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The bookkeeping course was developed for first time learners who are interested in bookkeeping. It provides the learners with fundamentals of bookkeeping.

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COURSE OVERVIEW

Course Introduction

Welcome to the Introduction to Bookkeeping course. You are taking this course because you want to become a bookkeeper. Careers in bookkeeping are found both in public and private organisations. Indeed, in all organisations where there are business transactions, there must be a bookkeeper. The aim of this course is to provide you with essential skills and knowledge on bookkeeping, so that you can either run your own business or find employment in an organisation that requires the services of a bookkeeper.

This course starts by explaining the difference between accounting and bookkeeping. It proceeds to discuss different types of business organisations, the three elements of accounting, and the principles and concepts of accounting. Lastly, it looks at depreciation, petty cash management and how to perform a bank reconciliation.

This course is divided into eight units and we recommend that you read through the content of each unit and complete all the activities that you find in the units.

Course Outcomes

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

1. Explain the difference between accounting and bookkeeping
2. Apply the general acceptable principles of accounting in your bookkeeping work
3. Record transactions in the correct book of accounts
4. Prepare a trial balance, profit and loss statement and balance sheet.
5. Calculate depreciation using the straight line, units of production, declining balance and sum of years digits methods
6. Calculate gross and net salary payments and prepare a payslip
7. Establish a petty cash fund and maintain accurate records of petty cash transactions
8. Prepare a bank reconciliation statement

Course Content and Structure

This course is divided into 8 units, which are designed to help you achieve the outcomes we have just stated. These are:

1. Nature of Accounting
2. Concept and Principles of Accounting
3. The Accounting System Part I
4. The Accounting System Part II
5. Depreciation
6. Pay Roll Accounting
7. Petty cash
8. Bank reconciliation
Course Duration
This course will take you a minimum of 4 weeks to complete.

Course Assessment and Evaluation
Your work in this course will be assessed in the following three ways:

- Two (2) assignment projects
- One (1) Test
- One (1) Examination

Assessment Criteria
The following is the assessment criteria:

- Active participation in assignment projects
- Sitting for the test and examination
- Active participation in group discussions and presentation during face to face meetings
- Active interaction with the trainer during face to face meetings.

Evaluation
An evaluation will be done at the end of this training. You will be given a chance to give us feedback on any aspect of the course content and structure. Your constructive feedback will help us to make this course better.

Icons Used in the Units
In the margins of the units you will find the following icons which tell you what to do:

- Read the outcomes of the unit
- Complete the Activity. Activities help you to process and apply what you are learning.
- Read the Unit summary
- Apply the accounting knowledge and skills you have learnt to answer the self-test questions.
UNIT 1: NATURE OF ACCOUNTING

1.1 Introduction to the Unit
Welcome to the first unit of this course on bookkeeping. In this unit you will learn about the difference between bookkeeping and accounting. We shall also explain the various types of businesses and the three fundamental elements of accounting.

1.2 Unit Outcomes
By the end of this unit you should be able to:

1. Explain the difference between accounting and bookkeeping
2. Describe the different types of business organisations
3. Describe the three fundamental elements of accounting
4. Use the accounting equation to show the relationship between the three fundamental elements of accounting

1.3 Bookkeeping and Accounting

What is Bookkeeping?
Bookkeeping is a systematic method of maintaining accurate and complete records of daily financial transactions of a business. It is the first step of the accounting process. Bookkeeping uses basic accounting processes.

What is Accounting?
Accounting is the process of analysing, classifying, recording, summarizing, communicating and interpreting business transactions and events expressed in monetary terms. It is much wider than bookkeeping. An accountant sets up the accounting system that is used by the bookkeeper to keep records and supervises the work of the bookkeeper.

What is a Business Transaction?
A business transaction is an event which is expressed in monetary terms, and that is capable of being recorded in the books of accounts. Examples of a business transaction are buying goods, paying wages, paying rent and selling goods.
1.4 Types of Business Organisations

There are many types of business organisations in the world. In this section, we shall discuss the most common ones. These are:

- sole traders (sole or single proprietorship)
- partnership,
- company, and
- co-operatives.

Let us look at each type in turn.

**Sole trader or Sole proprietorship**

This is one of the most common type of business. It is owned by one person who is in charge of the day to day activities of the business and who makes managerial decisions. If the business succeeds, he makes a profit and if the business fails, he suffers loss. An example of a sole trader is a trade store, repair workshops, etc.

**Partnership**

This is a type of business that is owned by two or more people. The individuals who own this business are known as partners. The business partners bring together their skills and resources with a view of making a profit. Each partnership has an agreement in written or oral form, which lays down how much each partner has contributed in terms of resources, capital, equipment and how the profits will be shared out. The benefit of a partnership is the owners share the risk, liability and management of the business, depending on the percentage of ownership they have agreed upon.

**Company**

A company is created by the laws of the land. The company can buy or sell property, make contracts, borrow money, sue and be sued in court and must have a common seal. Ownership of a company is in the hands of the shareholders. Shareholders are people who contribute towards the initial capital that is used to establish the company. The shareholders elect a board of directors and the board of directors appoints officers and managers to manage the company.

**Co-operative**

A co-operative is a form of business owned by its customers. The purpose of a co-operative is to provide a common service to its members at a low cost rather earn a profit. The profit made by a cooperative is distributed to the members in proportion to the amount of business each one does with the co-operative.

You now know the difference between accounting and bookkeeping and the different types of business organisations. As a way of reflecting on what you have just learnt, please complete the following activity.
ACTIVITY 1. (Allow 5 – 10 minutes for this activity)
Indicate whether the following statements are True or False by writing “T” in the space provided if the statement is True or (“F) if it is False.

Bookkeeping is a subset of accounting (___)

1. An accountant is only interested in analysing business transactions (___)
2. A sole trader is owned by one person (___)
3. A Cooperative is a form of business whose sole purpose is to make a profit (___)
4. A business should be a separate entity from its owner (___)

Compare your answers with those provided at the end of this course.

Next, we shall discuss the elements of accounting.

1.5 Elements of Accounting
There are three fundamental elements of accounting. These are known as:

- Assets,
- Liabilities, and
- Owner’s Equity or proprietorship

The financial position of a business is represented by the relationship of these three elements. Let us discuss each element in turn.

Assets
These are the things that a business owns and uses to generate cash. There are 3 types of assets:

**Current assets:** these are items such as cash, accounts receivable (debtors), inventory (or stock), and prepayments. They are current because they can be converted into cash within a short period of time.

**Fixed assets:** these are assets that are used in the normal operation of a business to produce and sell goods or perform services for its clients. Examples are buildings, equipment, land, vehicles, etc.

**Intangible assets:** these are assets that provide benefits to a business entity for many years, but have no physical substance. Examples are good will, patents, trade name, etc.
Liabilities
These are the debts a business owes to its creditors for goods or services it has received. If a business borrows money, it becomes a debtor and the person or business to whom it owes is called a creditor. If a business fails to pay its debts when they are due, the creditor can claim against the assets of the business as a whole.

Owner’s Equity
When a business starts, it has no money of its own. The owner puts in his or her own money or borrows money in order to start it off. This money is known as owner’s equity. It is that part of the business that belongs to the owner. In a partnership, it is called partnership equity, in a company it is called shareholders equity. Other terms such as proprietorship, net worth or present worth are sometimes used to mean the same thing.

The owner’s equity increases when money is invested in the business or through revenue generated from the sale of goods and services. It decreases when the owner takes money from the business for personal use and when money is used to purchase items for normal business use, such as a computer.

Before we continue with our discussion, complete the following activity.

**ACTIVITY 2: Elements of Accounting**  
(*Allow 5 – 10 minutes for this activity*)

Write next to the following list of items whether they are an Asset, Liability or Equity

- Cash in the Bank (__________)
- Money from a business owner (__________)
- Furniture in a business (____________)
- Money owed to creditors (____________)
- Business loan from the bank (___)
- Business trade name (____)

Compare your answers with those given at the end of this course.

Next, we will discuss the relationship between the three fundamental elements of accounting.
1.6 The Accounting Equation

The accounting equation is a simple way of showing how the three elements of accounting (assets, liabilities and owner’s equity) relate with each other.

When you start a business, you need to invest some money in it. You could either put in your own money (owner’s equity) and/or borrow money from a bank to start off your business. The accounting record of your business always separates the finance put in by you, the owner, from the finance you have borrowed. You will agree that without this initial cash put in by the owner, a business cannot start or buy the assets it needs to take off. This relationship between owner’s equity and business assets is expressed by the following accounting equation:

\[
\text{ASSETS} = \text{EQUITY}
\]

The equity in the above formula can be divided into two forms:

- Equity that the owner has borrowed from a bank
- Equity from the business owner’s sources

If we take these two forms of equity into the consideration, then the relationship between assets and equity can be expressed with the following accounting equation:

\[
\text{ASSETS} = \text{LIABILITIES} + \text{OWNER’S EQUITY}
\]

This equation shows that the business assets owned by the company are purchased by creditors (liabilities) and its owners.

The accounting equation can also be reversed to show the owner’s equity. Read through Example 1 below to better understand this relationship.

**EXAMPLE 1**

In January 1st 2015, Mr Fay the owner of Loa Kava Enterprise borrowed K500 from BSP Bank to add to his start-up capital of K5000. Therefore, his business had assets of K5,500. The accounting equation was therefore written as follows:

\[
\text{Equity} = \text{Assets} - \text{Liabilities}
\]

\[
\begin{align*}
\text{K5,000} & = \text{K5,500} - \text{K500} \\
\end{align*}
\]

This means that the amount of total assets minus liabilities is equal to equity. If a business goes bankrupt, the liabilities are paid off first to creditors, while the owner’s equity is the last to be paid.

An accounting equation is displayed in what is known as a BALANCE SHEET.
1.6.1 What Is a Balance Sheet?

A balance sheet is a statement which shows the assets, liabilities and owner’s equity of a business at a specific point in time. It is an extended form of the accounting equation. Figure 1.1 below shows a simple balance sheet format that presents the accounting equation: \( \text{assets} = \text{liabilities} + \text{owner’s equity} \).

<table>
<thead>
<tr>
<th>BALANCE SHEET</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>ASSETS</strong></td>
</tr>
</tbody>
</table>

*Figure 1.1: Example of a Balance Sheet*

Let us now use the transactions in Example 2 to create a balance sheet.

**EXAMPLE 2:**

On 1st January 2015, Mr Fay commenced Loa Kava Enterprise by opening a business bank account with a deposit of K5,500.00. This was expressed in the accounting equation as follows:

\[
\text{Assets} = \text{Equity} \\
K5,500.00 = K5,500.00
\]

This equation was presented in a balance sheet as shown in Figure 1.2 below.

<table>
<thead>
<tr>
<th>Loa Kava Enterprises</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Balance Sheet as at January 15, 2015</strong></td>
</tr>
<tr>
<td><strong>Assets</strong></td>
</tr>
<tr>
<td>Cash</td>
</tr>
</tbody>
</table>

*Figure 1.2: Loa Kava Enterprise Balance Sheet*

As you can see in Figure 1.2, the balance sheet is divided into two parts:

- the assets are on the left side; and
- the equity on the right side.

**EACH SIDE OF THE ACCOUNTING EQUATION MUST ALWAYS BALANCE**
From Figure 1.2, you can also see that there are other important elements of a balance sheet, namely:

- name of the business,
- type of the report, and
- date of the report.

Let us now look at the effect of a transaction on the accounting equation.

Effects of a Transaction on the Accounting Equation

Study Example 3 of Loa Kava Enterprises in order to learn the effects its purchases of a truck, furniture and stationery (assets) have on the accounting equation.

**EXAMPLE 3**

On January 3rd 2015, Loa Kava made the following cash purchases:

- A second-hand truck for K3,500.00,
- furniture for K1,000.00 and
- Office Stationeries for K1,000.00.

Using the basic accounting equation, these purchases would appear as follows:

\[
\text{Assets} = \text{Owner’s Equity} \\
\text{Motor Vehicle} \quad + \quad \text{Furniture} \quad + \quad \text{Office Stationeries} \quad = \quad \text{Owner’s Equity} \\
K3,500 \quad + \quad K1,000 \quad + \quad K1,000 \quad = \quad K5,500
\]

In Example 3, we can see from the accounting equation that Loa Kava has purchased a number of assets all which are equal to owner’s equity. This equation has to balance because everything Loa Kava owns is purchased with equity. In other words, without owner’s equity a business cannot buy the assets it needs to operate.

The balance sheet presented from the accounting equation in Example 3 would look as shown in Figure 1.3.

<table>
<thead>
<tr>
<th>Assets</th>
<th>Equity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Motor Vehicle</td>
<td>Capital, Loa Kava</td>
</tr>
<tr>
<td>K3,500</td>
<td>K5,500</td>
</tr>
<tr>
<td>Furniture</td>
<td>K1,000</td>
</tr>
<tr>
<td>Office Stationeries</td>
<td></td>
</tr>
<tr>
<td>K1,000</td>
<td></td>
</tr>
<tr>
<td><strong>K5,500</strong></td>
<td><strong>K5,500</strong></td>
</tr>
</tbody>
</table>

*Figure 1.3: Loa Kava Balance sheet, May 1, 2015*
Classification of Balance Sheet Items

The classification of balance sheet items groups the assets and equities of a business into sub-categories of accounts. This helps to organise the information in a format that is easy to read. Table 1.1 shows the most common classifications used in a balance sheet.

Table 1.1 Classification of balance sheet items

<table>
<thead>
<tr>
<th>Assets consists of</th>
<th>Liabilities and Equities consists of</th>
</tr>
</thead>
<tbody>
<tr>
<td>2. Fixed assets</td>
<td>2. Long-term liabilities</td>
</tr>
<tr>
<td>3. Investments</td>
<td>3. Owner’s Equity</td>
</tr>
<tr>
<td>4. Intangible assets</td>
<td>4. Retained profits</td>
</tr>
</tbody>
</table>

In section 1.5 of this unit, we defined current assets, fixed assets and intangible assets. Can you still remember what they mean? Find out by completing the following activity.

**ACTIVITY 3: Classification of balance sheet items**
*(Allow 1 - 15 minutes for this activity)*

Write down the meaning of the following terms:

1. Current assets:

2. Fixed assets:

3. Intangible assets:

Well done! Now compare your answers with those given at the end of this course. You can also refer to our discussion in section 1.5 of this unit.

Let us look at the meaning of the remaining balance sheet items in Table 1.1

- **Investments**: these include investments in bonds, stocks and shares for one or more years.
- **Current Liabilities**: these are all the claims against the assets of the business during the year. For example, notes payable, taxes payable, dividends payable, trade creditors.
• **Long Term Liabilities**: these are liabilities which are not due for payment within twelve months of the date of the balance sheet. For example, loans on mortgages and bonds payable.

• **Owner’s Equity**: this is the amounts to which the owners of an enterprise have a claim.

**Types of a Balance Sheet**

There are two types of a balance sheet. These are:

1. Account Form
2. Financial Position Form

1. **Account Form Balance Sheet**

This is a visual representation of the accounting equation, which reports assets on the right side and liabilities and equities on the left side of the table. Figure 1.3 is an example of an Account Form Balance Sheet.

2. **Financial Position Form of Balance Sheet**

This is the most common form of Balance Sheet. It shows the business assets, liabilities and equity arranged in a vertical format. We have used the information for Loa Kava in Example 3 to create a financial position form balance sheet as shown in Figure 1.4 below.

<table>
<thead>
<tr>
<th>Loa Kava</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Balance Sheet</strong></td>
</tr>
<tr>
<td><strong>As at May 1, 2015</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Assets</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Current Assets:</strong></td>
<td></td>
</tr>
<tr>
<td>Motor Vehicle</td>
<td>K3,000.00</td>
</tr>
<tr>
<td>Furniture</td>
<td>K1,000.00</td>
</tr>
<tr>
<td>Office Stationery</td>
<td>K1,000.00</td>
</tr>
<tr>
<td>Total Current Assets</td>
<td>K5,000.00</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Owner’s Equity</th>
<th>K5,000.00</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Assets</td>
<td>K5,000.00</td>
</tr>
<tr>
<td>Owner’s Equity</td>
<td>K5,000.00</td>
</tr>
<tr>
<td>Total Liabilities</td>
<td>K5,000.00</td>
</tr>
</tbody>
</table>

*Figure 1.4: Financial position form of balance sheet*

Well, that discussion on the types of balance sheets brings us to the end of this unit. We hope you have found it interesting and informative. Let us now review what you have learnt.
1.7 What Have You Learnt?

In this unit you have learnt the following:

- Bookkeeping is a subset of accounting and is defined as a systematic method of recording financial transaction, reconciling statements and preparing financial reports.
- There are many types of business organisations in the world but the most common ones are sole trader, partnership, company and cooperative.
- There are three fundamental elements of accounting, namely: assets, liabilities and equity.
- The accounting equation is used to display the relationship between assets, liabilities and equity in a balance sheet.
- A balance sheet shows the assets, liabilities and owner’s equity of a business at a specific point in time. It is an extended form of the accounting equation.
- There are two forms of a balance sheet, namely: the account form and the financial position form.

Before you move on to the next unit, test your understanding of what you have learnt in this unit by completing the following self-test.

1.8 Apply Your Accounting Knowledge

1. In the table below, determine the value of the assets, liabilities and equity.

<table>
<thead>
<tr>
<th>ASSETS</th>
<th>LIABILITIES</th>
<th>EQUITY</th>
</tr>
</thead>
<tbody>
<tr>
<td>K1,000.00</td>
<td>?</td>
<td>K5,000.00</td>
</tr>
<tr>
<td>K78,000.00</td>
<td>K24,400.00</td>
<td>?</td>
</tr>
<tr>
<td>?</td>
<td>K14,560.00</td>
<td>K39,700.00</td>
</tr>
</tbody>
</table>

2. State whether the following would be categorised as an asset, liability or equity.

(a) Savings in the bank _______________
(b) Money owed to the lender _______________
(c) Owner invested K5,000.00 into the business _______________
(d) Rent paid in advance to landlord _______________
(e) A piece of land _______________
3. Create a financial position form of Balance Sheet as at June 30, using the information below.

- Cash at Bank K4,000.00
- Office and Supplies K2,000.00
- Stock K1,000.00

4. Match the forms of businesses in Column A with their correct descriptions in Column B, by writing the number of the business form next to the description. The first one has been done for you.

<table>
<thead>
<tr>
<th>Column A: Forms of Businesses</th>
<th>Column B: Descriptions of Business</th>
<th>Answer</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Sole Trader</td>
<td>Owned by shareholders</td>
<td>3</td>
</tr>
<tr>
<td>2. Partnership</td>
<td>More interested in providing services at low cost rather than making profit</td>
<td></td>
</tr>
<tr>
<td>3. Company</td>
<td>Owners share the risk, liability and management of the business</td>
<td></td>
</tr>
<tr>
<td>4. Cooperative</td>
<td>Is owned by one person</td>
<td></td>
</tr>
</tbody>
</table>
UNIT 2: ACCOUNTING PRINCIPLES AND CONCEPTS

2.1 Introduction to the Unit

Welcome to the second unit of this course on bookkeeping. In the last unit, we introduced you to the concept of bookkeeping and accounting. You also learnt about the different types of businesses, the fundamental elements of accounting and their relationship as expressed by the accounting formula. In this unit we shall discuss the principles and concepts of accounting, which have been developed for measuring and reporting the results of business transactions and events. These principles and standards are collectively known as ‘Generally Accepted Accounting Principles’ (GAAP).

2.2 Unit Outcome

By the end of this unit you should be able to apply accounting principles and concepts in the reporting of business transactions.

2.3 Accounting Principles

Basic accounting principles and concepts ensure that there is consistency from year to year in the methods that you use to prepare a company’s financial statements. They also enable you to make fairly confident conclusions when comparing one company to another. Further, they help banks and people who want to invest in your business to easily review and interpret your accounts.

In this unit we shall discuss the following 11 principles and concepts of accounting, namely:

1. Entity assumption
2. Going Concern Consumption
3. Periodicity assumption
4. Monetary unit assumption
5. Historical cost principle
6. Objectivity Principle
7. Revenue realization principle
8. Matching principle
9. Consistency principle
10. Disclosure principle
11. Prudence principle

Let us discuss each principle and concept in turn.

1. Entity Principle

The entity principle states that an organization is separate from the owner who establishes it. The personal affairs of the owner must not mingle with the business.
2. **Going Concern Principle**
   The going concern principle states that a business will continue its business forever as a going concern. As you may know, there are people who started a business and died, but their business is still going on today. A good example is Brian Bell Company which was started by Sir Brian Bell in 1961 and is still going strong despite the death of its founder in 2010.

3. **Periodicity Principle**
   A business should report the results of its operations over a standard period of time. The period may be a day, a week, a month, a year or even a year and a half. It is very important to show the period of time covered by a report in the heading of each financial statement.

4. **Monetary Unit Principle**
   A business should only record transactions that can be stated in terms of a unit of currency. In other words, money is the basis for all financial reporting. This makes it easy for business owners to record the purchase of a fixed asset or estimate the value of its assets and liabilities. Kina is the currency of Papua New Guinea and all transactions in this country are recorded in kina and toea.

5. **Historical Cost Principle**
   This principle requires that assets and liabilities are recorded at their acquisition price. For example, let’s say that a company premises, which includes the land and a building, was bought in 1990 for K50,000. Today its expected market value is K100,000. You should still record this asset in your balance sheet as K50,000. This original cost remains in the accounting books until it is sold or written off at the end of the end of its useful life.

Before you continue, reflect on what you have just learnt by completing Activity 4.

---

**ACTIVITY 4 (Allow 10 minutes for this activity)**

Match each principle with its correct definition by writing the number of the correct principle in the last column.

<table>
<thead>
<tr>
<th>Principle</th>
<th>Definition</th>
<th>No.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Entity Principle</td>
<td>Company’s balance sheet should report its land at the price they paid to acquire it.</td>
<td></td>
</tr>
<tr>
<td>2. Going Concern Principle</td>
<td>A company accounts should cover a specific period of time</td>
<td></td>
</tr>
<tr>
<td>3. Periodicity Principle</td>
<td>Personal assets of owner should not appear in the balance sheet</td>
<td></td>
</tr>
<tr>
<td>4. Monetary unit Principle</td>
<td>A business will remain in operation for the foreseeable future</td>
<td></td>
</tr>
<tr>
<td>5. Historical Cost Principle</td>
<td>Transactions should be recorded in a unit of currency.</td>
<td></td>
</tr>
</tbody>
</table>

Compare your answers with those given at the end of this course.
Let’s now continue with our discussion and look at the remaining principles of accounting.

6. **Objectivity Principle**
   This principle requires that all financial and accounting information of a company should be independent and based on evidence or verifiable data. This helps to make the information reliable.

7. **Revenue Realization Principle**
   The price paid for goods or services is called revenue. This principle means that revenue is realized and recorded when goods are sold or services are rendered. And not when the actual cash is received. For example, say you supply your customer with goods worth K1,000 today. The K1,000 should be record as revenue as soon as the delivery is made. It does not matter if the client pays immediately or in 30 days.

8. **Matching Principle**
   Costs incurred must match the revenue earned in the same period.

9. **Consistency Principle**
   This principle means that once you adopt an accounting practice, method or procedure, you should continue to use it throughout the reporting period. This makes your reports easy to understand.

10. **Disclosure Principle**
    This principle states that a business must provide all the relevant facts and information in its financial statements and accompanying notes to enable a reader understand them and make informed decisions concerning the company.

11. **Prudence Principle**
    Prudence means carefulness or caution or good judgement.

    This principle states that we should be cautious or prudent when reporting financial information. If a situation arises where there are two acceptable alternatives for reporting an item, we should choose the alternative that will result in less net income and/or less asset amount. This principle makes sure that you do not overestimate your assets and income or underestimate your liabilities and expenses.

You have come to the end of this short unit on accounting principles and concepts. Let us now review what you have learnt.
2.4 What Have You Learnt?

In this unit, you have learnt about the basic accounting principles and concepts that govern how businesses prepare their financial statements. Let us briefly review the 11 accounting principles and their meaning:

1. *Entity assumption*: the owner and the business are two separate entities
2. *Going concern principle*: business will remain in operation for the foreseeable future
3. *Periodicity principle*: report your financial results within a designated period of time;
4. *Monetary unit principle*: accounting transactions should be expressed in units of currency, *e.g.* Kina
5. *Historical cost principle*: the price of an asset in the balance sheet is based on its original cost not current value.
6. *Objectivity Principle*: accounting statements should be based on verifiable data
7. *Revenue realization principle*: revenue is recognised as soon as it is earned
8. *Matching principle*: expenses should be recorded in the period in which they are incurred
9. *Consistency principle*: adopt one accounting method throughout your reporting periods
10. *Disclosure principle*: provide all the necessary information needed to help people understand your financial statements
11. *Prudence principle*: do not overestimate your assets and income or underestimate your liabilities and expenses.

In the next unit, we shall discuss the various records of financial transactions that make up the accounting system. But before then, test your understanding of what you have just learnt by answering the following questions. Good luck!

2.5 Apply Your Accounting Knowledge

1. Which accounting principle applies in the following statements? Write your answer next to the statement.

<table>
<thead>
<tr>
<th>Statement</th>
<th>Accounting Principle</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. All transactions of a business should be recorded.</td>
<td></td>
</tr>
<tr>
<td>2. Brian Bell started the business Brian Bell Plaza. However, Brian Bell is not around the business is still in existence.</td>
<td></td>
</tr>
<tr>
<td>3. Accounting reports must be reported every year.</td>
<td></td>
</tr>
</tbody>
</table>
4. Personal affairs must not mingle with the business

5. Revenue earned must agree with the costs incurred.

Compare your answers with those found at the end of this course.
UNIT 3: ACCOUNTING SYSTEM PART 1

3.1 Introduction to the Unit
Welcome to the third unit of this course on bookkeeping. In the last unit we discussed various accounting principles and concepts. We hope you now understand how they are applied. In this unit we shall introduce you to the accounting system. The accounting system is an organized or systematic way of keeping accounting records. In part 1 of this topic we shall look at the books of accounts which are used to record the financial transactions of a business, while in Part II we shall discuss statements of accounts. As we mentioned in Unit 1, recording financial information is one of the key responsibilities of a bookkeeper. Therefore, this unit is very important as it will provide you with the knowledge and skills you need to record transactions correctly in books of accounts. You will also learn how the double and single entry systems in accounting work. We shall use the example of Loa Kava Enterprise and Sanap Bakery, both fictional sole trader business entities, to illustrate how to prepare the various books of accounts.

3.2 Unit Outcomes
By the end of this unit you should be able to:

- Record financial transactions in the journal and ledger
- Differentiate between single and double entry bookkeeping

3.3 Basic Books of Accounts
Books of accounts refer to all the records or books in which financial information or transactions of a business is recorded and maintained. These records include documents such as, cash receipts, cheques, payment vouchers, invoices, the journal and ledger.

Books of accounts are divided into two main categories:

- **Books of original entries:** these are books in which we first record transactions. For example, cash receipts, checks, payment vouchers and journals. They provide detailed information of a transaction, such as name of the client, nature of transaction, date, client’s contact details, etc.

- **Books of secondary entries:** these books use previously recorded financial information from books of original entries. They help to summarise and group different transactions related to the same item or person, which is helpful in preparing financial statements. A good example is the ledger.

In this section, we shall discuss the following two book of accounts:

- the journal, and
- the ledger.
3.3.1 The Journal

The Journal is the first book of accounts where business transactions are recorded. It is sometime called the book of original entry because all transactions are recorded in chronological order as they occur.

There are many different types of journals used in accounting but in this section, we shall learn about seven. These are:

1. **General Journal**: this is a journal that first records general financial transactions as well as information that cannot be recorded in the other journals. Figure 3.1 shows the format of a general journal.

   ![Figure 3.1: The Journal](image)

   As you can see in Figure 3.1, the journal has 5 columns used as follows:

   a) The date column where the date, month and year of transaction is entered
   b) The description column is used to enter the name of the account involved in the transaction
   c) PR is short for posting reference and is used to write the page number of the ledger account to which the account where the entry is written
   d) The amounts of the accounts being debited are written here
   e) The amounts of the accounts being credited are written here.

2. **Cash Receipts Journal**: this journal records all cash coming into a business, e.g., receipts of cash

3. **Cash Payments Journal**: this journal records all cash payments made by the business.

4. **Purchase Journal**: this journal records goods purchased on credit

5. **Sales Journal**: this journal records goods sold on credit

6. **Purchase returns and allowance journal**: this journal records returns or allowances on goods previously sold on credit

7. **Sales return and allowance journal**: this journal records returns or allowances on goods previously sold cash
3.3.2 The Ledger

The ledger is the home of accounts.

What is an account?
An account is a detailed financial record which stores information associated with individual assets, liabilities, equity, revenue and expenses.

The ledger is the destination of all entries in the journal. In other words, the financial information in ledger accounts comes from the Journal. The process of transferring information from the journal to the ledger accounts is known as posting.

Each account in a ledger is divided into two identical sides: the left-hand side and the right-hand side. Instead of using the terms ‘Left-hand side’ and ‘Right-hand side’, accountants use the term Debit (Dr) and Credit (Cr). A debit entry is made on the left-hand side of the account, while a credit entry is on the right-hand side of an account.

A ledger account looks like the English alphabet letter “T”. That is why a ledger is also referred to as a “T” ACCOUNT, see Figure 3.8 below.

<table>
<thead>
<tr>
<th>Account Name</th>
</tr>
</thead>
<tbody>
<tr>
<td>Debit (Dr.)</td>
</tr>
<tr>
<td>Credit (Cr.)</td>
</tr>
</tbody>
</table>

*Figure 3.8: “T” Account*

Why are all accounts divided into a debit side and a credit side?
This is due to the dual nature of bookkeeping. If one account changes as a result of a financial transaction, then another account needs to change to keep the accounting equation in balance. This is shown in a “T” account by recording a transaction twice: once as a debit-entry in one account, and once as a credit-entry in another account.

There are four basic rules to remember about “T” accounts. These are:

- The left-hand side of the accounting equation increases in assets
- The right-hand side of the accounting equation decreases in assets
- The left-hand side of the accounting equation decreases in equity
- The right-hand side of the accounting equation increases in equity

Figure 3.9 below shows how these rules appear in two “T” accounts.
The following procedures are important when recording transactions in the ‘T’ account.

- Analyse the account concerned
- Decide whether the account affected is an increase or a decrease

There are two methods used to record financial transactions in books of accounts. These are known as DOUBLE ENTRY and SINGLE ENTRY bookkeeping. In double entry bookkeeping, every transaction is recorded in at least two accounts. While in single entry bookkeeping, a transaction is recorded in only one account. We shall discuss both in detail in the next section.

But before then, reflect on what you have learnt so far by doing the following activity.

**Activity 5  (Allow 10 minutes for this activity)**

Write “T” if a statement is True or “F” if a statement is False.

Double entry accounting means that every transaction affects one account ___

1. A ledger is also known as the Book of original entries ___
2. A journal is the first book of accounts where business transactions are recorded _____
3. A debit amount appears on the right-hand side of the “T” account ___
4. The cash receipts journal records all cash coming into business ___
5. A ledger is also known as a “T” Account _____
6. In a “T” account, the left-hand side or debit side decreases in assets ___

Compare your answers with those given at the end of this course.

We have mentioned that there are two methods used to record financial transactions, namely: double-entry bookkeeping and single entry bookkeeping. In the next section, you will learn how to record transactions using the two methods.
3.4 Double Entry and Single Entry Bookkeeping

As we mentioned in the last section, there are two ways of recording financial transactions in bookkeeping and accounting. These are:

- Double entry bookkeeping
- Single entry bookkeeping.

Let us consider each in turn starting with double entry bookkeeping.

3.4.1 Double Entry Bookkeeping

Very simply, in a double entry system at least two entries of equal amounts must be made for each business transaction, one a debit entry and another a credit entry. This is a very important fact and is called the golden rule of accounting. Further, the Debits must always equal Credits. Double entry bookkeeping is used in all businesses that need to produce a balance sheet and a profit and loss statement. It uses the same basic rules of “T” accounts which we discussed in the last section, see Figure 3.9. These are:

- A DEBIT is an accounting entry that increases an asset or decreases a liability or equity.
- A CREDIT is an accounting entry that increases equities and decreases assets.

To understand how double entry bookkeeping works, let us use the transactions of Loa Kava Enterprise in Example 4.

**EXAMPLE 4:**

In January 2015, Loa Kava Enterprises recorded the following transactions:

1. 1/1/2015 The owner invested K5,000 in his business.
2. 2/1/2015 The business made a cash purchase of a second-hand truck for K3,500.00
3. 3/1/2015 The business bought furniture on credit for K1,000.00
4. 4/1/2015 The business borrowed K500 from BSP Bank to add to the business capital
5. 4/1/2015 The business bought stationery for K1,000 by cheque

The transactions in Example 4 will look as follows when recorded using double entry bookkeeping rules:

**Transaction 1:** the owner of Loa Kava started the business and banked 5,000 in the business account on 1\textsuperscript{st} January 2015. Following the rules of bookkeeping, we should debit the cash at bank (asset account) and credit the equity account.
Transaction 2: the business makes a cash purchase of a second-hand truck for K3,500 on 2\textsuperscript{nd} January, 2015. We should credit the liability account and debit the truck (asset) account.

\begin{tabular}{c|c|c}
\hline
\textbf{Cash at Bank} & & \\
\hline
\textbf{debit} & \textbf{($K$)} & \textbf{credit} \\
1/1/2015 & Equity & 5,000 \\
\hline
\textbf{Equity Account} & & \\
\hline
\textbf{debit} & \textbf{($K$)} & \textbf{credit} \\
1/1/2015 & Bank & 5,000 \\
\hline
\end{tabular}

\begin{tabular}{c|c|c}
\hline
\textbf{Cash at Bank} & & \\
\hline
\textbf{debit} & \textbf{($K$)} & \textbf{credit} \\
2/1/15 & Truck & 3,500 \\
\hline
\textbf{Truck} & & \\
\hline
\textbf{debit} & \textbf{($K$)} & \textbf{credit} \\
2/1/15 & Cash at Bank & 3,500 \\
\hline
\end{tabular}

Transaction 3: the business buys furniture on credit for K1,000 on 2\textsuperscript{nd} January, 2015. We should debit the furniture account (asset) and credit the accounts payable (liability) account.

\begin{tabular}{c|c|c}
\hline
\textbf{Furniture} & & \\
\hline
\textbf{debit} & \textbf{($K$)} & \textbf{credit} \\
Accounts Payable & 1,000 & \\
\hline
\textbf{Accounts Payable} & & \\
\hline
\textbf{debit} & \textbf{($K$)} & \textbf{credit} \\
Furniture & 1,000 & \\
\hline
\end{tabular}

Transaction 4: the business borrows K500 form BSP Bank to add to the business capital on 4\textsuperscript{th} January, 2015. We should debit the cash at bank account and credit the loan payable account.
Transaction 5: the business buys stationery with a cheque of K1,000 on 4th January, 2015. We should debit the stationery account (asset) and credit the cash at bank (asset) account.

<table>
<thead>
<tr>
<th>Stationery</th>
<th>debit</th>
<th>(K)</th>
<th>credit</th>
<th>(K)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash at Bank</td>
<td>1,000.00</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

We hope you have noticed that each “T” account, when recording a transaction, names the corresponding “T” account to show that the transaction reflects a double entry in the ledger account. Having individual “T” accounts in the ledger makes it easy to collect information from many different types of transactions.

Next, we shall look at single entry bookkeeping.

### 3.4.2 Single Entry Bookkeeping (Cash Book Bookkeeping)

What Is Single Entry Bookkeeping?

Single entry bookkeeping is a simple form of bookkeeping and accounting which records transactions as a single entry in an accounting record. The most common type of record used in a single-entry system is the cash book. That is why this method is also known as cash book bookkeeping. This method is popular with small businesses whose transactions are few.
Advantages and Disadvantages of Single Entry Bookkeeping

The advantages of Single Entry Bookkeeping are:

- It is simple and easy to understand
- You can follow the transactions in line with the dates
- Figures in each column of the cash book can added up easily.
- The balance column of the cash book matches the difference between the total sum of the debits and the total sum of the credits.

The disadvantages of single entry bookkeeping are:

- Misstatement of figures in the columns can lead to unreliable sums in the cash book columns and balance;
- Wrong analysis or misinterpretation of transactions entered in the cash book can lead to the creation of inappropriate ledgers accounts.

How to Record Transactions in a Cash Book

The cash book is made up of the following parts, see Figure 3.10.

- A column showing the date of the transaction
- A column showing the description of the transaction, e.g. bank loan
- A column showing the reference number of the transaction, e.g. a receipt number or cheque number
- A column where the Cash In is recorded
- A column where the Cash Out is recorded
- A column which shows the running balance or the amount of funds available in the account after each transaction.

To obtain the cash book summary, all you have to do is to:

- add all the Cash In and Cash Out separately
- then subtract the total Cash In from the total Cash out

The formula is as follows:

\[ \text{Cash Book Summary} = \text{TOTAL CASH IN} - \text{TOTAL CASH OUT} \]

The cash book summary should be equal to the ending balance for that period.

Let’s use the example of Sanap Bakery transactions below to prepare a cash book record.
EXAMPLE 5: Sanap Bakery Transactions

In February 2012, Sanap Bakery had the following transactions:

- 01/02/2012: Sanap Bakery capital deposited K500.00, slip no: 1791
- 03/02/2012: Loan from BSP Bank K500.00, rec no: 99
- 08/02/2012: Bought ten items/goods at K30.00 each Chq no: 011
- 11/02/2012: Sales K300.00 receipt no 100
- 15/02/2012: Bills K100.00 cheque no: 012
- 19/02/2012: Transport hire K100.00 chq no: 013
- 24/02/2012: Donations K200.00 receipt no: 101
- 28/02/2012: Sales K250.00 receipt no: 102
- 29/02/2012: Loan repayment K100.00 chq no: 014

This information was recorded in a cash book as shown in Figure 3.10 below.

<table>
<thead>
<tr>
<th>Month: February Year: 2012</th>
<th>Sanap Bakery Cash Book</th>
</tr>
</thead>
<tbody>
<tr>
<td>Date</td>
<td>Particulars</td>
</tr>
<tr>
<td>01/02/2012</td>
<td>Capital</td>
</tr>
<tr>
<td>05/02/2012</td>
<td>Bank loan</td>
</tr>
<tr>
<td>08/02/2012</td>
<td>Goods</td>
</tr>
<tr>
<td>11/02/2012</td>
<td>Sales</td>
</tr>
<tr>
<td>15/02/2012</td>
<td>Bills</td>
</tr>
<tr>
<td>19/02/2012</td>
<td>Transport</td>
</tr>
<tr>
<td>24/02/2012</td>
<td>Donations</td>
</tr>
<tr>
<td>28/02/2012</td>
<td>Sales</td>
</tr>
<tr>
<td>29/02/2012</td>
<td>Loan repayment</td>
</tr>
</tbody>
</table>

|  | Total In K1,750.00 | Total Out K600.00 | Balance c/f K1,150.00 |

Figure 3.10: Cash book Record for Sanap Bakery

What was the cash book summary for this period? Find out by completing the following activity.
ACTIVITY 6 (Allow 10 - 15 minutes for this activity)

Using the formula we have just discussed, calculate the cash book summary for Sanap Bakery in the space provided below and compare it with the ending balance.

Well done! We hope your calculation was as follows:

\[
\text{Total cash in} - \text{Total Cash out} = \text{Cash book summary}
\]

\[
K1,750 - K600 = K1,150
\]

If the Cash Book Summary matches the ending balance in the cash book then your cash book has balanced. The ending balance is carried forward to the cash book of the next month (in this case March). It is recorded in the March cash book as the beginning Balance.

That brings us to the end of this unit in which we have discussed the main books of accounts and the difference between double and single entry bookkeeping. Let us now review what you have learnt.

3.5 What Have You Learnt?

In this unit, you have learnt how to record transactions in two basic books of accounting, namely the journal and ledger. The journal is the first book we use to enter details of all transactions. These are then summarized and recorded in the ledger book in the form of “T” accounts. You have also learnt that “T” accounts are divided into two sides, the left side records the debits, while the right side records the credits. In addition, we have discussed how to record transactions using double and single entry bookkeeping methods. We have seen that the single-entry bookkeeping system records one single entry per transaction in the cash book. It is ideal for small businesses with a low volume of transactions and that do not need to prepare balance sheets or track assets and liabilities. Double entry bookkeeping records transaction in “T” accounts, where two entries are made for each transaction - one in the debit column and one in the credit column. This method enables the owner of the business to prepare the balance sheet and profit and loss statements.

Congratulations you are now on your way to becoming a seasoned bookkeeper. In the next unit, we shall discuss how to use the information you have collected in the ledger and journal to prepare statements of accounts. But before then, it’s time to apply your accounting knowledge in the following self-test. Good luck!
3.6 Apply Your Accounting Knowledge

Indicate whether the following statements are True or False by writing “T” in the space provided if the statement is True or (“F”) if it is False.

a) In an accounting equation both accounts either increase or decrease
b) Equity increases in credit and decreases in debit.
c) Liabilities = Asset – owner’s equity
d) A double entry posting requires a minimum of two accounts
e) Single entry bookkeeping is the same as cash bookkeeping
f) Financial information in the ledger comes from daily transactions
g) Cash book bookkeeping is only suitable for big businesses
h) The journal keeps a record of transactions from the ledger
UNIT 4: ACCOUNTING SYSTEM PART II

4.1 Unit Introduction
Welcome to the second part of our discussion on the accounting system. In the last unit, you learnt how to maintain two key bookkeeping records, namely the journal and ledger. You also learnt the difference between single and double entry bookkeeping. In this unit we are going to discuss how to prepare statements of accounts. It is a continuation of Accounting System Part I in that, statements of accounts are prepared using information from books of accounts.

In this unit, we shall discuss how to prepare the trial balance, balance sheet, revenue and loss account, and profit and loss account. Once again, we shall use the example of Loa Kava Enterprise to illustrate how to prepare these statements.

4.2 Unit Outcomes
By the end of this unit you should be able to prepare the following statements of accounts:

- The trial balance
- Balance sheet
- Trading statement
- Profit and loss account

4.3 The Trial Balance

4.3.1 What is a Trial Balance?
A trial balance is a list of all account balances extracted from the ledger on a specific date. The objective of this record is to check the arithmetical accuracy of the books of accounts. It ensures that for every transaction, a debit recorded in one ledger account has been matched with a credit in another. A trial balance is prepared monthly, quarterly or half yearly depending on the requirement of the business. It’s prepared for internal use and forms the basis for the preparation of the balance sheet.

4.3.2 Steps of Preparing a Trial Balance
The following are the 7 basic steps of preparing a trial balance:

1. Prepare a 3-column table as shown in Figure 4.1
2. Write the name of your business, type of report and date of reporting at the head of the table.
3. Record the account titles in the Account column in the order in which they appear in the ledger
4. Record the debit balances in the debit column
5. Record the credit balances in the credit column
6. Total the debit and credit columns
7. Compare the total of the two columns to see if they balance.
Let us now use Loa Kava’s transactions in Example 4 below to prepare the trial balance.

**EXAMPLE 4:**
On May 1, Loa Kava Enterprise invested K5,500 in his business. He made the following cash purchases: a second-hand truck for K3,500.00, furniture for K1,000.00 and Office Stationeries for K1,000.00.

Using Example 4, the trial balance for Loa Kava Enterprise would look as shown in Figure 4.1.

<table>
<thead>
<tr>
<th>Account</th>
<th>Debit (Dr)</th>
<th>Credit (Cr)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Motor Vehicle</td>
<td>K3,500.00</td>
<td></td>
</tr>
<tr>
<td>Furniture</td>
<td>K1,000.00</td>
<td></td>
</tr>
<tr>
<td>Office Stationeries</td>
<td>K1,000.00</td>
<td></td>
</tr>
<tr>
<td>Owner’s Equity</td>
<td></td>
<td>K5,500.00</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>K5,500.00</strong></td>
<td><strong>K5,500.00</strong></td>
</tr>
</tbody>
</table>

*Figure 4.1: Trial Balance*

As you can see, the totals of debit and credit columns of the trial balance in Figure 4.1 agree. This means that there were no errors when the entries in the “T” accounts were recorded. If there were any errors the two would not have balanced.

### 4.4 The Balance Sheet

In Unit 1, we discussed the balance sheet and its relationship with the accounting equation. Can you remember how we defined it? Try to remember by completing the following activity.

**ACTIVITY 7 (Allow 5 minutes for this activity)**

Write the meaning of the term ‘balance sheet’ in the space provided below.
We hope your answer stated that a balance sheet is a statement which shows the financial position of a company in terms of its assets, liabilities and owner’s equity. A balance sheet uses the following basic accounting equation:

$$\text{Assets} = \text{Liabilities} + \text{Owner’s Equity}$$

As we saw in Unit 1, the total sum of assets must equal to the sum of liabilities and owners’ equity. To remind yourself how a balance sheet looks like, see Figure 4.1 below.

<table>
<thead>
<tr>
<th>Sanap Bakery</th>
<th>Liabilities</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Balance Sheet</strong></td>
<td><strong>Loan Payable</strong></td>
</tr>
<tr>
<td>For The Year Ended 29th February 2012</td>
<td><strong>K500.00</strong></td>
</tr>
<tr>
<td><strong>ASSETS</strong></td>
<td><strong>LIABILITIES</strong></td>
</tr>
<tr>
<td>Cash at Bank</td>
<td><strong>Capital</strong></td>
</tr>
<tr>
<td>K1,150.00</td>
<td><strong>K500.00</strong></td>
</tr>
<tr>
<td>Goods</td>
<td><strong>Donation</strong></td>
</tr>
<tr>
<td>K300.00</td>
<td><strong>K200.00</strong></td>
</tr>
<tr>
<td><strong>Total Assets</strong></td>
<td><strong>Add: Profit</strong></td>
</tr>
<tr>
<td>K1,450.00</td>
<td><strong>K250.00</strong></td>
</tr>
</tbody>
</table>

**Figure 4.2: Balance sheet**

We hope you now remember how to prepare a balance sheet. Next, we shall discuss how to prepare the trading, profit and loss statements, also known as income statements.

4.5 Trading, Profit and Loss Statements

Trading, profit and loss statements are financial statements that are prepared after the trial balance. They are collectively known as income statements. The trading statement shows the gross profit or gross loss to the business. While, the profit and loss statement shows the net profit or what remains after all other costs used up in the period are deducted from the gross profit. Before we look at each statement in detail, let us define the terms revenue, income and profit.

What is Revenue?

Revenue is the money that a business makes from selling goods or services to its customers. For example, if your business sells fish, then the money you receive from the sale of fish is your revenue.

What is Income?

Income refers to net profit or what remains after expenses and taxes are deducted from revenue.
**What is Profit?**

One of the main objectives of a new business is to make profit. If a business is able to sell its goods and services for more than it cost to produce them in the same period, then it makes a profit. In business terms therefore, profit is simply defined as income minus expenses. If you put all the income in one column and subtract all the expenses from it, the figure you get is the profit.

There are two kinds of profit in a business:

- Gross Profit or trading profit, which is recorded in a trading statement
- Net Profit or operating profit, which is recorded in a profit and loss account.

Now, let us look at the two income statements in turn.

**4.5.1 Trading Statement**

This is a statement that shows the gross profitability of business activities within a specific accounting period. In other words, it shows the total sales, total purchases and all direct expenses related to purchase and sales. It is prepared in businesses which deal with the purchase and sale of goods. A trading statement is useful because it tells a business owner whether to continue, discontinue or modify a particular product in order to reduce losses or earn maximum profit.

**What is Gross Profit?**

Gross profit is the difference between sales and the cost of the goods sold. It is the profit earned by a business before the overheads and other running expenses are deducted. Once again let us use the example of Loa Kava Enterprise in Example 5 to calculate gross profit.

**EXAMPLE 5**

Loa Kava Enterprise bought a flash drive for K10.00 and sold it for K20.00. They made a gross profit of K10.00. Gross profit is the difference between what you sell an item for and what the item cost. It is expressed by the following formula:

\[
\text{GROSS PROFIT} = \text{SALES} - \text{COST OF GOODS SOLD}
\]

To arrive at gross profit, the owner of Loa Kava needs to not only know the sales, but also the cost of goods sold. To find the cost of goods sold, he needs to take the following three (3) things into consideration:

- Stock of goods at the beginning of the year
- Goods bought (purchases) during the year
- Stock of goods at the end of the year

To help you understand how to calculate the cost of goods sold, let’s look at the transactions of Loa Kava again in Example 6 below.
EXAMPLE 6

At the beginning of 2014, Loa Kava Enterprise had a beginning stock worth K1,000.00. During the year, they added stock worth K42,000. Therefore, the stock they bought during the year was:

\[ K1,000.00 + K42,000.00 = K43,000.00. \]

Did they sell all the goods? No! They still had K2,000.00 worth of unsold stock left over on 31 December. So, what was the cost of goods sold at the end of that year? It was as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>Opening stock</td>
<td>K1,000</td>
</tr>
<tr>
<td>Plus purchases</td>
<td>K42,000</td>
</tr>
<tr>
<td>Goods available for sale</td>
<td>K43,000</td>
</tr>
<tr>
<td>Less closing stock</td>
<td>K2,000</td>
</tr>
<tr>
<td>Cost of goods sold</td>
<td>K41,000</td>
</tr>
</tbody>
</table>

Let us assume that Loa Kava made K70,000 from the sale of goods. How much was their gross profit? Work out the gross profit in the following activity.

ACTIVITY 8 (Allow 8 minutes for this activity)

Assuming that Loa Kava made K70,000 from the sale of goods, calculate the gross profit they made from the sale of its goods using the formula:

\[ \text{SALES} - \text{COST OF GOODS SOLD} = \text{GROSS PROFIT} \]

We hope your calculation gave you a gross profit of K29,000, calculated as follows:

\[ \frac{\text{Income from sale of goods}}{K70,000} - \frac{\text{Cost of goods sold}}{K41,000} = \text{GROSS PROFIT} \]

\[ \frac{K70,000}{K41,000} = K29,000 \]

Figure 4.3 shows an example of Loa Kava Enterprise Trading Statement.
Loa Kava Enterprise
Trading Statement
For The Year Ended 31 December 2014

Sales                                                                                                      K30,000.00
Less: returns in                                                                                           K 2,000.00

Less cost of goods sold
Stock 31/12/2013                                                    K1,500.00
Add purchases                            K20,000.00
Less purchase returns out        K  1,000.00         K19,000.00
Goods available for sale          K20,500.00
Less stock 31/12/2014                               K  5,000.00
Cost of goods sold                                                                                         K15,500.00
Gross profit                                                                                               K12,500.00

Figure 4.3: Loa Kava Trading Statement

TAKE NOTE
Sales Returns: refers to goods bought by a client and returned
Purchase returns in: refers to goods purchased by a business which are returned

As you can see from the trading statement of Loa Kava in Figure 4.3, the contents of a trading account are as follows:

Debit side
- Opening stock
- Purchases and purchase returns
- Direct expenses such as wages, rent, insurance, customs, etc.

Credit Side
- Sales and sales returns
- Closing stock: this is the stock of unsold goods at the end of the accounting period

If the sales are higher than the cost of goods sold, then the excess is GROSS PROFIT. If on the other hand, the cost of goods sold is higher than the sales, there is GROSS LOSS.

Gross profit is recorded in the credit side of the profit and loss statement, while the gross loss is recorded in the debit side.

Let us now learn about the profit and loss statement.
4.5.2 Profit and Loss Statement

A profit and loss statement shows the net profit of a business after taking into consideration all indirect expenses and indirect incomes. Indirect expenses are expenses that are not directly related to the purchase of goods. For example, staff salaries, rent, legal costs, etc. Similarly, indirect income is earned through activities not related to the core business. For example, sale of old assets or newspapers. A profit and loss statement helps a business owner to control expenses.

What is Net Profit?

Net profit is measured by matching the revenue of a specific period with the expenses of the same period. If revenue exceeds expenses, the result is net profit or net income. If the revenue is less than the expenses, the result is a net loss for the period. This is represented by the following formula:

- Revenue – Expense = Net Income
- Expenses – Revenue = Net Loss

In other words, revenue increases the owner’s equity, while expenses decrease the owner’s equity. Therefore, the key elements of an income statement are revenue and expenses.

A business enterprise that specialises in merchandising has two major types of expenses:

- **General and administration expenses**: examples include rent, insurance, audit, depreciation, doubtful accounts, legal expenses and others.
- **Distribution and selling expenses**: these include store supplies, sales, salaries, advertising, office equipment, bad debts, office salaries and general expenses,

A profit and loss statement starts with the gross profit, which is given by the trading statement. As we have seen in Loa Kava’s trading statement, gross profit is what is left after we have accounted for the cost of goods sold. However, that is not the end. From the gross profit, Loa Kava must pay for the other expenses of running the business.

These expenses can be divided into:

- Selling expenses, such as delivery expenses and advertising
- Administration expenses, such as stationery, telephone, postage
- Financial expenses, such as bank interest etc.

When preparing a profit and loss account, the expenses and losses are shown on the debit side while income and items of profit are shown on the credit side of the statement. If the credit side is more than the debit side, then it shows a net profit. If the debit side is more than the credit side, then it shows a net loss. Now let’s translate Loa Kava’s expenses in Example 7 into a Profit and Loss Statement.
EXAMPLE 7
By December, 2014, Loa Kava trading statement showed a gross profit of K12,500. The business running expenses were as follows:

**Selling Expenses**
- Delivery Expenses - K3,750
- Advertising - K 1,150

**Administration Expenses**
- Office rent - K 2,000
- Postage - K 250
- Telephone - K 220
- Stationery - K 150

**Financial Expenses**
- Discount allowed - K 250
- Interest on bank overdraft - K 200

The profit and loss statement would look as shown in Figure 4.4 below.

<table>
<thead>
<tr>
<th></th>
<th>Dr.</th>
<th>Cr.</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Profit and Loss Statement</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Loa Kava Trading Enterprise</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>For The Year ended December 2014</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Gross Profit</strong></td>
<td>K12,500.00</td>
<td></td>
</tr>
<tr>
<td><strong>Less: Operating Expenses</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Selling Expenses</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Delivery Expenses</td>
<td>K3,750.00</td>
<td></td>
</tr>
<tr>
<td>Advertising</td>
<td>K1,150.00</td>
<td>K4,900.00</td>
</tr>
<tr>
<td><strong>Administration Expenses</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Office Rent</td>
<td>K2,000.00</td>
<td></td>
</tr>
<tr>
<td>Postage</td>
<td>K250.00</td>
<td></td>
</tr>
<tr>
<td>Telephone</td>
<td>K220.00</td>
<td></td>
</tr>
<tr>
<td>Stationery</td>
<td>K150.00</td>
<td>K2,620.00</td>
</tr>
<tr>
<td><strong>Financial Expenses</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Discount allowed</td>
<td>K250.00</td>
<td></td>
</tr>
<tr>
<td>Interest on bank overdraft</td>
<td>K200.00</td>
<td>K450.00</td>
</tr>
<tr>
<td></td>
<td>K7,970.00</td>
<td></td>
</tr>
<tr>
<td></td>
<td>K4,530.00</td>
<td></td>
</tr>
</tbody>
</table>

*Figure 4.4 Profit and Loss Account*

That bring us to the end of this section. Before we continue, use the knowledge you have gained to complete Activity 9.
ACTIVITY 9  (Allow 30 minutes for this activity)

Silip Kirap owns and operates a plumbing company under the name Sanap Strong Plumbing. The balances in his accounts as of January 31, 2015 were as follows:

- Cash K17,980.00
- Office Supplies K435.00
- Office Equipment K4,980.00
- Tools & Fittings K20,075.00
- Accounts Payable K1,225.00
- Silip Kirap, Capital, K20,310.00
- Service Revenue K25,770.00
- Rent Expense K1,500.00
- Salary Expense K2,200.00
- Telephone Expense K135.00

Using this information, create a trial balance and profit and loss statement. Then compare your answers with those given at the end of this course.

Congratulations! You have come to the end of this unit on statements of accounts. Let us now review what you have learnt.

4.8 What Have You Learnt?

In this unit you have learnt how to prepare the following 4 statements of accounts:

- **A trial balance**: lists all account balances extracted from the ledger on a specific date. The objective of this record is to check the arithmetical accuracy of the books of accounts.
- **A balance sheet**: shows the financial position of a company in terms of its assets, liabilities and owner’s equity.
- **A trading statement**: shows the gross profitability of business activities within an accounting period. In other words, it shows the total sales, total purchases and all direct expenses related to purchase and sales. It is prepared in businesses which deal with the purchase and sale of goods and services.
- **A profit and loss statement**: shows the net profit of a business after taking into consideration all indirect expenses and indirect incomes. It helps a business owner to control expenses.

In the next unit, we shall discuss depreciation. But before then, test your understanding of what you have just learnt by answering the following questions.
4.9 Apply Your Accounting Knowledge

1. Work out the trial balance for Loa Kava Enterprise from the information provided below.

<table>
<thead>
<tr>
<th>Account</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>K35,960.00</td>
</tr>
<tr>
<td>Office Supplies</td>
<td>K870.00</td>
</tr>
<tr>
<td>Office Equipment</td>
<td>K9,960.00</td>
</tr>
<tr>
<td>Laboratory Equipment</td>
<td>K40,150.00</td>
</tr>
<tr>
<td>Accounts Payable</td>
<td>K2,450.00</td>
</tr>
<tr>
<td>Capital</td>
<td>K40,620.00</td>
</tr>
<tr>
<td>Laboratory Revenue</td>
<td>K51,540.00</td>
</tr>
<tr>
<td>Rent Expense</td>
<td>K3,000.00</td>
</tr>
<tr>
<td>Salary Expense</td>
<td>K4,400.00</td>
</tr>
<tr>
<td>Telephone</td>
<td>K270.00</td>
</tr>
</tbody>
</table>

2. As the Bookkeeper for Sanap Strong Investment Company, prepare a trading statement for the year ended 30/6/2015.

<table>
<thead>
<tr>
<th>Account</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales</td>
<td>K126,394.00</td>
</tr>
<tr>
<td>Purchases</td>
<td>K59,860.00</td>
</tr>
<tr>
<td>Stock 1/7/2014</td>
<td></td>
</tr>
<tr>
<td>Stock 30/6/2015</td>
<td></td>
</tr>
<tr>
<td>Returns in K390.00</td>
<td></td>
</tr>
<tr>
<td>Returns out K420.00</td>
<td></td>
</tr>
</tbody>
</table>

3. Prepare a profit and loss statement for Loa Kava Enterprise for the year ended 31/7/2015 using the information given below.

- Gross profit K50,000.00
- Administration expense K15,000.00
- Selling and distribution expense K20,000.00
- Financial expenses K2,000.00

4. As a bookkeeper for Silip Kirap Enterprise, prepare both a trading statement and a profit and loss statement for the year ended 31/7/2015 using the following information.

<table>
<thead>
<tr>
<th>Account</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Purchases K139,534.00</td>
<td>Discount allowed K856.00</td>
</tr>
<tr>
<td>Rent K6,917.00</td>
<td>Sales K227,904.00</td>
</tr>
<tr>
<td>Cartage inwards K3,746.00</td>
<td>Stock 1/7/2014</td>
</tr>
<tr>
<td>Returns out K652.00</td>
<td>Stock 30/6/2015</td>
</tr>
<tr>
<td>Advertising K2,497.00</td>
<td>Delivery Expenses K15,618.00</td>
</tr>
<tr>
<td>Telephone K996.00</td>
<td>Office salaries K34,279.00</td>
</tr>
<tr>
<td></td>
<td>Interest paid on loan K1,960.00</td>
</tr>
<tr>
<td></td>
<td>Returns in K794.00</td>
</tr>
<tr>
<td></td>
<td>Insurances K1,601.00</td>
</tr>
<tr>
<td></td>
<td>Postage and Stationery K1,780.00</td>
</tr>
</tbody>
</table>
UNIT 5: DEPRECIATION

5.1 Unit Introduction
In the last two units, we discussed books and statements of accounts. We hope you are now familiar with the use of a journal and ledger and can prepare various statements of accounts. In Unit 3, we mentioned depreciation as one of the examples of the general and administrative expenses of a business. In this unit, we shall look at depreciation in detail. You will learn about the meaning of depreciation, the factors that determine depreciation and the methods used in depreciation. Let’s start by reviewing our outcomes for this unit.

5.2 Unit Outcomes
By the end of this unit you should be able to:

- Define the term depreciation
- Explain the factors that cause depreciation
- Apply the methods used for depreciating assets.

5.3 What is Depreciation
Depreciation refers to the reduction of the value of a fixed asset arising from the passage of time. As you well know, the monetary value of some fixed assets such as buildings, furniture, machinery and vehicles does not remain the same over the years. It decreases over time due to use, wear and tear or obsolescence. The only exception is land, which is considered to have an unlimited lifespan. Depreciation therefore, is a way of matching the cost of a fixed asset with the revenue (or other economic benefits) it generates over its useful life. It only applies to items that lose useful value over time.

5.4 Causes of Depreciation
The causes of depreciation can be divided into two main groups, namely:

- **Physical depreciation**: this includes wear and tear from use and deterioration caused by action of the elements.

- **Functional depreciation**: this includes inadequacy and obsolescence. A plant asset becomes inadequate if its capacity is insufficient to meet the demands of production. A plant becomes obsolete if the commodity it produces is no longer in demand or a new machine can produce better quality at less cost.
5.5 Factors That Determine Amount of Depreciation

There are three (3) factors that we need to consider when calculating depreciation. These are:

- initial cost of an asset
- residual value
- useful life

Let us look at each factor in turn.

1. Initial Cost of an Asset

This is the actual cost that was used to acquire this asset plus all other expenses, such as transport and insurance, that were used to bring the asset to its current location and condition.

2. Residual Value

This is the value of the asset that will be realized when it is sold or exchanged at the end of its useful life.

3. Useful Life

This refers to the period or number of years which the asset is expected to be used by the business. It can also be expressed in terms of the number of units that the asset will produce during its useful life.

You now know the meaning of depreciation, its causes and the factors that you need to consider when calculating depreciation. Now complete the following activity to help you review what you have just learnt.

**ACTIVITY 10 (Allow 10 minutes for this activity)**

Answer whether the following statements are True or False by writing “T” if the statement is True or “F” if the statement is False.

1. Land as an asset is depreciated ______
2. Depreciation only applies to assets that lose value over time ______
3. Physical depreciation refers to inadequacy and obsolesce ______
4. Functional depreciation refers the inability of a plant to meet its production capacity ______
5. Residual value is the money that a business expects to get at the end of an asset’s useful life ______
6. The initial cost of an asset is not considered when determining the amount of depreciation ______

Compare your answers with those given at the end of this course. Next, we shall look at the various methods used for depreciating assets.
5.6 Types of Depreciation Methods

There are four (4) types of depreciation methods. These are:

- Straight Line Method
- Units of Production Method
- Declining Balance Method
- Sum of the Years Digits Method

Let us consider each method in turn.

5.6.1 Straight Line Method

This method allocates an equal amount of the asset cost every year over the useful life of the asset. It is represented by the following formula:

\[
\text{DEPRECIATION} = \frac{\text{COST} - \text{RESIDUAL VALUE}}{\text{USEFUL LIFE}}
\]

Let’s apply this formula to calculate depreciation for Example 8.

**EXAMPLE 8**

The cost of a PMV bus is K80,000.00, its residual value is 10% of the cost annually and its estimated life is 10 years.

Using the formula for this method, the annual depreciation amount would be:

\[
\frac{K80,000.00 - (10\% \text{ of } K80,000.00)}{10} = K7,200.00 \text{ annual depreciation}
\]

The annual depreciation is K7,200.00. Therefore, monthly depreciation would be K600.00 if we divide K7,200.00 by 12 months.

This method is easy to calculate and is suitable for depreciating assets such as buildings, whose economic benefits remain the same over time.

5.6.2 Units of Production Depreciation Method

This method calculates depreciation according to the actual usage of an asset or production levels. Since the actual usage or production level of an asset varies from time to time, then the depreciation amount also varies. When the asset is used more, depreciation will be high, and when the asset is used less, then depreciation will be low.

To apply this method, the length of life of the asset is expressed in terms of productive capacity, such as hours, kilometres or number of units. The following formula is used to calculate depreciation under this method:
As you can see in this formula, the useful life of the asset is expressed in units rather than years of service. Let us apply this formula to calculate depreciation for Example 9.

**EXAMPLE 9**

A PMV bus cost K80,000.00, its residual value is 20% of the cost and it is expected to have an estimated life of 38,000 kilometres.

Using the formula above, the depreciation would be calculated as follows:

\[
\text{K80,000.00} - (20\% \text{ of K80,000.00}) = \text{K1.68 per kilometre depreciation}
\]

\[
\frac{38,000}{38,000}
\]

The depreciation cost for this bus would therefore be K1.68 per kilometre.

Let us assume that the bus covered 2,000 km during a particular year. The depreciation for that year would be K3,360 calculated as follows:

\[
\text{K1.68 X 2,000 km} = \text{K3,360.00}
\]

This method provides an accurate way of charging depreciation as it links closely to the wear and tear of an asset.

To test your understanding of what you have just learnt, complete the following activity.

**ACTIVITY 11 (Allow 15 - 20 minutes for this activity)**

Calculate the depreciation costs for the following two assets and then compare your answers with those given at the end of this unit.

1. Sanap bakery bought an oven at a cost of K15,000. Its residual value is 10% of its annual cost and its estimated life is 10 years. Calculate the depreciation cost using the straight line method.
2. Sanap bakery also purchased a van for K60,000. Its residual value is 20% and it’s expected to have an estimated life of 38,000 kilometres. Calculate the depreciation cost per kilometre using the units of production depreciation method.

### 5.6.3 Declining Balance Method

In this method, depreciation reduces at a constant rate as the life of the asset progresses. In other words, the depreciation expense progressively declines over the assets useful life. If we use Example 9, the depreciation expense for the first 5 years would be as shown in Table 5.1.

**Table 5.1: Declining Balance Depreciation Method**

<table>
<thead>
<tr>
<th>Year</th>
<th>Cost</th>
<th>Accumulated Depreciation at Beginning of Year</th>
<th>Book Value at Beginning of Year</th>
<th>Rate</th>
<th>Depreciation per Year</th>
<th>Book Value at End of Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>K80,000.00</td>
<td>-</td>
<td>K80,000.00</td>
<td>20%</td>
<td>K16,000.00</td>
<td>K64,000.00</td>
</tr>
<tr>
<td>2</td>
<td>K80,000.00</td>
<td>K16,000.00</td>
<td>K64,000.00</td>
<td>20%</td>
<td>K12,800.00</td>
<td>K51,200.00</td>
</tr>
<tr>
<td>3</td>
<td>K80,000.00</td>
<td>K28,800.00</td>
<td>K51,200.00</td>
<td>20%</td>
<td>K10,240.00</td>
<td>K40,960.00</td>
</tr>
<tr>
<td>4</td>
<td>K80,000.00</td>
<td>K39,040.00</td>
<td>K40,960.00</td>
<td>20%</td>
<td>K8,192.00</td>
<td>K32,768.00</td>
</tr>
<tr>
<td>5</td>
<td>K80,000.00</td>
<td>K47,232.00</td>
<td>K32,768.00</td>
<td>20%</td>
<td>K6,553.60</td>
<td>K26,214.40</td>
</tr>
</tbody>
</table>

As you can see from Table 5.1, the depreciation cost and book value of the asset progressively declines every year.

### 5.6.4 Sum of the Year’s Digits Method

This method calculates depreciation based on the sum of the number of years in an asset’s useful life. The depreciation charge declines by a constant amount as the life of the asset progresses. It is similar to the declining balance method in that it also allocates a higher depreciation expense in the earlier years of an assets useful life.

Let’s consider Example 10 below and use it to calculate the depreciation cost using this method.

**EXAMPLE 10**

Let’s assume the PMV bus purchased for K80,000.00, has an estimated life of 4 years and a residual value of K1,000.00.

The calculation of depreciation under the sum of years’ digits method can be summarised in the following 4 steps:
Step 1: Calculate sum of years’ digits in an asset’s useful life

Since in this case the estimated life of the bus is 4 years. The sum of years’ digits is 10, calculated by adding all the years together as follows:

\[
\text{Sum of years digits} = 4 + 3 + 2 + 1 = 10.
\]

Step 2: Calculate the depreciable amount

The depreciable amount in this case is K79,000 calculated as follows:

Asset’s cost of acquisition (in this case K80,000) minus Estimated residual value (K1,000)

Step 3: Calculate the number of years of useful life

This is the number of years in an asset’s useful life that have not yet been subjected to depreciation. That is, 4 years in year 1; 3 years in year 2; and so on.

Step 4: Calculate depreciation using the following formula:

\[
\text{Depreciation} = \frac{\text{Years of useful life (Step 3)}}{\text{Sum of years digits (Step 1)}} \times \text{depreciable amount (Step 2)}
\]

Using Example 10, Year 1 depreciation would be as follows:

\[
\frac{4 \times K79,000}{10} = K31,600
\]

Year 2 depreciation:

\[
\frac{3 \times K79,000}{10} = K23,700
\]

Year 3 Depreciation

\[
\frac{2 \times K79,000}{10} = K15,800
\]

Year 4 Depreciation

\[
\frac{1 \times K79,000}{10} = K7,900
\]

Table 5.2 summarises the depreciation schedule for the PMV bus.

Table 5.2: Sum of Year’s Digits Depreciation Method
<table>
<thead>
<tr>
<th>Year</th>
<th>Cost Less Residual Value</th>
<th>Rate</th>
<th>Depreciation for Year</th>
<th>Accumulated Depreciation at End of Year</th>
<th>Book Value at End of Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>K79,000.00</td>
<td>4/10</td>
<td>K31,600.00</td>
<td>K31,600.00</td>
<td>K48,400.00</td>
</tr>
<tr>
<td>2</td>
<td>K79,000.00</td>
<td>3/10</td>
<td>K23,700.00</td>
<td>K55,300.00</td>
<td>K24,700.00</td>
</tr>
<tr>
<td>3</td>
<td>K79,000.00</td>
<td>2/10</td>
<td>K15,800.00</td>
<td>K71,100.00</td>
<td>K8,900.00</td>
</tr>
<tr>
<td>4</td>
<td>K79,000.00</td>
<td>1/10</td>
<td>K7,900.00</td>
<td>K79,000.00</td>
<td>K1,000.00</td>
</tr>
</tbody>
</table>

Congratulations! You have come to the end of this unit on depreciation. As usual, let’s review what you have learnt.

5.7 What Have You Learnt?

In this unit, you have learnt that depreciation refers to the reduction of the value of a fixed asset arising from the passage of time. It is caused by either physical depreciation, such as, wear and tear, or functional depreciation due to inadequacy and obsolescence. You have also learnt about the following four common methods of depreciation and how they are calculated:

- **Straight Line Method**: same depreciation is charged over the entire useful life of the asset;
- **Units of Production Method**: depreciation varies according to the usage of the asset;
- **Declining Balance Method**: depreciation decreases at a constant rate as the life of the asset progresses
- **Sum of the Years Digits Method**: Depreciation charge declines by a constant amount as the life of the asset progresses.

In the next unit, we shall discuss how to prepare the accounting payroll. But before then, find out how much you still remember by completing the following self-test.

5.8 Apply Your Accounting Knowledge

1. Lazarus bought a second-hand taxi for K8,000.00. The useful life of taxi is five (5) years. The residual value is 10%. Determine the value of the taxi after three (3) years using the following 3 methods:
   - Straight Line Method
   - Declining Balance Method
   - Sum of the Years Digits Method
UNIT 6: PAYROLL ACCOUNTING

6.1 Unit Introduction

Congratulations for coming this far. In the last unit, you learnt about depreciation. We hope you are now able to calculate depreciation expense using the methods we discussed. In this unit, you will learn about payroll accounting. In particular, we shall define key terms used in payroll accounting and calculate and record employee gross and net pay. We shall also discuss how to prepare a payslip.

6.2 Unit Outcomes

By the end of this unit you will be able to:

- Define terms commonly used in payroll accounting
- Calculate employee gross and net pay and record the transaction in the relevant accounts
- Prepare a payslip.

6.3 Definition of Terms

In this section, we will define the following terms commonly used in payroll accounting:

- Payroll accounting
- Salary
- Wages
- Overtime

6.3.1 What is Payroll Accounting?

Before we define payroll accounting let us first look at the meaning of the term ‘payroll’. How would you define it? Write your definition in the following activity.

ACTIVITY 12

Write the meaning of the term ‘payroll’ in the space provided below.
Well done! Now compare your definition with the one in the following discussion.

A payroll is a financial record of a business which lists all the employees and the salaries that they earn. It shows the employees’ gross pay, tax and other deductions and net pay.

Having defined the term ‘payroll’, let’s now define payroll accounting.

Payroll accounting is the process of calculating, recording and paying employee salaries and benefits. Payroll accounting produces accurate records of all expenses related to employee compensation and benefits. It also facilitates timely payments.

6.3.2 What is a Salary?

A salary is a fixed amount of money or compensation that is paid periodically to an employee by an employer in return for work performed. The period may be every fortnight or month.

6.3.3 What are Wages?

Wages refer to employee compensation that are paid according to the number of hours worked. Wages are paid either weekly or bi-weekly and are calculated by multiplying the hourly rate by the number of hours worked.

6.3.4 What is Overtime?

This is the time that an employee works beyond normal working hours. In most businesses, employees are expected to work 7 hours a day, from Monday to Friday. If they come to work on Saturday and Sunday, depending on their job responsibilities, this time is considered as overtime and they are paid for working extra hours.

You now know the meaning of some of the key terms used in payroll accounting. Next, you will learn how to calculate and record employee payments.

6.4 Calculating and Recording Employee Gross and Net Pay

In this section, you will learn how to calculate and record employees’ gross and net pay using Example 11 drawn from Loa Kava enterprise.
EXAMPLE 11

Marie, Rodney, Jessica, Lazarus and Junior worked for Loa Kava Enterprise. Their hourly rates are as follows:

- Marie K4.70,
- Rodney K6.90,
- Jessica K9.00,
- Lazarus K7.90 and
- Junior K4.80.

The working hours at Loa Kava are 8:00am to 4:30pm. 12pm to 1pm is lunchbreak, making a total of 7.5 hours per day.

Suppose they:

- worked for 2 weeks (10 working days).
- Jessica and Rodney worked overtime on Saturday and Sunday from 8am to 12 midday.

Below is a calculation of how their hours were calculated for one week.

To calculate the rate per day in kina for normal working hours, you multiply the hourly rate by the number of hours worked. The formula is as follows:

\[ \text{HOURLY RATE} \times \text{NUMBER OF HOURS WORKED} = \text{DAILY RATE} \]

Let us use this formula to calculate the daily rate for Marie who earns an hourly rate of K4.70.

\[
\begin{align*}
\text{HOURLY RATE} & \times \text{NUMBER OF HOURS WORKED} = \text{DAILY RATE} \\
K4.70 & \times 7.5 = 35.25
\end{align*}
\]

To calculate overtime payments on Saturday and Sundays, Loa Kava enterprise uses the following formula:

- **Saturday:** Hourly Rate \times Number of Hours Worked \times One and a Half (1.5)
- **Sunday:** Hourly Rate \times Number of Hours Worked \times Two (2)

Using this formula, let’s calculate the overtime rate for Jessica on Saturday and Sunday.

**Saturday:** \( \frac{\text{Hourly Rate} \times \text{Number of Hours Worked} \times 1.5}{9} = \frac{K54}{4} \)

**Sunday:** \( \frac{\text{Hourly Rate} \times \text{Number of Hours Worked} \times 2}{9} = \frac{K72}{4} \)

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With those two examples, am sure you can now calculate the daily rate for the remaining staff of Loa Kava in the following activity.

**ACTIVITY 13**

Calculate the rate per day for the following employees of Loa Kava:

- Rodney
- Lazarus
- Junior

Well done! We hope you noted that Rodney worked overtime on Saturday and Sunday. Now compare your daily rates with the ones we have calculated in Table 6.1 below.

**Table 6.1: Daily rates for Loa Kava staff**

<table>
<thead>
<tr>
<th>Staff</th>
<th>Monday</th>
<th>Tuesday</th>
<th>Wednesday</th>
<th>Thursday</th>
<th>Friday</th>
<th>Saturday</th>
<th>Sunday</th>
</tr>
</thead>
<tbody>
<tr>
<td>Marie</td>
<td>K35.25</td>
<td>K35.25</td>
<td>K35.25</td>
<td>K35.25</td>
<td>K35.25</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Rodney</td>
<td>K51.75</td>
<td>K51.75</td>
<td>K51.75</td>
<td>K51.75</td>
<td>K51.75</td>
<td>K54.00</td>
<td>K55.20</td>
</tr>
<tr>
<td>Jessica</td>
<td>K67.50</td>
<td>K67.50</td>
<td>K67.50</td>
<td>K67.50</td>
<td>K67.50</td>
<td>K54.00</td>
<td>K72.00</td>
</tr>
<tr>
<td>Lazarus</td>
<td>K59.25</td>
<td>K59.25</td>
<td>K59.25</td>
<td>K59.25</td>
<td>K59.25</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Junior</td>
<td>K36.00</td>
<td>K36.00</td>
<td>K36.00</td>
<td>K36.00</td>
<td>K36.00</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

The salary payments shown in Table 6.1 for Loa Kava staff do not have any deductions. They are known as **Gross Salary**. Examples of deductions that are normally made from employee salary include taxes such as Nasfund, IRC, POSF. Once these deductions are made from an employee’s salary, the remaining amount is known as **Net Pay**.

Now, let’s assume that the 5 employees of Loa Kava worked for two weeks including overtime for Rodney and Jessica. Their gross and net pay for the two weeks (10 days) would be as shown in Table 6.2 below.
Table 6.2: Gross and Net Salary Payments

<table>
<thead>
<tr>
<th>Staff</th>
<th>Total hours</th>
<th>Overtime</th>
<th>Gross Pay</th>
<th>Deductions</th>
<th>Net Pay</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Saturday</td>
<td>Sunday</td>
<td>Nasfund (6%)</td>
<td>IRC</td>
</tr>
<tr>
<td>Marie</td>
<td>7.5 x 10 = 75 hrs x 4.70</td>
<td>-</td>
<td>-</td>
<td>K21.15</td>
<td>K17.60</td>
</tr>
<tr>
<td>Rodney</td>
<td>7.5 x 10 = 75 hrs x 6.90</td>
<td>K41.40</td>
<td>K55.20</td>
<td>K36.85</td>
<td>K31.20</td>
</tr>
<tr>
<td>Jessica</td>
<td>7.5 x 10 = 75 hrs x 9.00</td>
<td>K54.00</td>
<td>K72.00</td>
<td>K48.06</td>
<td>K39.20</td>
</tr>
<tr>
<td>Lazarus</td>
<td>7.5 x 10 = 75 hrs x 7.90</td>
<td>-</td>
<td>-</td>
<td>K35.55</td>
<td>K28.41</td>
</tr>
<tr>
<td>Junior</td>
<td>7.5 x 10 = 75 hrs x 4.80</td>
<td>-</td>
<td>-</td>
<td>K22.10</td>
<td>K21.60</td>
</tr>
<tr>
<td></td>
<td>Total</td>
<td>K95.40</td>
<td>K127.20</td>
<td>K163.71</td>
<td>K138.01</td>
</tr>
</tbody>
</table>

Once you calculate and pay out employees’ salaries, you need to record this transactions in the ledger. You will recall in Unit 2 we discussed the ledger book of account and how to record entries in the “T” accounts. In payroll accounting, the following entries are made in the affected accounts:

**Salaries Payable**

<table>
<thead>
<tr>
<th></th>
<th>debit (K)</th>
<th>credit (K)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Salaries Payable</td>
<td>K2,720</td>
<td></td>
</tr>
</tbody>
</table>

The following accounts are recorded after salary payment:

**Salaries Expense**

<table>
<thead>
<tr>
<th></th>
<th>debit (K)</th>
<th>credit (K)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Salaries Expense</td>
<td>K2,720</td>
<td></td>
</tr>
</tbody>
</table>

**Cash at Bank**

<table>
<thead>
<tr>
<th></th>
<th>debit (K)</th>
<th>credit (K)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash at Bank</td>
<td>K2,720</td>
<td></td>
</tr>
</tbody>
</table>
6.5 The Pay Slip

What is a pay slip? Take a minute to think about it and then complete the following activity.

ACTIVITY 14

Using your own words, write down the meaning of the term ‘pay slip’ in the space provided below.

Now compare your answer with what you read in the following discussion.

A pay slip is a note or form that is given to an employee to show how much they have earned for work done in a certain period. The details include the following information:

- the number of hours worked,
- the hourly rate,
- gross pay, that is the full pay before deductions
- tax and other deductions,
- net pay, the take-home pay after deductions

Each employee of an organization should receive a pay slip every fortnight or month in line with the contract signed with the employer. Figure 6.1 shows an example of a payslip for Jessica, one of the employees of Loa Kava Enterprise.
Loa Kava Enterprises  
Name: Jessica Sepoe  
Occupation: Data Operator  
PPE: 1st June to 12th June 2015  

**PAY SLIP**

<table>
<thead>
<tr>
<th>Day</th>
<th>Start Time</th>
<th>Finish Time</th>
<th>Hours worked</th>
<th>Gross Pay</th>
</tr>
</thead>
<tbody>
<tr>
<td>Monday 1/6/2015</td>
<td>8:00</td>
<td>4:30</td>
<td>7.5</td>
<td></td>
</tr>
<tr>
<td>Tuesday 2/6/2015</td>
<td>8:00</td>
<td>4:30</td>
<td>7.5</td>
<td></td>
</tr>
<tr>
<td>Wednesday 3/6/2015</td>
<td>7:57</td>
<td>4:30</td>
<td>7.5</td>
<td></td>
</tr>
<tr>
<td>Thursday 4/6/2015</td>
<td>7:39</td>
<td>4:30</td>
<td>7.5</td>
<td></td>
</tr>
<tr>
<td>Friday 5/6/2015</td>
<td>8:00</td>
<td>4:30</td>
<td>7.5</td>
<td></td>
</tr>
<tr>
<td>Monday 8/6/2015</td>
<td>7:48</td>
<td>4:30</td>
<td>7.5</td>
<td></td>
</tr>
<tr>
<td>Tuesday 9/6/2015</td>
<td>7:34</td>
<td>4:34</td>
<td>7.5</td>
<td></td>
</tr>
<tr>
<td>Wednesday 10/6/2015</td>
<td>7:56</td>
<td>4:32</td>
<td>7.5</td>
<td></td>
</tr>
<tr>
<td>Thursday 11/6/2015</td>
<td>8:00</td>
<td>4:35</td>
<td>7.5</td>
<td></td>
</tr>
<tr>
<td>Friday 12/6/2015</td>
<td>7:50</td>
<td>4:31</td>
<td>7.5</td>
<td></td>
</tr>
</tbody>
</table>

**Normal Pay**

\[7.5 \times 10 \times K9.00 = K675.00\]

**Overtime: Saturday**

\[1.5 \times 4 \times K9.00 = K54.00\]

**Sunday**

\[2 \times 4 \times K9.00 = K72.00\]

**Total Gross Pay**

\[K801.00\]

**Deductions**

- Nasfund (6%): K48.06
- IRC: K39.20

**Net Pay**

\[K713.74\]

*Figure 6.1: Sample pay slip*

You have now come to the end of this unit on payroll accounting. Let’s review what you have learnt.

### 6.6 What Have You Learnt?

In this unit, you have learnt the meaning of payroll accounting and other terms, such as salary, wages and overtime. You have also learnt that gross pay is the total payment for an employee before tax and other deductions are made. While net pay is what an employee takes home, after all the deductions have been made. We hope you can now confidently calculate employee gross and net pay. In addition, you have learnt what a pay slip is and how it is prepared.

In the next unit we shall discuss petty cash. But before you move on to the next unit, test your knowledge of payroll accounting by answering the questions in the following self-test.

### 6.7 Apply Your Accounting Knowledge

1. Joanne, Tom, Rachael and John work for a private organisation. Their hourly rates are as follows:

   - Joanne K4.50,
   - Tom K5.75,
   - Rachael K8.40

They all worked for 10 days (1st to 12th May 2015) from 8am to 4pm with a one hour lunch break. Tom worked overtime on Saturday and Sunday, at a rate of 1.5 and 2
times of the normal hourly rate, respectively. The Nasfund contribution is 6%. From this information, calculate the following:

(a) Gross pay for each worker  
(b) Net pay for each worker  
(c) Overtime rate for Tom who worked 4 hours on Saturday and Sunday  
(d) Pay slip for each worker

2. Doris, Keppo, Amos and Lina worked for Raka Hebou Organisation and their rates are as follows: Doris K5.50 per hour, Keppo K8.33 per hour, Amos K4.50 per hour and Lina K6.00 per hour. They start at 8am, lunch is from 12 to 1pm and they finish at 4pm daily.

a) Calculate their fortnight pay if they worked for two weeks (May 15th to 26th 2015. (Nasfund deductions is 6%)

b) If Keppo and Amos worked on Saturday and Saturday for six (6) hours excluding lunch, calculate their:
   • overtime pay  
   • gross pay  
   • net pay

c) Prepare a pay slip for Doris, Keppo and Amos.
Unit 7: Petty Cash

7.1 Unit Introduction
Welcome to Unit 7 on petty cash. In this unit, you will learn how to establish a petty cash fund and account for it. The unit begins with the definition of petty cash and then shows you how to organise a petty cash fund. It also discusses with examples how to record petty cash transactions in two books of accounts, namely, the Cash Payment Journals and Petty Cash Book. Let’s start by reviewing our unit outcomes.

7.2 Unit Outcomes
By the end of this unit you will be able to:

- Define the term petty cash
- Explain the steps to follow when establishing a petty cash fund
- Record petty cash transactions in the relevant books of accounts

7.3 What is Petty Cash

**ACTIVITY 15: (Allow 5 minutes for this activity)**

Before you read the following section, write down the definition of the term ‘petty cash’ in the space provided below.

Compare your answer with what you read in the following discussion.

Petty cash is a special cash fund that a business keeps on hand in order to pay for minor cash transactions. For example, postage, transport, office coffee and sugar, etc. If these transactions were made by cheque, they would result in delay and the unnecessary expense of maintaining records. The person who keeps petty cash is known as a petty cashier or petty cash custodian.
7.4 Organizing a Petty Cash Fund

There are three basic steps that are followed when organising a petty cash fund. These are:

- **Step 1: Establish the Petty Cash Fund**
  The organization decides how much cash-in-hand is needed to meet cash payments for a week, fortnight or month. This is called the Petty Cash Fund. The petty cash is kept and managed by the petty cashier.

- **Step 2: Record Petty Cash Payments**
  The petty cashier has to prepare a petty cash voucher whenever he or she makes payments. A Petty cash voucher is a source document for petty cash payments.

- **Step 3: Balance Petty Cash and draw a reimbursement cheque**
  When the petty cashier makes payments for a week, the amounts are reimbursed by cheque after he or she balances the petty cash book.

7.5 Accounting for Petty Cash

Once a petty cash fund is established, the transactions are recorded in two (2) books of accounts, namely: Cash Payment Journals and Petty Cash Book. In addition, two “T” accounts are also affected, that is, Cash at Bank and Petty Cash. Before cash is disbursed, a petty cash voucher is used to record the transaction. A petty cash voucher records the following details:

- Voucher number
- Name of the receiver and the witness or person who has paid the money
- Amount disbursed
- Purpose of petty cash
- Signature of both receiver and witness

Figure 7.2 shows an example of a petty cash voucher.

![Figure 7.2: Petty cash voucher.](image)

Let us now use the example of Loa Kava Enterprise petty cash transactions to illustrate how to record transactions in the petty cash book.
EXAMPLE 12

In 2015, Loa Kava Enterprise established a petty cash fund of K250.00. During the month of May, 2015, the petty cashier made the following payments from this fund:

May 1  Issued cheque no 120 for petty cash advance of K250.00
May 2  Taxi fare K20.00, voucher no 1.
May 5  Cleaning expenses K11.00, voucher no 2.
May 6  Postage stamp exercises K12.00, voucher no 3.
May 11 Stationery K63.00, voucher no 4.
May 19 Cleaning expense K19.00, voucher no 5
May 23 Postage stamps exercise K20.00, voucher no 6
May 26 Stationery expense K22.00 voucher no 7
May 28 Taxi fare K30.00, voucher no 8
May 30 Cleaning expense K10.00, voucher no 9

At the end of the month, the petty cashier requested a reimbursement of the amount spent and he received the cheque no 121 for the amount on May 31.

The petty cash transactions shown in Example 12 were recorded in a petty cash book as shown in Figure 7.1 below.
### Loa Kava: Petty Cash Book

<table>
<thead>
<tr>
<th>Receipts</th>
<th>Date</th>
<th>Voucher No</th>
<th>Particulars</th>
<th>Payments</th>
<th>Analysis</th>
</tr>
</thead>
<tbody>
<tr>
<td>250</td>
<td>2015 May 1</td>
<td>1</td>
<td>Petty Cash advance (cheque no 120)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>1</td>
<td>2015 May 1</td>
<td>Taxi fare</td>
<td>K20.00</td>
<td>K20</td>
</tr>
<tr>
<td>5</td>
<td>2</td>
<td>2015 May 1</td>
<td>Cleaning expense</td>
<td>K11.00</td>
<td>K11</td>
</tr>
<tr>
<td>6</td>
<td>3</td>
<td>2015 May 1</td>
<td>Postage stamp</td>
<td>K12.00</td>
<td>K12</td>
</tr>
<tr>
<td>11</td>
<td>4</td>
<td>2015 May 1</td>
<td>Stationery expense</td>
<td>K63.00</td>
<td>K63</td>
</tr>
<tr>
<td>19</td>
<td>5</td>
<td>2015 May 1</td>
<td>Cleaning expense</td>
<td>K19.00</td>
<td>K19</td>
</tr>
<tr>
<td>23</td>
<td>6</td>
<td>2015 May 1</td>
<td>Postage stamp</td>
<td>K20.00</td>
<td>K20</td>
</tr>
<tr>
<td>26</td>
<td>7</td>
<td>2015 May 1</td>
<td>Stationery expense</td>
<td>K22.00</td>
<td>K22</td>
</tr>
<tr>
<td>28</td>
<td>8</td>
<td>2015 May 1</td>
<td>Taxi fare</td>
<td>K30.00</td>
<td>K30</td>
</tr>
<tr>
<td>30</td>
<td>9</td>
<td>2015 May 1</td>
<td>Cleaning expense</td>
<td>K10.00</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>207</td>
<td>50 22 32 85</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Balance c/d</td>
<td>43</td>
<td></td>
<td></td>
</tr>
<tr>
<td>250</td>
<td></td>
<td>Balance b/d</td>
<td>250</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

| 207      | 1st June | Petty cash reimbursement (cheque no 121) | | |
| 43       |          | Balance b/d | | |
| 207      |          | Cash received | | |

**Figure 7.1: Petty cash book**

Well, that brings us to the end of this unit on petty cash. We hope you are now able to establish a petty cash fund and keep an accurate record of each transaction in the petty cash book. Let us now review what you have learnt.

### 7.6 What Have You Learnt

In this unit you have learnt about the meaning of the term petty cash, which we defined as a small amount of cash that is kept in a business premises in order to pay for minor cash transactions. You have also learnt the 3 steps to follow when organising a petty cash fund. These are: establishing the fund; recording petty cash payments; and balancing petty cash and drawing a reimbursement cheque. Finally, we also discussed how to account for petty cash using the petty cash voucher and book.

In the next unit we shall discuss bank reconciliation. But before you move on, test your understanding of what you have learnt in this unit by completing the following self-test.
7.7 Apply Your Accounting Knowledge

Below are petty cash transactions for Mauta Stationery Company for July, 2015:

- July 1   Issued cheque, no 101 for petty cash advance of K300.00
- July 8   Paid postage K11.00, voucher no. 12
- July 15  Coffee and sugar K12.80, voucher no.13
- July 19  Cleaning expense K23.00, voucher no.14
- July 22  Postage K11.00, voucher no. 15
- July 25  Stationeries K42.10, voucher no. 16
- July 28  Cleaning expense K29.34, voucher no. 17
- July 29  Coffee and sugar K10.90, voucher no. 18
- July 30  Car wash K40.00, voucher no. 19
- July 31  Postage K10.80, voucher no. 20
- July 31  Petty cashier received the reimbursement of the amount spent by cheque no. 131 on July 31

1. Prepare a Petty Cash Book and record all the above petty cash transactions correctly.
2. Prepare a petty cash voucher for the dates, 8th, 19th, 25th and 30th July.
3. Determine how much will be drawn in cheque for petty cash reimbursement for the month of August.
UNIT 8: BANK RECONCILIATION

8.1 Unit Introduction
Welcome to the final unit in our bookkeeping course. In the last unit, we discussed how to start a petty cash fund and record petty cash transactions. In this unit, you will learn about the meaning of bank reconciliation and the steps to follow in reconciling the cash book/journal with a bank statement.

8.2 Unit Outcomes
By the end of this unit you will be able to:

- Explain the meaning of bank reconciliation
- Describe the steps to follow when reconciling a cash book/journal with a bank statement

8.3 What is Bank Reconciliation?

ACTIVITY 16: (Allow 5 minutes for this activity)

Before we discuss the meaning of bank reconciliation, write down the meaning of the term ‘reconciliation’ in the space provided below.

Well done! Now compare your answer with the definition below.

According to the Oxford Dictionary¹, the term ‘reconciliation’ has several meanings. It may mean to restore friendly relations between two or more people or the action of making two financial accounts consistent or even.

If we use the latter definition, then we can define bank reconciliation as an activity that attempts to match a business cash book with its bank statement. Bank reconciliation entails comparing the activities in the bank statement with the transactions in the cash book in order to ensure that the amounts in the bank statement match with those in the cash book. The cash book or journal is also known as the depositor’s record. The bank statement and the cash book/journal must agree.

This process helps the business owner to monitor the cash going in and out of the bank account and also to identify fraud or unauthorised cash transactions.

The procedure for a bank reconciliation is as follows:

- Identify the credit balance as per the bank statement
- Add deposits not yet credited
- Deduct unpresented Cheques
- Credit balance as per Bank Statement

Next, we shall discuss the steps that one should follow to reconcile a bank statement with the cash/journal book.

### 8.4 Steps in Reconciliation of Cash Book/Journals and Bank Statement

There are four main steps in the reconciliation of the cash book/journal and bank statements. These are:

- **Step 1**: Compare the transactions in the credit column of the bank statement with those in the Cash Coming column in (DR) the Cash Book
- **Step 2**: Compare the transactions in the debit column of the bank statement with those in the Cash Going Out (CR) column in the Cash Book.
- **Step 3**: Enter in the Debit column (Cash in) of the cash book the transactions not ticked in the bank statement.
- **Step 4**: Enter in the Credit column (Cash out) of the cash book the item not ticked in the bank statement.

Using these steps, let’s now prepare a bank reconciliation statement for Loa Kava enterprise transactions in Example 13 below. As you can see, the example, shows the transactions recorded in Loa Kava’s cash book in the month of February, 2015. Study the transactions in the cash book and compare them with the bank statement in Figure 8.1. In a bank statement, debits mean withdrawals from the bank while credits mean deposits to the bank.

#### EXAMPLE 13:
The following transactions are recorded in Loa Kava’s cash book:

- 01/02/2015 Loa Kava’s Capital K500.00, receipt no: 99
- 03/02/2015 Loan from BSP Bank K500.00 receipt no: 100
- 08/02/2015 Bought goods worth K300.00 by Cheque no: 012,
- 19/02/2015 Transport hire K100.00 by Cheque no: 013
- 28/02/2015 Sales K250.00 receipt no: 101
- 29/02/2015 Loan repayment K100.00, cheque no: 014
### Figure 8.1: Loa Kava’s Bank Statement

Have you compare Loa Kava’s transactions in the cash book in Example 13 with the items in the bank statement in Figure 8.1.? What did you see?

We hope you noted that there are two transactions found in the cash book that are missing in the bank statement. These are:

- Sales of K250 on 28th February and
- Loan repayment of K100.00 by cheque on 29th February.

Similarly, the cash book is also missing some items found in the bank statement. For example, bank charges, interest and cheque butt are missing. Reconciliation simply entails making sure that the missing transactions are added to the relevant book or statement.

The reconciliation of these two documents is shown in the bank reconciliation statement in Figure 8.2. The statement is divided into two sections, which end with an adjusted balance:

- Balance according to the bank statement. It includes the transactions in the cash book that were missing.
- Balance according to Loa Kava’s cash book. As you can see, transactions which were missing earlier, such as, interest, check butt and bank charges have been recorded.

Once all the transactions are recorded, the two adjusted balances (statement and cash book) in Figure 8.2 balance or are equal (K738). This shows that the differences between the two accounts have been reconciled.
Loa Kava Enterprise  
Bank Reconciliation Statement  
As at 29 February 2015

*Credit balance as per bank statement*  
K588.20 Cr

**Add:** Deposits not yet credited: Sales Receipt No. 101  
K250.00  
**K838.20 Cr**

**Less:** Unpresented cheques  014  
K100.00  
**Adjusted Balance**  
**K738.20**

*Balance as per Loa Kava’s Cash Book/Journals*  
K750.00 Cr

**Add:** interest  
K 7.70  
(a) **K757.70 Cr**

**Deduct:**  
Cheque butt  
Bank Charges  
K7.50  
K12.00  
(b) **K19.50 Cr**

**Adjusted Balance (a – b)**  
**K738.20** Cr

*Figure 8.2: Bank reconciliation statement*

We hope you now understand how to perform a bank reconciliation. That section brings us to the end of this unit. Let us now review what you have learnt.

### 8.5 What Have You Learnt?

In this unit you have learnt how to reconcile the cash account with the bank statement. We started by defining bank reconciliation as an activity that tries to match the transactions in a business cash account with the items in the bank statement. You have also learnt that bank reconciliation entails the following:

- Identify items that appear in only one account and marking them as items that require reconciling.
- Including the missing items or transactions in both the cash book and bank statement.
- Ensuring that the adjusted balances for the cash book and bank statement match.

To help you remember what you have learnt in this unit, please complete the self-test in the following section.
8.6 Apply Your Accounting Knowledge

1. Below is a cash book and bank statement for Mauta Trading showing its transactions for the month of June, 2017. Use this information to prepare a bank reconciliation statement for Mauta Trading.

### MAUTA TRADING: CASH BOOK

<table>
<thead>
<tr>
<th>Date</th>
<th>Particulars</th>
<th>Ref. No</th>
<th>Cash in (DR)</th>
<th>Cash Out (CR)</th>
<th>Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>1/6/2015</td>
<td>Capital</td>
<td>Rec. no 117</td>
<td>K250.00</td>
<td></td>
<td>K250.00</td>
</tr>
<tr>
<td>8/6/2015</td>
<td>Loan BSP</td>
<td>Rec. no 118</td>
<td>K250.00</td>
<td></td>
<td>K500.00</td>
</tr>
<tr>
<td>15/6/2015</td>
<td>Bought goods</td>
<td>Cheq. no 24</td>
<td></td>
<td>K150.00</td>
<td>K350.00</td>
</tr>
<tr>
<td>19/6/2015</td>
<td>Transport Hire</td>
<td>Cheq. no 25</td>
<td></td>
<td>K50.00</td>
<td>K300.00</td>
</tr>
<tr>
<td>23/6/2015</td>
<td>Sales</td>
<td>Rec. no 119</td>
<td>K125.00</td>
<td></td>
<td>K425.00</td>
</tr>
<tr>
<td>30/6/2015</td>
<td>Loan repayment</td>
<td>Cheq. no 26</td>
<td></td>
<td>K50.00</td>
<td>K375.00</td>
</tr>
</tbody>
</table>

### BANK STATEMENT

Statement of Account
Bank of South Pacific
Town

Account No: 10098178657  30th June 2017

Mauta Trading
P.O Box 1842
Port Moresby

<table>
<thead>
<tr>
<th>Date</th>
<th>Particulars</th>
<th>Debit (K)</th>
<th>Credit (K)</th>
<th>Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>2015</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Jun 1</td>
<td>Deposit</td>
<td></td>
<td>K250.00</td>
<td>K250.00 Cr</td>
</tr>
<tr>
<td>Jun 8</td>
<td>Deposit</td>
<td></td>
<td>K250.00</td>
<td>K500.00 Cr</td>
</tr>
<tr>
<td>Jun 15</td>
<td>024</td>
<td>K150.00</td>
<td></td>
<td>K350.00 Cr</td>
</tr>
<tr>
<td>Jun 19</td>
<td>025</td>
<td>K50.00</td>
<td></td>
<td>K300.00 Cr</td>
</tr>
<tr>
<td>Jun 23</td>
<td>Interest</td>
<td></td>
<td>K4.50</td>
<td>K304.50 Cr</td>
</tr>
<tr>
<td>Jun 28</td>
<td>Cheque Butt</td>
<td>K3.50</td>
<td></td>
<td>K301.00 Cr</td>
</tr>
<tr>
<td></td>
<td>Bank Charges</td>
<td>K5.80</td>
<td></td>
<td>K295.20 Cr</td>
</tr>
</tbody>
</table>
Congratulations!
You have come to the end of this course. This course set out to provide you with basic bookkeeping knowledge and skills which you can either apply in your own business or in employment as a bookkeeper.

Go back to the course overview at the beginning of this course and review the course outcomes. Have you achieved them all? If there is any outcome you are not sure about, please review the relevant unit again or talk to your tutor at Ginigoada Foundation. If you have achieved them all, we wish you great success in your bookkeeping career.
ANSWERS TO LEARNING ACTIVITIES

ACTIVITY 1

Indicate whether the following statements are True or False by writing “T” in the space provided if the statement is True or (“F”) if it is False.

1. Bookkeeping is a subset of accounting (T)
2. An accountant is only interested in analysing business transactions (F)
3. A sole trader is owned by one person (T)
4. A Cooperative is a form of business whose sole purpose is to make a profit (F)
5. The ownership of a company is in the hands of shareholders (T)

ACTIVITY 2:

Write next to the following statements whether they describe an Asset, Liability or Equity

1. Cash in the Bank (Asset)
2. Money from a business owner (Equity)
3. Furniture owned by a business (Asset)
4. Money owed to creditors (Liability)
5. Business loan from the bank (Liability)
**ACTIVITY 3:**

Write down the meaning of the terms: current assets, fixed assets and intangible assets.

1. **Current assets:**
   These are items such as cash, accounts receivable (debtors), inventory (or stock), and prepayments. They are current because they can be converted into cash within a short period of time.

2. **Fixed assets:**
   These are assets that are used in the normal operation of a business to produce and sell goods or perform services for its clients. Examples are buildings, equipment, land, vehicles, etc.

3. **Intangible assets:**
   These are assets that provide benefits to a business entity for many years, but have no physical substance. Examples are good will, patents, trade name, etc.

**ACTIVITY 4:**

Match each principle with its correct definition by writing the number of the correct principle in the last column.

<table>
<thead>
<tr>
<th>Principle</th>
<th>Definition</th>
<th>No.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Entity Principle</td>
<td>Company’s balance sheet should report the value of its land at the acquisition cost</td>
<td>5</td>
</tr>
<tr>
<td>2. Going Concern Principle</td>
<td>A company accounts should cover a specific period of time</td>
<td>3</td>
</tr>
<tr>
<td>3. Periodicity Principle</td>
<td>Personal affairs of the owner should not mix with the business</td>
<td>1</td>
</tr>
<tr>
<td>4. Monetary unit Principle</td>
<td>A business will remain in operation for the foreseeable future</td>
<td>2</td>
</tr>
<tr>
<td>5. Historical Cost Principle</td>
<td>Transactions should be recorded in a unit of currency.</td>
<td>4</td>
</tr>
</tbody>
</table>
ACTIVITY 5:

Write “T” if a statement is True or “F” if a statement is False.

1. Double entry accounting means that every transaction affects one account  __F__
2. A ledger is also known as the Book of original entries __F__
3. A journal is the first book of accounts where business transactions are recorded __T__
4. A debit amount appears on the right-hand side of the “T” account __F__
5. The cash receipts journal records all cash coming into business __T__
6. A ledger is also known as a “T” Account __T__
7. In a “T” account, the left-hand or debit of the accounting equation decreases in assets __F__

ACTIVITY 9

Silip Kirap owns and operates a plumbing company under the name Sanap Strong Plumbing. The balances in his accounts as of January 31, 2015 were as follows:

- Cash K17,980.00
- Office Supplies K435.00
- Office Equipment K4,980.00
- Tools & Fittings K20,075.00
- Accounts Payable K1,225.00
- Silip Kirap, Capital, K20,310.00
- Service Revenue K25,770.00
- Rent Expense K1,500.00
- Salary Expense K2,200.00
- Telephone Expense K135.00

Using this information, create a trial balance and profit and loss statement. Then compare your answers with those given below.
### Trial Balance

**Sanap Strong Plumbing**  
**Trial Balance**  
**As at January 31, 2015**  

<table>
<thead>
<tr>
<th>Account</th>
<th>Debit (Dr)</th>
<th>Credit (Cr)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>K17,980.00</td>
<td></td>
</tr>
<tr>
<td>Office Supplies</td>
<td>K435.00</td>
<td></td>
</tr>
<tr>
<td>Office Equipment</td>
<td>K4,980.00</td>
<td></td>
</tr>
<tr>
<td>Tools &amp; Fittings</td>
<td>K20,075.00</td>
<td></td>
</tr>
<tr>
<td>Rent Expense</td>
<td>K1,500.00</td>
<td></td>
</tr>
<tr>
<td>Salary Expense</td>
<td>K2,200.00</td>
<td></td>
</tr>
<tr>
<td>Telephone Expense</td>
<td>K135.00</td>
<td></td>
</tr>
<tr>
<td>Capital</td>
<td></td>
<td>K20,310.00</td>
</tr>
<tr>
<td>Service Revenue</td>
<td></td>
<td>K25,770.00</td>
</tr>
<tr>
<td>Accounts Payable</td>
<td></td>
<td>K1,225.00</td>
</tr>
<tr>
<td></td>
<td></td>
<td><strong>K47,305.00</strong></td>
</tr>
</tbody>
</table>

### Profit and Loss Statement

**Sanap Strong Plumbing**  
**As at January 31, 2015**

**Income:**  
Service Revenue                                                                        K25,770.00

**Less:**  
**Expenses**

Administration                                    K1,500.00  
Rent Expense                                     K2,200.00  
Salary Expense                                   K135.00    
Telephone Expense                                K135.00  
**Profit/Net Profit**                            K21,935.00

### Balance Sheet

**Sanap Strong Plumbing**  
**For The Year Ended 31st January 2012**

<table>
<thead>
<tr>
<th>ASSETS</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Current Asset</strong></td>
<td></td>
</tr>
<tr>
<td>Cash</td>
<td>K17,980.00</td>
</tr>
<tr>
<td>Office Supplies</td>
<td>K435.00</td>
</tr>
<tr>
<td><strong>Fixed Asset</strong></td>
<td></td>
</tr>
<tr>
<td>Office Equipment</td>
<td>K4,980.00</td>
</tr>
<tr>
<td>Tools &amp; Fitting</td>
<td>K20,075.00</td>
</tr>
<tr>
<td><strong>Total Assets</strong></td>
<td><strong>K43,470.00</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>LIABILITIES &amp; OWNER’S EQUITY</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Current Liability</strong></td>
<td></td>
</tr>
<tr>
<td>Accounts Payable</td>
<td>K1,225.00</td>
</tr>
<tr>
<td><strong>Proprietorship</strong></td>
<td></td>
</tr>
<tr>
<td>Capital</td>
<td>K20,310.00</td>
</tr>
<tr>
<td>Add: Profit</td>
<td>K21,935.00</td>
</tr>
<tr>
<td><strong>Total Liabilities &amp; Owners</strong></td>
<td></td>
</tr>
<tr>
<td>Equity</td>
<td><strong>K43,470.00</strong></td>
</tr>
</tbody>
</table>
ACTIVITY 10

Write “T” if a statement is True or “F” if a statement is False.

7. Land as an asset is depreciated ___F___
8. Depreciation only applies to assets that lose value over time ___T___
9. Inadequacy and obsolesce are types of physical depreciation ___F___
10. Functional depreciation occurs when a plant is able to meet its production capacity ___T___
11. Residual value is the money that a business expects to get at the end of an asset’s useful life ___T___
12. The initial cost of an asset is not considered when determining the amount of depreciation ___F___

ACTIVITY 11

Calculate the depreciation costs for the following two assets and then compare your answers with those given at the end of this unit.

3. Sanap bakery bought an oven at a cost of K15,000. Its residual value is 10% of its annual cost and its estimated life is 10 years. Calculate the depreciation cost per year using the straight line method.

\[
\text{COST} - \text{RESIDUAL VALUE} = \text{DEPRECIATION} \\
\text{USEFUL LIFE}
\]

\[
\begin{align*}
\text{K15,000} - 10\% \text{ of K15,000} &= \text{K1,350 per year} \\
10 &
\end{align*}
\]

4. Sanap bakery also purchased a van for K60,000. Its residual value is 20% and it’s expected to have an estimated life of 30,000 kilometres. Calculate the depreciation cost per kilometre using the units of production depreciation method.

\[
\begin{align*}
\text{COST} - \text{RESIDUAL VALUE} &= \text{DEPRECIATION} \\
\text{NUMBER OF UNITS}
\end{align*}
\]

\[
\begin{align*}
\text{K60,000.00} - (20\% \text{ of K60,000.00}) &= \text{K1.6 per kilometre depreciation} \\
30,000 &
\end{align*}
\]