



INTRODUCTION TO BOOKKEEPING

TUTORIAL



SUPPORT
AS YOU
LEARN

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1 The accounting system

this chapter covers...

This chapter is a basic introduction to the accounting system of a business and gives an overview of all the topics that will be explained throughout this book.

It is the aim of the course you are studying that you will acquire the knowledge and skills to enable you to work effectively in an accounting and finance environment.

This chapter describes and explains the basic structure of the accounting system:

- *the range of financial transactions in business, eg buying, selling, making payments*
- *how financial (business) documents, such as invoices, are used to record financial transactions*
- *the way in which financial transactions are first recorded in the books of the business – using 'books of prime entry'*
- *how an accounting system is set up, for example a double-entry system using ledger accounts*
- *how the accounts are brought together in a summary known as the 'trial balance'*
- *the ways in which an accounting system can be used to provide information for the business owners and management, for example how much is owed by customers and how much profit has been made*

FINANCIAL TRANSACTIONS

All businesses carry out a wide range of financial transactions on a daily basis. These transactions will need documenting and then recording in a manual or a digital bookkeeping system. Common transactions include:

selling goods and services

Goods and services can be sold:

- either for immediate payment – known as ‘cash’ sales, although confusingly this word ‘cash’ also involves payment by credit or debit card as well as cash itself in the form of notes and coins; or
- for payment at a later date – known as ‘credit’ sales

making purchases and paying expenses

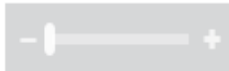
Examples of purchases and expenses include a wide range of large and small transactions, some more important than others:

- settling purchase invoices, eg paying by cheque or electronically for goods or services received during the previous month
- buying an item for use in the business, eg a new delivery van, paid for by bank transfer
- buying fuel for the delivery van, using the company credit card
- buying postage stamps for the office using cash

payments in and out of the bank account

The money received by the business and the money paid out by the business will pass through the bank account, for example:

- cash, cheque and electronic receipts from selling goods and services
- paying for purchases by cash, cheque or electronic payment
- settling the company credit card by direct debit payment from the bank account
- paying employee wages by bank transfer through the bank account
- drawing cash from the bank for use in the business



the importance of keeping track

As you will see from the above examples, recording financial transactions is a complex process. A business needs to keep track of:

- expenses and purchases
- wages paid
- what each customer owes, and when the money is due
- amounts owed to suppliers, and when the payment is due
- amounts paid into the bank and out of the bank

If these transactions are not recorded accurately, the owner of the business and other interested organisations – such as the bank and the tax authorities – will not know how much money the business is making (or losing!).

DIGITAL BOOKKEEPING SYSTEMS

Most businesses are able to make use of digital bookkeeping systems to record their financial transactions electronically. The form these systems take include:

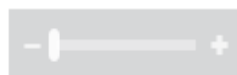
- spreadsheets, such as Microsoft Excel
- app and cloud-based software, such as Xero, QuickBooks, Sage
- desktop software, such as Sage
- custom software tailor-made to the specific needs of the business

As to which system is used will depend on the size of the business. We will look more fully at the benefits and drawbacks of using digital bookkeeping systems in Chapter 3.

THE FIVE STAGE ACCOUNTING SYSTEM

The accounting system, which will be set in motion by all the transactions listed on the previous page, can be broken down into five stages. These will be covered in greater detail later in this chapter. These stages (illustrated on the next page) are as follows:

- 1 A **financial transaction** takes place – a sale, a purchase, a payment.
- 2 The transaction involves a **financial (business) document**, for example an invoice (a sale), a credit note (returned goods), a petty cash voucher (small cash payments).
- 3 The document is first recorded by the business, for example a day book (for credit transactions) recording sales of goods or goods returned, a cash book recording payments in and out of the bank, or a petty cash book



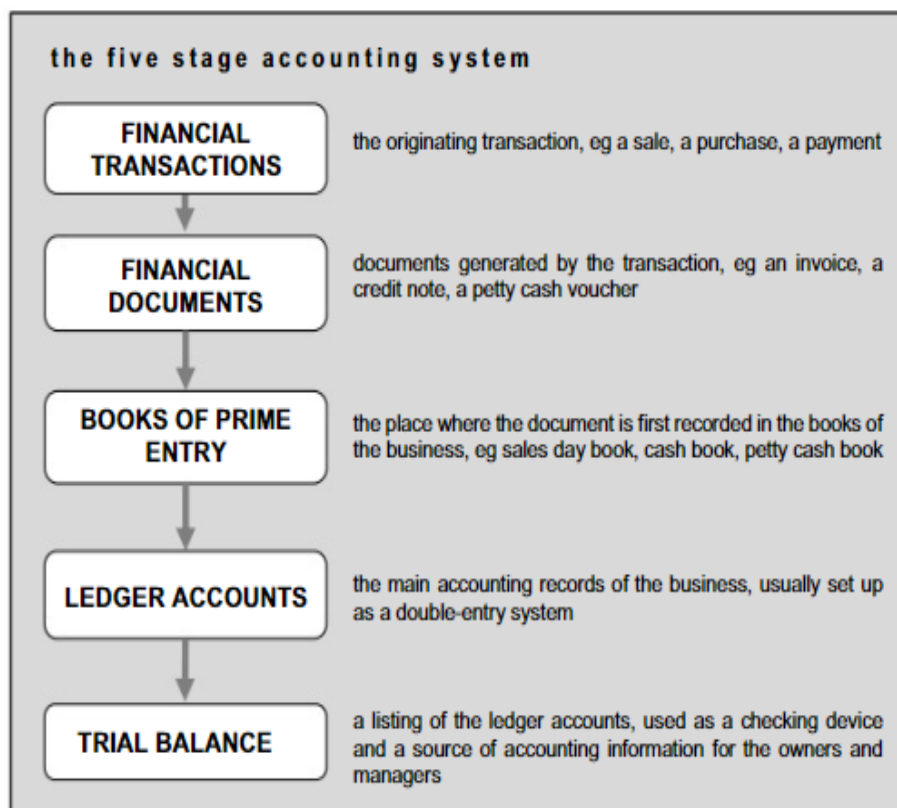
which records small cash payments (eg buying postage stamps for use by the business)

These books are known as the **books of prime entry**; this simply means 'the first place a transaction is recorded in the accounting records'.

- 4 The entries in the books of prime entry, eg the day books, are then transferred to the **ledger accounts** of the business. These are a formal record of the financial transactions and normally involve **double-entry accounts**.

The double-entry system, which involves two entries for each transaction, a debit entry and a credit entry, is explained in more detail on pages 8-11.

- 5 The final stage in the accounting system covered in your current studies is the **trial balance**. This is a list of the balances of the double-entry accounts. It is used as a check on the accuracy of the account entries and is also a source of information for the business owners and managers: it enables them to monitor items such as expenses and what their customers owe, and also to calculate how much profit the business has made. The trial balance is explained in more detail on pages 12-13.



We will now explain the last four of these five stages in more detail. The first stage, financial transactions, has already been covered on page 3.

FROM DOCUMENTS TO BOOKS OF PRIME ENTRY

You will need to study a wide variety of financial documents as part of your course. On the next page a Case Study shows how a sales invoice – a **financial document** – is recorded in the sales day book, which is a list of sales invoices issued and a **book of prime entry**. You do not at this stage need to learn all the details of how this record is entered. This will be covered in Chapter 4.



Case Study

FROM DOCUMENT TO BOOK OF PRIME ENTRY

situation

Your business, Computrade, has sold a laptop computer to R S George Limited, for £576.00 (which is list price of £480 plus £96.00 VAT at 20%). The financial document issued is a sales invoice (see below) which requires payment in 30 days' time. The details from this invoice are recorded in a sales day book (see bottom of the page), a book of prime entry.

<h2 style="margin: 0;">INVOICE</h2>	<p>COMPUTRADE Ardent House, Mercia Way Newtown, NT1 6TF Tel 01722 295875 Fax 01722 295611 Email sales@computrade.com VAT Reg GB 02756 6865 06</p>																			
invoice to <div style="border: 1px solid black; padding: 5px; margin-top: 10px;"> R S George Limited Unit 32 Bruges Trading Estate Winter Road Maidstone ME7 2PH </div>	invoice no 2984 account 8934 your reference CT524 date/tax point 02 04 20-3																			
<table border="1" style="width: 100%; border-collapse: collapse;"> <thead> <tr> <th style="width: 40%;">description</th> <th style="width: 10%;">quantity</th> <th style="width: 15%;">price</th> <th style="width: 15%;">unit</th> <th style="width: 20%;">total</th> </tr> </thead> <tbody> <tr> <td>Extreme 2120 Laptop</td> <td style="text-align: center;">1</td> <td style="text-align: right;">480.00</td> <td style="text-align: center;">each</td> <td style="text-align: right;">480.00</td> </tr> </tbody> </table>	description	quantity	price	unit	total	Extreme 2120 Laptop	1	480.00	each	480.00	<table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 70%;">terms</td> <td style="width: 30%; text-align: right;">Goods total</td> <td style="text-align: right;">480.00</td> </tr> <tr> <td>30 days</td> <td style="text-align: right;">VAT</td> <td style="text-align: right;">96.00</td> </tr> <tr> <td>E & OE</td> <td style="text-align: right;">TOTAL</td> <td style="text-align: right;">576.00</td> </tr> </table>	terms	Goods total	480.00	30 days	VAT	96.00	E & OE	TOTAL	576.00
description	quantity	price	unit	total																
Extreme 2120 Laptop	1	480.00	each	480.00																
terms	Goods total	480.00																		
30 days	VAT	96.00																		
E & OE	TOTAL	576.00																		

Sales Day Book					
Date	Customer	Invoice No.	Total	VAT	Net
20-3			£	£	£
2 April	R S George Limited	2984	576.00	96.00	480.00

