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Accounting

Coursebook

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Chapter 1

Double-entry bookkeeping: cash transactions

Learning objectives

In this chapter you will learn:

- that every transaction has two aspects
- that double-entry bookkeeping records both aspects of a transaction
- what ledger accounts are
- the meanings of the terms 'debit' and 'credit'
- how to record cash transactions in ledger accounts.

1.1 What is double-entry bookkeeping?

It is important for every business to have an **accounting system** in place to record its financial transactions. This usually comprises an organised set of manual or computerised records which classify the transactions, allowing them to be used to make decisions or report the financial performance of the business to others. The accounting system will be based on **double-entry bookkeeping**.

Double-entry bookkeeping is a system of recording transactions that recognises that there are two sides (or aspects) to every transaction. For example, you give your friend \$10 in exchange for his watch. This involves you giving him \$10 (one aspect) and your friend receiving \$10 (the other aspect). Every transaction involves giving and receiving. It is important that you **recognise** and **record** both aspects of every transaction in your bookkeeping. The term double-entry bookkeeping comes from the fact that both aspects are recorded. It is the starting point of your studies as it underpins everything else which follows. It is probably the most important thing to remember: that every transaction is recorded twice in the books of account. The two entries to record the two aspects are made in **ledger** accounts.

1.2 Ledger accounts

Transactions are recorded in **ledger accounts**. An account is a history of all transactions of a similar nature. A ledger is a book that contains the ledger accounts. An account separates what is received from what is given.

Walkthrough

For example, a cash account records cash received and cash paid, as in the following ledger account:

Cash account					
Debit			Credit		
		\$			\$
Mar 1	Cash received from customers	240	Mar 2	Cash paid to suppliers	80
Mar 4	Cash received from customers	118	Mar 3	Wages paid	116

The **left-hand** side of the account is called the **debit side** and is used to record cash received (that is, coming into the account).

The **right-hand** side of the account is the **credit side** and shows cash paid (that is, going out of the account).

- All accounts have a debit side on the left to record what is received, and a credit side on the right to record what is given.
- In practice, the words 'debit' and 'credit' are not shown because bookkeepers do not need to be reminded of them.



TOP TIP

When recording transactions, think very carefully about which account 'gives' and which account 'receives'. Credit the account that 'gives' and debit the account that 'receives'.

KEY TERMS

Accounting system: A system of collecting, storing and processing financial information and accounting data used by managers.

Double-entry bookkeeping: A system of recording accounting transactions that recognises that there are two sides (or aspects) to every transaction.

Ledger: A book containing accounts.

Ledger account: A history of all transactions of a similar nature.

Debit side: Left-hand side of an account.

Credit side: Right-hand side of an account.

1.3 How to record cash transactions

Bookkeeping treats businesses as ‘persons’ with separate identities from their owners. For example, if Abdul is a trader, all his business transactions are recorded as those of the business and not as Abdul’s own transactions.

In the example that follows, some transactions are recorded in ledger accounts. Make sure you understand the bookkeeping entries, and observe the wording carefully. This is important as you must be able to record transactions in ledger accounts correctly.



TOP TIPS

- Remember, all transactions are recorded from the point of view of Abdul’s business, not from those of its customers and suppliers.
- Date every entry and enter the name of the other account in which the double entry is completed in the details column.
- Make sure you complete the double entry for every transaction before starting to record the next one.

Walkthrough

KEY TERMS

Capital account: The account which records the capital introduced into the business by the owner.

Postings: The process of recording financial transactions in ledger accounts.

Transaction 1 April 1. Abdul starts business as a trader by paying \$10 000 into a bank account which he opens for the business. Abdul gives, and the business receives, \$10 000. An account for Abdul will be opened (his **capital account**) and credited with his ‘capital’. The business bank account will be debited.

Business bank account			
Debit		Credit	
		\$	\$
Apr 1	Abdul – capital	10 000 [1]	

Abdul – capital account			
Debit		Credit	
		\$	\$
			Apr 1 Bank
			10 000 [2]

[1] The business has received \$10 000 which has been paid into the business bank account, hence that account has been **debited**.

[2] In this example, Abdul has given the business \$10 000, hence his capital account has been **credited**.

Notes:

- Each entry is dated and shows the name of the other account in which the double entry is completed. Make sure you show these details for every entry you make in a ledger account.
- Entries in ledger accounts are known as **postings**, and bookkeepers are said to ‘post’ transactions to the accounts.

Transaction 2 April 2. Abdul buys a motor vehicle for the business and pays \$2 000 from the business bank account. A motor vehicles account must be opened.

Bank account					
Debit			Credit		
		\$			\$
Apr 1	Abdul – capital	10 000	Apr 2	Motor vehicles	2 000

Motor vehicles account					
Debit			Credit		
		\$			\$
Apr 2	Bank	2 000			

Transaction 3 April 3. Abdul buys goods which he will resell in the normal course of trade for \$3 000 and pays by cheque.

Bank account					
Debit			Credit		
		\$			\$
Apr 1	Abdul – capital	10 000	Apr 2	Motor vehicles	2 000
			Apr 3	Purchases	3 000

Purchases account					
Debit			Credit		
		\$			\$
Apr 3	Bank	3 000			

Transaction 4 April 4. Abdul sells a quantity of the goods for \$800 and pays the money into the bank.

Bank account					
Debit			Credit		
		\$			\$
Apr 1	Abdul – capital	10 000	Apr 2	Motor vehicles	2 000
Apr 4	Sales	800	Apr 3	Purchases	3 000

Sales account					
Debit			Credit		
		\$			\$
			Apr 4	Bank	800

Transaction 5 April 7. A customer returns some goods and receives a refund of \$40.

Bank account					
Debit			Credit		
		\$			\$
Apr 1	Abdul – capital	10 000	Apr 2	Motor vehicles	2 000
Apr 4	Sales	800	Apr 3	Purchases	3 000
			Apr 7	Sales returns	40

Sales returns account			
		\$	\$
Apr 7	Bank	40	

Note: Goods returned are not debited to sales account, but to sales returns account. This account is also known as goods inwards, or returns inwards, account.

Transaction 6 April 8. Abdul returns some goods costing \$100 to a supplier and receives a refund.

Bank account			
		\$	\$
Apr 1	Abdul – capital	10 000	Apr 2 Motor vehicles 2 000
Apr 4	Sales	800	Apr 3 Purchases 3 000
Apr 8	Purchases returns	100	Apr 7 Sales returns 100

Purchases returns account			
		\$	\$
	Apr 8	Bank	100

Note: Goods returned to a supplier are credited to purchases returns account. This account is also known as goods outward account or returns outwards.

KEY TERM

Golden rule: For every debit entry in a ledger account there must be an equal credit entry in another ledger account.

TOP TIPS

- Notice how quickly the number of accounts increase as more transactions take place. It may start to look very complicated. Work through things logically and never be afraid to open new accounts.
- Always remember to keep track of the debit and credit postings and include the correct wording and the \$ sign.
- The most important thing is to remember the **golden rule**: for every debit entry in one account there must be an equal credit entry in another account.

Transaction 7 April 10. Abdul buys another motor vehicle for the business and pays \$4 000 by cheque.

Bank account			
		\$	\$
Apr 1	Abdul – capital	10 000	Apr 2 Motor vehicles 2 000
Apr 4	Sales	800	Apr 3 Purchases 3 000
Apr 8	Purchases returns	100	Apr 7 Sales returns 40
			Apr 10 Motor vehicles 4 000

Motor vehicles account			
		\$	\$
Apr 2	Bank	2 000	
Apr 10	Bank	4 000	

Note: As explained in Section 1.2, an account is a history of all transactions of a similar nature. Therefore, it is not necessary to open another account for the second motor vehicle. Similarly, all purchases of office equipment are posted to office equipment account, and all purchases of office furniture are posted to office furniture account. You will encounter other examples such as plant and machinery, and fixtures and fittings.

Transaction 8 April 11. Tania lends the business \$5 000. Abdul pays the money into the business bank account.

Bank account							
			\$				\$
Apr 1	Abdul – capital	10 000	Apr 2	Motor vehicles	2 000		
Apr 4	Sales	800	Apr 3	Purchases	3 000		
Apr 8	Purchases returns	100	Apr 7	Sales returns	40		
Apr 11	Tania – loan	5 000	Apr 10	Motor vehicles	4 000		

Tania – loan account			
		\$	\$
	Apr 11	Bank	5 000

Transaction 9 April 12. Abdul pays rent on a warehouse by cheque, \$1 000.

Bank account							
			\$				\$
Apr 1	Abdul – capital	10 000	Apr 2	Motor vehicles	2 000		
Apr 4	Sales	800	Apr 3	Purchases	3 000		
Apr 8	Purchases returns	100	Apr 7	Sales returns	40		
Apr 11	Tania – loan	5 000	Apr 10	Motor vehicles	4 000		
			Apr 12	Rent payable	1 000		

Rent payable account			
		\$	\$
Apr 12	Bank	1 000	

Transaction 10 April 14. Abdul sublets part of the warehouse and receives a cheque for \$300 for the rent. This is paid into the bank.

Bank account							
			\$				\$
Apr 1	Abdul – capital	10 000	Apr 2	Motor vehicles	2 000		
Apr 4	Sales	800	Apr 3	Purchases	3 000		
Apr 8	Purchases returns	100	Apr 7	Sales returns	40		
Apr 11	Tania – loan	5 000	Apr 10	Motor vehicles	4 000		
Apr 14	Rent receivable	300	Apr 12	Rent payable	1 000		

Rent receivable account			
		\$	\$
	April 14	Bank	300

Note: Rent receivable is not posted to the rent payable account. It is important to keep income and expenditure in separate accounts.

Transaction 11 April 15. Abdul pays wages by cheque, \$1 200.

Bank account					
		\$			\$
Apr 1	Abdul – capital	10 000	Apr 2	Motor vehicles	2 000
Apr 4	Sales	800	Apr 3	Purchases	3 000
Apr 8	Purchases returns	100	Apr 7	Sales returns	40
Apr 11	Tania – loan	5 000	Apr 10	Motor vehicles	4 000
Apr 14	Rent receivable	300	Apr 12	Rent payable	1 000
			Apr 15	Wages	1 200

Wages			
		\$	\$
Apr 15	Bank	1 200	

Transaction 12 April 16. Abdul withdraws \$600 from the business bank account for personal use.

Bank account					
		\$			\$
Apr 1	Abdul – capital	10 000	Apr 2	Motor vehicles	2 000
Apr 4	Sales	800	Apr 3	Purchases	3 000
Apr 8	Purchases returns	100	Apr 7	Sales returns	40
Apr 11	Tania – loan	5 000	Apr 10	Motor vehicles	4 000
Apr 14	Rent receivable	300	Apr 12	Rent payable	1 000
			Apr 12	Wages	1 200
			Apr 16	Drawings	600

Drawings account			
		\$	\$
Apr 16	Bank	600	

Note: Money drawn out of a business by the owner for personal use is debited to a drawings account, not to the owner's capital account.

Chapter summary

In this chapter you have learnt about the most important aspects of double-entry bookkeeping. You should now understand that every transaction a business makes has two aspects to it and that double-entry bookkeeping records both aspects of the transactions.

You should also know that each aspect of the transaction is recorded in its own ledger account, which has two sides (the left-hand side is the debit side and the right-hand side is the credit side). Finally, you should now have a good understanding of how to use these accounts to record basic cash transactions.

**TOP TIP**

If you make a mistake in an exercise, study the answers online and make sure you understand what you should have done **and why**.

Practice exercises

- 1 Complete the entries for the following table. The first item has been done for you.

		Debit account	Credit account
1	Noel pays a cheque into his business bank account as capital	Bank	Noel – capital
2	Purchases some goods for resale and pays by cheque		
3	Sells some goods and banks the takings		
4	Pays rent by cheque		
5	Purchases shop fittings and pays by cheque		
6	Cashes cheque for personal expenses		
7	Pays wages by cheque		
8	Returns goods to supplier and banks refund		
9	Receives rent from tenant and banks cheque		
10	Refunds money to customer by cheque for goods returned		
11	Motor vehicle purchased and paid for by cheque		
12	Pays for petrol for motor vehicle and pays by cheque		

- 2 Open the necessary ledger accounts and post the following transactions to them. All transactions took place in the bank account.

- May 1** Martine started business as a florist by paying \$300 into a business bank account.
- 2** Charline lent the business \$1 000.
Martine then had the following transactions:
- 3** Paid rent, \$100.
- 4** Purchased shop fittings, \$400.
Purchased flowers \$300, paying by cheque.
- 5** Received refund of \$20 for flowers returned to supplier.
- 6** Sold some flowers and received \$40.
- 7** Paid wages, \$60.
- 8** Withdrew \$100 for personal use.

3 a Complete the entries for the following table:

	Debit account	Credit account
July 1	Lee started business by paying \$20 000 of his savings into a business bank account He also had \$500 in cash which he decided to use to pay cash expenses for the business	
2	Bought some goods for resale for \$1 300, paying by cheque	
3	Paid \$2 500 by cheque to rent some business premises	
4	Bought some office furniture by cheque for \$750 Bought office stationery for \$120, paying by cash	
6	Sold some goods for \$1 700 and paid the money into the bank Sold more goods for \$180. He received cash for this sale	
8	Returned some faulty goods valued at \$60 to the supplier and received a cheque refund	
9	A customer returned some faulty goods. Lee gave the customer a cash refund of \$25	
10	Sold goods for \$420. Lee received cash for the goods. He kept \$200 of the cash and banked the rest	
11	Lee took cash drawings of \$160	

b Now open the necessary ledger accounts to record these transactions.

4 Complete the entries for the following table with information taken from the accounts of a trader:

	Debit account	Credit account
1	Local taxes paid by cheque	
2	Bank pays interest to trader	
3	Other operating expenses paid by cheque	
4	Postage and stationery paid by cheque	
5	Telephone bill paid by cheque	
6	Carriage inwards* paid by cheque	
7	Carriage outwards** paid by cheque	
8	Interest paid by cheque to brother in respect of a loan received from him	
9	Interest paid to bank	

* Carriage inwards is the delivery cost of bringing the goods from the supplier to the business.

** Carriage outwards is the cost of delivering goods to a customer.

5 Open the necessary ledger accounts and post the following transactions to them:

- June 1** Farook commenced business by paying \$15 000 into his business bank account.
Amna lent the business \$5 000.
Farook then had the following business transactions:
- 2** Purchased premises and paid \$8 000, paying by cheque.
 - 3** Bought office furniture for \$2 000 and paid by cheque.
 - 4** Paid \$5 000 by cheque for goods for resale.
 - 5** Sold some goods for \$1 500 and banked the proceeds.
 - 6** Paid insurance premium by cheque, \$600.
 - 7** Bought motor van and paid \$3 000 by cheque.
 - 8** Drew cheque for \$50 to pay for petrol for motor van.
 - 9** Bought some goods costing \$2 000 for resale and paid by cheque.
 - 10** Sold goods for \$2 400 and banked the proceeds.
Drew cheque for wages, \$400.
 - 11** Repaid \$1 200 by cheque to customers for goods returned.
 - 12** Received a refund of \$900 from suppliers for goods returned.
 - 13** Received a refund of insurance of \$100.
Withdrew \$200 from business bank account for personal expenses.
 - 14** Returned some office furniture that was damaged and received a refund of \$800.
 - 15** Repaid \$1 000 of the loan from Amna.

Exam practice questions

Multiple-choice questions

- 1 Joel occupies part of Natasha's business premises. Which entries in Natasha's books record the rent Joel pays her by cheque?

	Debit account	Credit account
A	Bank	Rent payable
B	Bank	Rent receivable
C	Rent payable	Bank
D	Rent receivable	Bank

- 2 Yasmina purchased some office equipment for use in her business. The equipment was faulty and she returned it to the supplier who refunded the cost to Yasmina. Which entries in Yasmina's books record the return of the equipment?

	Debit account	Credit account
A	Bank	Purchases returns
B	Bank	Office equipment
C	Purchases returns	Bank
D	Office equipment	Bank

- 3 A trader withdraws money from his business bank account for personal expenses. Which entries record this in his books?

	Debit account	Credit account
A	Bank	Capital
B	Bank	Drawings
C	Capital	Bank
D	Drawings	Bank

- 4 A trader returns goods to the supplier and receives a refund. Which entries record the refund in the trader's books?

	Debit account	Credit account
A	Bank	Purchases
B	Bank	Purchases returns
C	Purchases	Bank
D	Purchases returns	Bank

Total: 4 marks



Chapter 2

Double-entry bookkeeping: credit transactions

Learning objectives

In this chapter you will learn:

- how to record transactions which do not involve immediate cash payments in ledger accounts
- the difference between trade and cash discounts and how to treat them.

KEY TERMS

Credit transaction: A business transaction where no money changes hands at the time of the transaction.

Debtor: A customer (or other party) that owes the business money.

Creditor: Suppliers (or other parties) to whom the business owes money.

2.1 What are credit transactions?

Many transactions take place without any money being paid or received at the time. For example, Lai sells goods to Chin for \$500 on 31 May and gives Chin until 30 June to pay. The transaction is ‘on credit’ (a **credit transaction**). The sale has taken place on 31 May and must be recorded in the books of account of both Lai and Chin **at that date**. No entries to record payment are made in their books until Chin pays Lai.

2.2 How to record credit transactions

TOP TIP
Remember to record all transactions from the point of view of the business, not from those of its customers and suppliers.

In a seller’s books, a sale on credit is credited to sales account and debited to an account opened in the name of the customer. In accounting, someone who owes the business money (in this case, Chin, the customer) is known as a **debtor**. When the customer, or debtor, pays, their account is credited and the bank account debited.

In a customer’s books, a purchase on credit is debited to purchases account and credited to an account opened in the name of the supplier. In accounting, someone to whom the business owes money is known as a **creditor**. When the supplier is paid, their account is debited and the bank account credited.

Walkthrough

Lai sells goods to Chin for \$500 on 31 May and gives Chin until 30 June to pay.

In Lai’s books, credit the sale to sales account and debit it to an account for Chin:

Sales account			
Debit		Credit	
	\$		\$
May 31	Chin		500

Chin account			
Debit		Credit	
	\$		\$
May 31	Sales	500	

The debit entry in Chin’s account shows that he is a **debtor** in Lai’s books; that is, Chin owes Lai \$500 until he pays for the goods.

In Chin’s books, debit the purchase to purchases account and credit it to an account for Lai:

Purchases account			
Debit		Credit	
	\$		\$
May 31	Lai	500	

Lai account			
Debit		Credit	
	\$		\$
	May 31	Purchases	500

The credit entry in Lai's account shows that he is a **creditor** in Chin's books.

Goods returned

On 4 June, Chin returns some of the goods costing \$100 to Lai because they are damaged.

In Lai's books, credit Chin's account and debit sales returns account:

Chin account			
Debit		Credit	
	\$		\$
May 31	Sales	500	Jun 4
			Sales returns
			100

Sales returns account			
Debit		Credit	
	\$		\$
Jun 4	Chin	100	

In Chin's books, debit Lai's account and credit purchases returns account:

Lai account			
Debit		Credit	
	\$		\$
Jun 4	Purchases returns	100	May 31
			Purchases
			500

Purchases returns account			
Debit		Credit	
	\$		\$
	Jun 4	Lai	100

2.3 How to record payments for goods bought or sold on credit

Trade discount

Trade discount is an allowance made by one trader to another. In the above example, the goods which Lai sold to Chin may have been sold normally for \$625. Lai knows that Chin, also a trader, must make a profit on the goods when he sells them. He has allowed Chin a trade discount of \$125 (20% of \$625) so that when Chin sell the goods for \$625 he will make a profit of \$125.

This type of discount is only given where the buyer and seller are in the same line of business. In this example Lai and Chin will both be in the same line of work. Perhaps Lai may sell spare parts

KEY TERM

Trade discount:

A reduction in the selling price of goods made by one trader to another.

for cars to Chin. Chin may use those parts to repair the cars for his customers. Both Lai and Chin are in the same line of work, so Lai offers Chin a trade discount.

It may seem strange that by reducing his selling price, Lai is giving away some of his profit. However, it allows Chin to make some profit. It will also encourage Chin to use Lai as his regular supplier, so Lai's future sales will be increased and his cash flow may also be improved.

TOP TIP
Although the normal price of the goods was \$625, the transaction was for \$500 only, and only \$500 is entered into the books of both Lai and Chin. Trade discount is **never** recorded in ledger accounts.

KEY TERM

Cash (or settlement) discount: An allowance given by a seller to a customer to encourage the customer to pay an invoice before its due date for payment.

Cash (or settlement) discount

Lai has given Chin one month to pay for the goods. To encourage Chin to pay by 30 June, Lai may allow Chin to pay less than the amount due. This allowance is a **cash (or settlement) discount**. (Notice the difference between cash discount and trade discount: trade discount is not dependent on payment being made promptly, or even at all.)

TOP TIP
Cash discounts are **always** recorded in ledger accounts.

Walkthrough

Suppose Lai has allowed Chin a cash discount of 5% provided Chin pays by 30 June, and Chin pays Lai on 28 June. Chin owes Lai \$400 (\$500 – \$100), 5% of \$400 = \$20. He will, therefore, pay only \$380.

In Lai's books, debit the discount to discounts allowed account:

Chin account						
Debit			Credit			
			\$			\$
May 31	Sales	500	Jun 4	Sales returns	100	
			Jun 28	Bank	380	
			Jun 28	Discounts allowed	20	

Bank account						
Debit			Credit			
			\$			\$
Jun 28	Chin	380				

Discounts allowed account						
Debit			Credit			
			\$			\$
Jun 28	Chin	20				

In Chin's books, credit the discount to discounts received account:

Lai account					
Debit			Credit		
		\$			\$
Jun 4	Purchases returns	100	May 31	Purchases	500
Jun 28	Bank	380			
Jun 28	Discounts received	20			

Bank account					
Debit			Credit		
		\$			\$
			Jun 28	Lai	380

Discounts received account					
Debit			Credit		
		\$			\$
			Jun 28	Lai	20



TOP TIPS

- Note carefully whether cash discount is to be deducted from settlements.
- Remember to complete the entries for cash discounts in the correct discount accounts.
- Be accurate in all your calculations.

Walkthrough

The following worked example aims to bring together everything you have learnt in this chapter. It covers how to deal with trade discount and how to record cash (or settlement) discount.

Work through it logically and follow how each transaction is recorded in Andrew's ledger.

Andrew had the following transactions in May:

- May 1** Purchased goods on credit from David. The goods cost \$1 000 less 10% trade discount.
- 2** Purchased goods on credit from Rafael for \$1 600 less 15% trade discount.
- 3** Purchased a computer for the office on credit from Bernard for \$2 000.
- 4** Sold goods on credit to Mario for \$800.
- 5** Returned goods which had cost \$100 after trade discount to David.
- 6** Purchased goods on credit from Ludovic for \$700 less trade discount at 20%.
- 7** Sold goods on credit to Ravin for \$500.
- 8** Mario returned goods which had been sold to him for \$40.
- 9** Received cheque from Ravin for amount owing less cash discount of 5%.
- 10** Paid amount owing to David less cash discount of 5%.
- 11** Paid amount owing to Rafael less cash discount of 5%. Paid Bernard for computer.
- 12** Received cheque from Mario for amount owing less 5% cash discount.
Paid amount owing to Ludovic less 5% cash discount.

If you want to test yourself use the following table to record the names of the accounts in which you feel each transaction should be recorded. Then check the answers online and see if you were correct.

	Details	Name of accounts to debit	Name of accounts to credit
May 1	Purchased goods on credit from David The goods cost \$1 000 less 10% trade discount		
2	Purchased goods on credit from Rafael for \$1 600 less 15% trade discount		
3	Purchased a computer for the office on credit from Bernard for \$2 000		
4	Sold goods on credit to Mario for \$800		
5	Returned goods which had cost \$100 after trade discount to David		
6	Purchased goods on credit from Ludovic for \$700 less trade discount at 20%		
7	Sold goods on credit to Ravin for \$500		
8	Mario returned goods which had been sold to him for \$40		
9	Received cheque from Ravin for amount owing less cash discount of 5%		
10	Paid amount owing to David less cash discount of 5%		
11	Paid amount owing to Rafael less cash discount of 5%. Paid Bernard for computer		
12	Received cheque from Mario for amount owing less 5% cash discount Paid amount owing to Ludovic less 5% cash discount		

As all the transactions have been carried out by Andrew, they are all recorded in Andrew's books of account. They are recorded as follows:

David account					
Debit			Credit		
		\$			\$
May 5	Purchases returns	100	May 1	Purchases	900
May 10	Bank	760			
May 10	Discounts received	40			

KEY TERM

Discount received:
Cash discount received by the purchaser from the seller of goods.

This account records all Andrew's transactions with David: the goods Andrew bought (purchases of \$1 000 less a 10% trade discount), the goods he returned (purchases returns), the amount Andrew paid David (bank) and the discount Andrew received from David (**discount received**). Andrew owed David \$800 (900 – 100). He received a 5% settlement discount when he paid David (800 × 5% = 40) so he wrote a cheque to David for \$760 (800 – 40).

Rafael account						
Debit			Credit			
			\$			\$
May 11	Bank	1 292	May 2	Purchases	1 360	
May 11	Discounts received	68				

This account records all Andrew's transactions with Rafael: the goods Andrew bought (purchases of \$1 600 less the trade discount of 15%), the amount Andrew paid Rafael (bank) and the discount Andrew received from Rafael (discount received). The discount Andrew received was 5% of \$1 360, so Andrew paid Rafael \$1 292 (1 360 – 68).

Bernard account						
Debit			Credit			
			\$			\$
May 11	Bank	2 000	May 3	Office computer	2 000	

This account records the purchase of the office computer from Bernard, and Andrew paying Bernard for it from his bank account.

Ludovic account						
Debit			Credit			
			\$			\$
May 12	Bank	532	May 6	Purchases	560	
May 12	Discounts received	28				

This account records all Andrew's transactions with Ludovic: the goods he bought (purchases of \$700 less a trade discount of 20%), the amount Andrew paid Ludovic (bank) and the discount Andrew received from Ludovic (discount received). Again, the discount received is 5% of \$560, so the cheque payment was for \$532 (560 – 28).

Mario account						
Debit			Credit			
			\$			\$
May 4	Sales	800	May 8	Sales returns	40	
			May 12	Bank	722	
			May 12	Discounts allowed	38	

This account records all Andrew's transactions with Mario: the goods he sold to Mario (sales), the goods Mario returned (sales returns), the amount Mario paid Andrew (bank) and the discount Andrew allowed Mario (**discount allowed**). Mario owed Andrew \$760 (800 – 40). Andrew allowed him a settlement discount of 5% ($\$760 \times 5\%$), so Mario sent Andrew a cheque for \$722 (760 – 38).

Ravin account						
Debit			Credit			
			\$			\$
May 7	Sales	500	May 9	Bank	475	
			May 9	Discounts allowed	25	

KEY TERM

Discount allowed:

Cash discount allowed by the seller to the purchaser of goods.

This account records all Andrew's transactions with Ravin: the goods he sold to Ravin (sales), the amount Ravin paid Andrew (bank) and the discount Andrew allowed Ravin (discounts allowed). Ravin owed Andrew \$500. Andrew allowed him a settlement discount of 5% ($\$500 \times 5\%$), so Ravin sent Andrew a cheque for \$475 ($500 - 25$).

Purchases account			
Debit			Credit
		\$	\$
May 1	David	900	
May 2	Rafael	1 360	
May 6	Ludovic	560	

This account records all the purchases of goods made by Andrew from his credit suppliers. They are debited to the purchases account and the credit entries are in the individual accounts for each supplier.

Purchases returns account			
Debit			Credit
		\$	\$
	May 5		David
			100

This account records the return of goods made by Andrew to David.

TOP TIP
 Purchases returns always go to a purchases returns account. They are never entered on the credit side of the purchases account.

Sales account			
Debit			Credit
		\$	\$
	May 4		Mario
			800
	May 7		Ravin
			500

This account records all the sales of goods by Andrew to his credit customers. The debit entries are in the individual accounts of those customers.

Sales returns account			
Debit			Credit
		\$	\$
May 8	Mario	40	

This account records the return of goods from customers to Andrew. The credit entry will be in the account of the customer.

TOP TIP
 Sales returns always go to a sales returns account. They are never entered on the debit side of the sales account.

Discounts allowed account			
Debit		Credit	
		\$	\$
May 9	Ravin	25	
May 12	Mario	38	

All the discounts which Andrew has allowed his customers are entered in this account. The credit entry will be in the accounts of Ravin and Mario.

Discounts received account			
Debit		Credit	
		\$	\$
	May 10	David	40
	May 11	Rafael	68
	May 12	Ludovic	28

All the discounts which Andrew received from his suppliers are entered in this account. The debit entry will be in the accounts of David, Rafael and Ludovic.

Office computer account			
Debit		Credit	
		\$	\$
May 3	Bernard	2 000	

This accounts records the purchase by Andrew of the office computer from Bernard. As Andrew intends to use this for the business rather than resell it to a customer, it goes to its own account and not to the purchases account.

Bank account					
Debit		Credit			
		\$	\$		
May 9	Ravin	475	May 10	David	760
May 12	Mario	722	May 11	Rafael	1 292
			May 11	Bernard	2 000
			May 12	Ludovic	532

This is Andrew's business bank account. On the debit side, all the money received is recorded. All the money Andrew pays out is recorded on the credit side.

This is one account which has entries on both sides.

Calculations

Purchases	Amount before trade discount	Trade discount	Cost to Andrew
	\$	\$	\$
From: David	1 000	(10%) 100	900
Rafael	1 600	(15%) 240	1 360
Ludovic	700	(20%) 140	560

Cash settlements	Amount before cash discount	Cash discount (5%)	Amount paid
	\$	\$	\$
By:			
Ravin	500	25	475
Mario	760	38	722

Chapter summary

In this chapter you have learnt how to record in the ledger transactions which do not involve the immediate payment of cash. You should also now be aware of what is meant by trade discount and cash (or settlement) discount and the difference between the two.

You should now be able to record credit transactions in both the seller's and customer's books of account.

Finally, you should now be familiar with the difference between discounts allowed and discounts received and how to record each in the appropriate account.

Practice exercises

- 1 Post the following transactions in the books of Geraud:



TOP TIPS

- If it helps, write down the names of the accounts you should debit or credit before you start posting the transactions to them.
- Work out the amounts of trade and cash discounts before you post them to their correct accounts.

- June 1** Purchased goods from Khor which cost \$3 000 less trade discount of 10%.
- 5** Sold goods to Lai for \$600.
- 10** Returned goods which had cost Geraud \$200 to Khor.
- 15** Purchased goods from Lim which cost \$2 800 before trade discount of 10%.
- 20** Sold goods to Chin for \$1 300.
- 25** Lai returned goods which had cost him \$200.
- 30** Geraud paid Khor and Lim the amounts due to them after deducting 5% cash discount.
Lai and Chin paid Geraud the amounts they owed him after deducting 5% cash discount.

2 Post the following transactions in the books of both Brian and Ken:

		Name of accounts to be debited	Name of accounts to be credited
April 1	Brian sold goods to Ken for \$1 500		
2	Ken sold goods to Brian at \$500 less trade discount of 20%		
3	Brian sold goods to Ken for \$800 less trade discount at 25%		
6	Ken sold goods to Brian at \$900 less trade discount of 20%		
10	Ken paid Brian for the goods he bought on 1 April less a cash discount of 3%		
12	Brian paid Ken for the goods he had bought on 2 April less a cash discount of 5%		

3 Fleming had the following transactions:

- July 1** Purchased goods from Adams for \$5 000 less trade discount of 15%. Adams allowed Fleming 4% cash discount.
- 4** Purchased goods from Bond for \$2 500 less trade discount of 10%. Bond allowed Fleming 4% cash discount.
- 5** Returned goods which had cost \$600 to Adams.
- 7** Purchased goods from Astle for \$7 000 less trade discount of 20%. Astle allowed Fleming 5% cash discount.
- 9** Returned goods which had cost \$800 to Astle.
- 10** Purchased goods from Cairns for \$4 200 less 10% trade discount. Cairns allowed Fleming 5% cash discount.
- 14** Fleming settled all accounts owing to his suppliers by cheque, taking advantage of the cash discount in each case.

Post the transactions listed above in Fleming's books in good form.

4 Streak had the following transactions in March:

- Mar 1** Sold goods to Blignaut for \$2 500 less trade discount of 10%, and allowed him cash discount of 4%.
- 4** Sold goods to Ebrahim for \$4 000 less trade discount of 15%, and allowed him cash discount of 5%.
- 6** Ebrahim returned goods which had cost him \$200.
- 8** Sold goods to Friend for \$3 200 less trade discount of 20%, and allowed him cash discount of 5%.
- 12** Sold goods to Flowers for \$2 000 less trade discount of 10%, and allowed him cash discount of 4%.
- 14** Flowers returned goods which had cost him \$350.
- 15** Blignaut, Ebrahim, Friend and Flowers settled their accounts by cheque, each taking advantage of the cash discount.

Post the transactions listed above in Streak's books in good form.

Exam practice questions

Multiple-choice questions

- 1 Davina bought goods on credit from Sharon for \$600 less trade discount of \$120. Which entries record this transaction in Davina's books?

Account to be debited	Account to be credited
A Purchases \$480	Sharon \$480
B Purchases \$480 Discounts allowed \$120	Sharon \$600
C Purchases \$600	Sharon \$600
D Purchases \$600 Discounts received \$120	Sharon \$480

- 2 Kristal bought goods on credit from Prisca. The goods had a list price of \$1 000 but Prisca allowed Kristal trade discount of 10% and cash discount of 4%. How much did Kristal have to pay Prisca?
A \$860 **B** \$864 **C** \$900 **D** \$960
- 3 Shirley bought goods from Corrine. The goods had a list price of \$800. Corrine allowed Shirley trade discount of 20% and cash discount of 5%. In Corrine's books, which entries record the cheque she received from Shirley?

Account to be debited	Account to be credited
A Bank \$608 Discounts allowed \$32	Shirley \$640
B Bank \$608 Discounts received \$32	Shirley \$640
C Bank \$608 Discounts allowed \$152	Shirley \$760
D Bank \$608 Discounts received \$152	Shirley \$760

Total: 3 marks