (1).

B uses the buyer's word, C is Omar's account the wrong way round, and D ignores the discount.

Example 2

A business's accounting equation is:

$$\text{assets } \$60\,000 = \text{liabilities } \$14\,000 + \text{capital } \$46\,000.$$

Then:

1. the owner pays \$5000 of her savings into the business bank account;
2. goods with a list price of \$2000 are bought on credit, less 20% trade discount;
3. goods that cost \$900 are sold on credit for \$1500;
4. the owner takes \$700 from the business bank account for private use.

What is the accounting equation after these transactions?

	Assets \$	Liabilities \$	Capital \$
A	66 500	15 600	50 900
B	65 900	15 600	50 300
C	66 500	14 000	52 500
D	67 200	15 600	51 600

[1]

	Assets	Liabilities	Capital
Start	60 000	14 000	46 000
1 Capital introduced	+5000		+5000
2 Goods on credit, $2000 \times 0.8 = 1600$	+1600	+1600	
3 Sale: +1500 receivable, -900 inventory	+600		+600 profit
4 Drawings	-700		-700
End	66 500	15 600	50 900

Check: $15\,600 + 50\,900 = 66\,500$. The answer is **A** (1). B forgets the \$600 profit on the sale, D forgets the drawings, and C leaves out the new liability.

Example 3

Ruth owns a shop. Her financial year ends on 31 December 2025.

(a) For each item, name the accounting concept that is applied and explain how it is applied. [8]

1. Ruth paid her home electricity bill of \$240 from the business bank account. It has been recorded as drawings, not as an expense of the shop.
2. On 1 April 2025 Ruth paid \$1200 for insurance for the twelve months to 31 March 2026. Only \$900 is charged as an expense for 2025.
3. Goods that cost \$2000 were damaged. After repairs they can be sold for only \$1400, so they are valued at \$1400.
4. Ruth wanted to change her depreciation method this year to report a higher profit. Her accountant advised her not to.

(b) Ruth also took goods costing \$350 from the shop for her family. State the double entry to record this. [2]

(a)

1. **Business entity** (1). The shop is treated as separate from Ruth, so her private bill is not a cost of the business; it is recorded as drawings, which reduce her capital (1).
2. **Matching (accruals)** (1). Expenses are charged to the period they relate to: 9 months of the 12 fall in 2025, so $1200 \times \frac{9}{12} = \900 is the expense and \$300 is prepaid for 2026 (1).
3. **Prudence** (1). Inventory is valued at the lower of cost and net realisable value, so profit and current assets are not overstated (1).
4. **Consistency** (1). The same depreciation method should be used every year so that results can be compared fairly from year to year (1).

(b) Debit: drawings \$350 (1). Credit: purchases \$350 (1).

Example 4

Mina sells goods on credit. On 1 May 2025, Leo, a customer, owed her \$1200.

- 6 May: Mina sold goods to Leo with a list price of \$2400, less 25% trade discount.
- 9 May: Leo returned goods; Mina sent him a credit note for \$300.
- 20 May: Leo paid, by bank transfer, the amount he owed on 1 May, less a 5% cash discount.

(a) Name the book of prime entry Mina uses for each of the transactions on 6, 9 and 20 May. [3]

(b) Prepare Leo's account in Mina's sales ledger for May 2025. Balance the account and bring down the balance on 1 June. [5]

(c) On 3 June Mina learns that Leo cannot pay anything more, and she writes off his balance. Prepare the journal entry. A narrative is not required. [2]

(a) 6 May: sales journal (1). 9 May: sales returns journal (1). 20 May: cash book (1).

(b) Sale: $2400 \times 0.75 = \$1800$ (trade discount is not recorded). Payment: $1200 \times 0.95 = \$1140$, discount \$60.

Date	Details	\$	Date	Details	\$
May 1	Balance b/d	1 200	May 9	Sales returns	300
May 6	Sales	1 800	May 20	Bank	1 140
			May 20	Discount allowed	60
			May 31	Balance c/d	1 500
		3 000			3 000
Jun 1	Balance b/d	1 500			

(1) balance b/d and sales at \$1800; (1) sales returns; (1) bank \$1140; (1) discount allowed \$60; (1) balance c/d \$1500 and b/d on the debit side (own figure).

(c)

Journal	Dr \$	Cr \$
Irrecoverable debts	1 500	
Leo		1 500

(1) for each line. The debts written off are an expense (debit); Leo's account is cleared (credit).

Common mistakes

- **Reversing the double entry.** Examiners see journal entries the wrong way round every year, for irrecoverable debts, goods for own use and share issues. Ask "which account receives value?" before writing.
- **Wrong labels in ledger accounts.** "Receipts", "payment" or "profit" earn nothing; the details column must name the other account ("Bank", "Income statement", "Discount allowed"). Marks cannot be given for wrong labels even with the right figure.
- **Discount allowed or received the wrong way round.** Decide whose books you are in first. And don't treat discount allowed as a reduction of revenue: it is an expense.
- **Mixing up trade and cash discount.** Trade discount is never recorded; cash discount is. Returns are at the price after trade discount.
- **Goods for own use credited to sales or inventory.** The credit is purchases, at cost.
- **Thinking the sales ledger is a book of prime entry.** Irrecoverable debts written off start in the general journal. Taking cash as drawings is a cash book entry, not a general journal one.
- **Naming a concept without explaining it.** "Prudence" alone earns 1 of 2 marks. Explaining questions need the concept **developed** for the item in the question.
- **Muddling the concepts.** Candidates often give matching when prudence is wanted (damaged inventory, an irrecoverable debt), and write about "the material a business uses" for materiality. Materiality is about whether an amount is big enough to affect users' decisions.
- **Believing a computer (or full records) makes accounts error-free.** It guarantees the arithmetic, not the entries. "Reduces errors" is not a valid benefit of full records.
- **Forgetting an overdraft is a liability** in accounting-equation questions.

How to get the marks

- **Multiple choice:** test every option or numbered statement on its own; with double entry, check both the account and the side, and whose books it is.
- **"State the double entry":** name the debit and credit accounts (and amounts if given); 1 mark each.
- **Journal entries:** Dr column first, Cr column second, accounts named exactly. No narrative unless asked.
- **Ledger accounts:** title, dates, the other account's name, amounts, balance c/d and b/d. Totals on both sides level. Many marks are "own figure" (**OF**), so a wrong earlier figure used correctly still scores.
- **"Identify" or "Name"** a concept or book: just the exact name.
- **"Explain" a concept:** name it (1) + what it requires and how it applies to the item in the question (1).
- **"Define ... and give an example":** a one-line definition, then a real example, not the definition again.
- **"State two advantages / three ways":** one different, short point per mark. Repeating a point in other words scores once.
- **"Advise ... justify":** points for, points against, then a clear decision with a reason.

Quick check

1. A business buys a stapler for \$12 and records it as an expense rather than as a non-current asset. Which accounting concept is applied?
2. At the start of the year a sole trader's capital was \$38 000. During the year she brought her own van, worth \$9000, into the business, the business made a loss of \$4500 and she took drawings of \$12 000. Calculate her capital at the end of the year.
3. Name the book of prime entry for each: (a) a credit note received from a supplier; (b) the sale of an old machine on credit; (c) cash sales; (d) an invoice received for goods bought for resale on credit.
4. State **three** disadvantages to a business of introducing a computerised accounting system. **[3]**
5. Kai owes a supplier \$2000 and pays by bank transfer, deducting a 3% cash discount. State the entries in **Kai's** books.

Answers

1. **Materiality.** The amount is too small to affect anyone's decisions, so it isn't worth treating as a non-current asset and depreciating.
2. $38\,000 + 9\,000 - 4\,500 - 12\,000 = \$30\,500$.
3. (a) Purchases returns journal. (b) General journal. (c) Cash book. (d) Purchases journal.
4. Any three, one mark each: the cost of hardware and software (1); the cost of training staff (1); disruption while changing over, or staff resistance (1); risk of hacking or viruses (1); data can be lost if not backed up (1).
5. $\text{Discount} = 2000 \times 3\% = \60 , so he pays \$1940. Debit: supplier \$2000. Credit: bank \$1940 and discount received \$60.

Past questions to try

- 9706/12/O/N/23 Q3: reversing a dishonoured cheque that had a cash discount.
- 9706/13/M/J/23 Q3: the accounting equation after drawings that overdraw the bank.
- 9706/23/M/J/22 Q2: parts (a) and (b), defining three concepts and a journal entry.
- 9706/22/M/J/23 Q3: parts (c) and (d), advantages and disadvantages of full accounting records.