VBEST

IGCSE ACCOUNTING DEFINITION

- 0452 -

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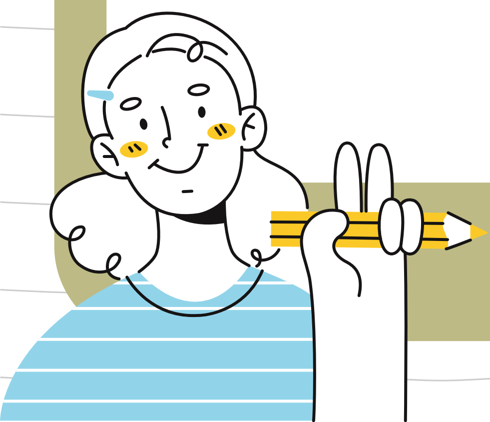
Introduction of Accounting

Terms	Definitions
Bookkeeping	Process of detailed recording of all the financial transactions of a business.
Accounting	Uses the bookkeeping records to prepare financial statements at regular intervals.
Assets	Anything owned by or owed to the business
Liabilities	Anything owed by the business
Capital	Owner's contributions into the business / Amount owed by the business to the owner

Double Entry Bookkeeping – Part A

Terms	Definitions
Drawings	Owner takes assets out from the business for personal use.
Trade receivables	Amount owed by the customers to the business.
Trade payables	Amount owed by the business to the suppliers.
Sales/Revenue	When goods are sold to the customer either on cash or credit terms.
Purchases	When goods are bought from the supplier either on cash or credit terms.
Purchases returns/ Returns outward	When purchased goods are returned to the supplier.
Sales returns/ Returns inward	When sold goods are returned by the customer.
Carriage Inwards	Cost of delivering purchased goods from supplier to business.
Carriage Outwards	Cost of delivering sold goods from business to customer.
Inventory	Goods bought for resale not yet sold.

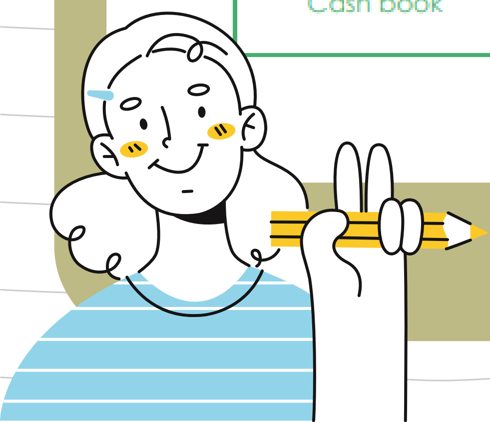


The Trial Balance and Errors

Terms	Definitions
Errors of Commission	Occurs when a transaction is entered using the **correct amount and on the correct side**, but in the **wrong account of the same class**.
Errors of Complete Reversal	Occurs when the **correct amount** is entered in the **correct accounts**, but the entry has been made on the **wrong side of each account**.
Errors of Omission	Occurs when a transaction has been **completely omitted** from the accounting records. Neither a debit entry nor a credit entry has been made.
Errors of Original Entry	Occurs when an **incorrect figure** is used when a transaction is first entered in the accounting records.
Errors of Principle	Occurs when a transaction is entered **using the correct amount** and on the **correct side**, but in the **wrong class of account**.
Compensating Errors	Occur when **two or more errors cancel each other out**.

Cash Book

Terms	Definitions
Contra entries	Occur when surplus cash is deposited into the bank or when cash is withdrawn from the bank for office use.
Bank overdraft	When the business paid out more from the bank than is put into the bank.
Trade discount	Reduction in the price of the goods. *Encourage bulk buying*
Cash discount	Allowance given to a customer when an account is settled within a time limit set by the supplier. *Encourage prompt payment*
Discount allowed (Cash discount)	Discount a business gives its credit customers when they pay their accounts within a set time.
Discount received (Cash discount)	Discount a business receives from its credit suppliers when it pays their accounts within a set time.
Dishonoured cheque	A cheque which is not accepted by the bank.
Sales ledger	Ledger which contains all the personal accounts of trade receivables.
Purchases ledger	Ledger which contains all the personal accounts of trade payables.
Nominal ledger	Ledger which contain accounts of assets (except bank and cash), liabilities, expenses, income, sales, purchases and returns.
Cash book	Both a book of prime entry and ledger which records cash transactions. Contains cash and bank account.



Petty Cash Book

Terms	Definitions
Imprest System	The petty cashier starts each period with a fixed amount of money known as imprest amount or float. At the end of the period, the chief cashier will provide the petty cashier with enough cash to restore the balance to the imprest amount.

Business Documents

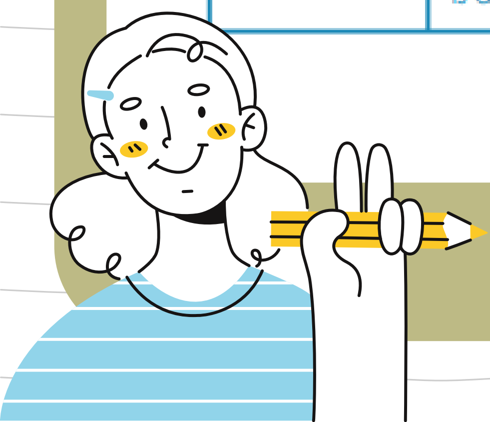
Terms	Definitions
Invoice	Issued to the customer when the business sold goods on credit.
Debit Notes	Issued to the supplier to inform the shortages, overcharges and faults.
Credit Note	Issued to the customer when goods are returned, reported faulty or where there has been an overcharge on an invoice.
Statement of Account	Summary of the transactions for the month issued by supplier to customer *Reminds customer of amount outstanding*

Books of Prime Entry

Terms	Definitions
Sales Journal	It is used to record credit sales.
Purchase Journal	It is used to record credit purchases.
Sales Return Journal	It is used to record goods returned from credit customers.
Purchase Return Journal	It is used to record goods returned to credit suppliers.

Control Account

Terms	Definitions
Contra Entry	When an account in the sales ledger is set against an account in the purchases ledger. Such an entry is made when a supplier is also a customer of the business and has an account in both ledgers.

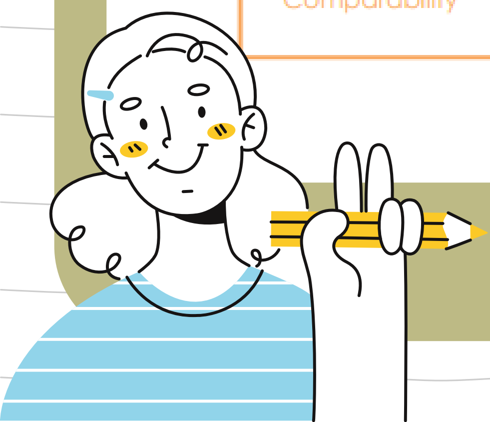


Accruals and Prepayments

Terms	Definitions
Accrued expense	Payment has not been paid but received services or benefits at the end of the financial year. (Other Payable - Current Liabilities)
Prepaid expense	Payment made during the financial year for some benefit or service to be received in the future. (Other Receivable - Current Assets)
Accrued Income	Business has provided a benefit or service to the customer but has not received the money at the end of the financial year. (Other Receivable - Current Asset)
Prepaid Income	Business has received money from customer but has not provided the benefit or service at the end of the financial year. (Other Payable - Current Liabilities)

Accounting Rules

Terms	Definitions
Business Entity	Business is treated as being completely separate from the owner of the business.
Duality	Every transaction has two aspects – a giving and a receiving.
Money measurement	Only information which can be expressed in terms of money can be recorded in the accounting records.
Realisation	Profit is only regarded as being earned when the legal title to goods or services passes from the seller to the buyer.
Consistency	Once a method has been selected, the method must be used consistently from one accounting period to the next.
Matching	Revenue of the accounting period is matched against the costs of the same period.
Prudence	Profits & assets are not overstated and liabilities & losses are not understated.
Going concern	Accounting records of a business is always maintained on the basis of assumed continuity.
Historical Cost	Assets should be valued at the cost at which they were acquired.
Relevance	Information is relevant when it is timely and affects business decisions.
Materiality	Financial information is only material if it will affect the decisions of the users of financial statements.
Comparability	Information is useful if it can be compared with similar information about the same business for another accounting period and with similar information about other business.

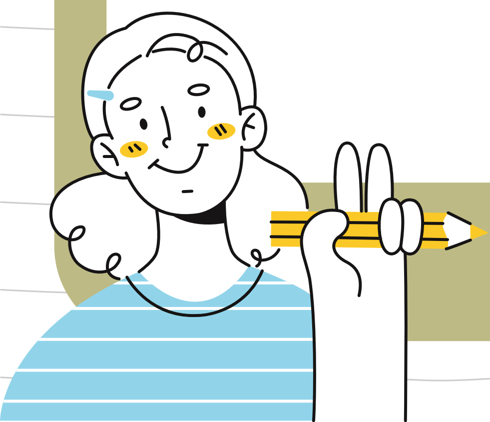


Accounting Rules

Terms	Definitions
Reliability	Information is reliable if it is: - capable of being depended upon by users as being a true representation of the underlying transactions and events - capable of being independently verified - free from bias - free from significant errors - prepared with suitable caution being applied to any judgements and estimates which are necessary
Understandability	Information in the financial statements must be clear and easily understood by the users.
Capital expenditure	Money spent by a business on purchasing, improving or extending non-current assets.
Revenue expenditure	Money spent on running a business on a day-to-day basis.
Capital receipt	Money received from selling non-current assets, loan and capital introduced by the owner.
Revenue receipt	Money received from sales or other income such as rent received, commission received, discount received and so on.
Inventory valuation	Lower of cost and net realisable value.
Cost	Actual purchase price plus any additional costs (such as carriage inwards) incurred in bringing the inventory to its present position and condition.
Net realisable value (NRV)	Estimated receipts from the sale of the inventory less any costs of completing or selling the inventory.

Depreciation and Disposal of NCA

Terms	Definitions
Depreciation	Estimate of the loss in value of a non-current asset over its expected working life.
Residual Value/ Scrap Value	Estimated value of a non-current asset at the end of its working life.
Disposal	When a non-current asset is sold.



Bad Debt and Bad Debt Recovered

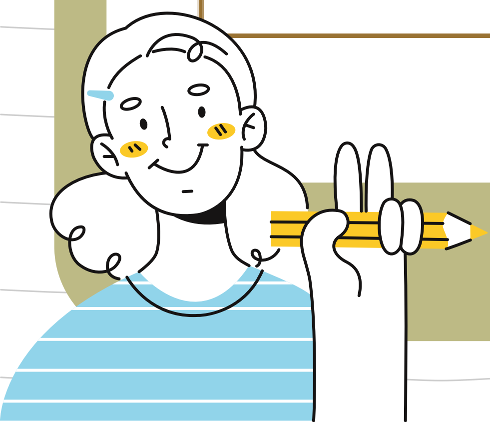
Terms	Definitions
Bad debts/ Irrecoverable debts	Amount owing to a business which will not be paid by the trade receivable.
Bad debts recovered/ Irrecoverable debts recovered	Amount owing to a business which will not be paid by the trade receivable.
Provision for doubtful debts	Estimate of the amount which a business will lose in a financial year because of bad debts.

Clubs and Soceties Account

Terms	Definitions
Subscriptions	Amounts members pay usually annually, to use the facilities provided by the club.
Accumulated Fund	A capital fund formed by the accumulation of surpluses within the clubs or societies.

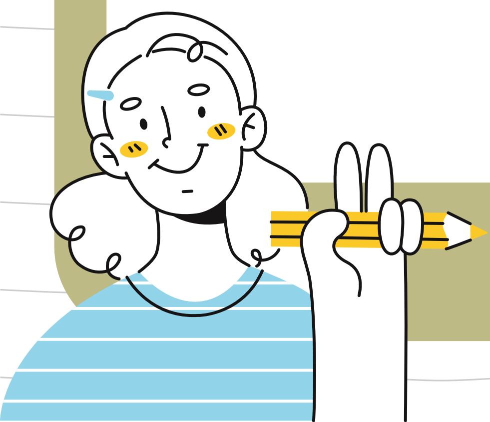
Manufacturing Account

Terms	Definitions
Direct material	Cost of raw materials to make the finished goods.
Direct labour/wages	Cost of wages of the people who are employed in the factory making the goods.
Indirect labour	Cost of wages of the people who are not directly involved in the production of finished goods. Eg: Supervisors, maintenance staff, factory cleaners, etc
Direct expenses	Any expenses which a manufacturer can directly link with the product being manufactured. Eg: Royalty, hire charge of special equipment
Factory overheads/ Indirect factory expenses	Costs involved in operating the factory which cannot be directly linked with the product being manufactured. Eg: Factory rent and rates, factory heat and light, factory machinery repairs, depreciation of factory machinery etc
Work in progress	Goods which are partly completed at the end of the financial year.



Limited Company Account

Terms	Definitions
Authorised share capital	Maximum amount of share capital the company is allowed to issue.
Issued share capital	Amount of share capital actually required that is issued to the shareholders.
Called up capital	Total amount a company has requested from the shareholders.
Paid up capital	Part of the called up capital for which a company has actually received cash from its shareholders.
Interim dividend	Any dividend paid during the financial year before a company's AGM & full-year financial statements
Final dividend	The last dividend paid at the end of the financial year after the full-year financial statements are available. This is declared during a company's AGM
Retained earnings/ Retained profits	Profits that have not been used to finance the payment of dividends nor have been transferred to a general reserve.



Introduction of Accounting

Accounting Equation:

Assets = Liabilities + Capital

Financial Statement - Balance Sheet

Working Capital = Current Assets - Current Liabilities

Depreciation and Disposal of Non-current Assets

Straight-Line Method = Cost x Depreciation Rate %

OR

$$\text{Straight Line Method} = \frac{\text{Cost - Residual / Scrap Value}}{\text{No. of Expected Years of Use}}$$

Reducing Balance Method = Net Book Value x Depreciation Rate %

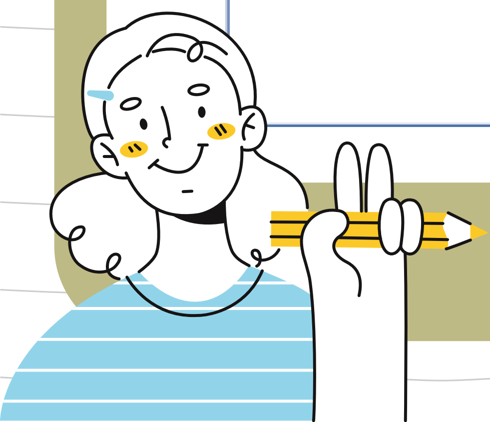
Net Book Value = Cost - Previous Year Provision for Depreciation

Revaluation Depreciation =

Value of asset at beginning of the year +
Additional purchases of asset during the year -
Value of asset at end of the year

Disposal of NCA

Profit: Net book value < Selling price
Loss: Net book value > Selling price



Bad Debts and Provision for Doubtful Debts

Provision for Doubtful Debts =
(Trade Receivable - Bad Debts) x % rate of PFDD

Incomplete Records

Estimate Profit For The Year =
Closing capital – Opening capital + Drawings – Capital introduced

Credit Sales =

Receipts from trade receivables – Opening trade receivables + Closing trade receivables + Discount allowed + Bad debts + Sales returns

OR

Use Sales Ledger Control Account

Credit Purchase =

Payments to trade payables – Opening trade payables + Closing trade payables + Discount received + Purchases returns

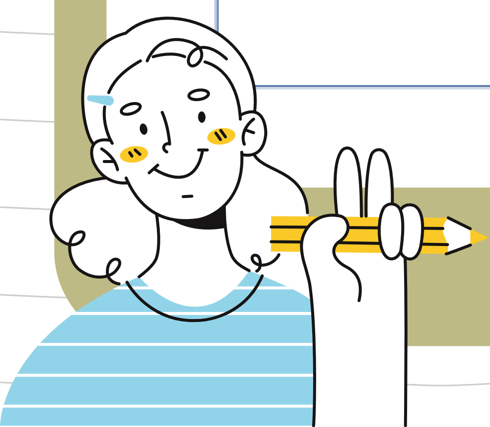
OR

Use Purchases Ledger Control Account

Closing Bank Balance =
Opening balance + Total receipts – Total payments

$$\text{Margin} = \frac{\text{Gross profit}}{\text{Sales}} \times 100$$

$$\text{Mark-up} = \frac{\text{Gross profit}}{\text{Cost of sales}} \times 100$$



Rate of inventory turnover (times) =

$$\frac{\text{Cost of goods sold}}{\text{Average inventory}}$$

$$\text{**Average inventory} = \frac{\text{Opening inventory} + \text{Closing inventory}}{2}$$

Club and Society Account

Accumulated Fund = Assets - Liabilities

Manufacturing Account

Direct Material = Opening inventory of raw material + Purchases of raw material + Carriage inwards on raw material – Closing inventory of raw material

Prime Cost = Direct material + Direct labour + Direct expenses

Cost of production = Prime cost + Factory overheads + Opening inventory of work in progress – Closing inventory of work in progress

Partnership Account

Residual Profit = Profit for the year + Interest on drawings – Interest on capital – Partner's salary

Current Account =
Opening balance** + Interest on capital + Partner's salary + Profit share – Drawings – Interest on drawings

** If opening balance is DR then put ( )

Profit Share =

Depends on the question:

(i) Based on proportion of capital invested:
Partner A:

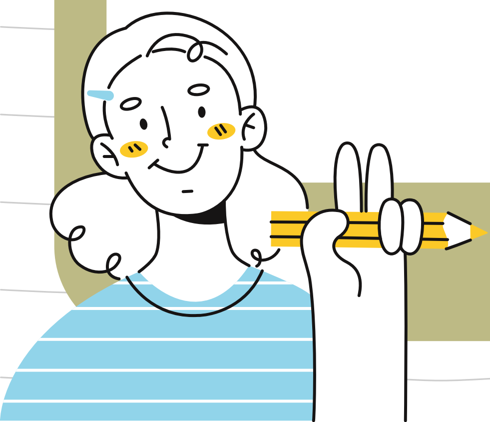
$$\frac{\text{A's capital}}{\text{A's capital + B's capital}} \times \text{Residual profit}$$

(ii) Based on ratio (eg: 3:2)
Partner A:

$$\frac{3 \times \text{Residual profit}}{5}$$

Interest on Drawings = Total drawings x %

Interest on Capital = Total Capital x %



Limited Liability Company Account

Issued Share Capital in $$ = Number of shares issued x $ per share

Dividend =

(i) Based on rate of dividend in %:
Number of shares issued x $ per share x %

(ii) Based on dividend of $x.xx per share:
Number of shares issued x dividend of $x.xx per share

Operating Profit / Loss =

Gross profit + Other income – Expenses (exclude finance charges)

Shareholder's funds =

Issued share capital + Reserves

*Issued share capital =
Issued ordinary shares + Issued preference shares

**Reserves = General reserve + Retained earnings

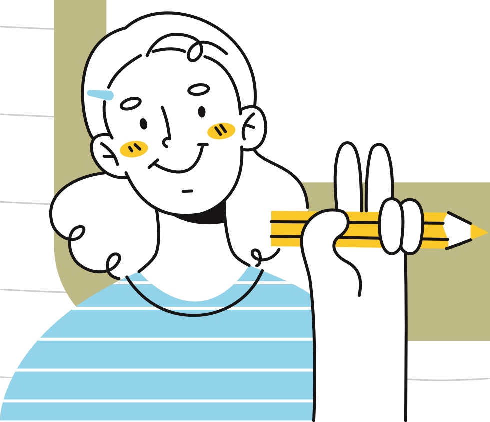
Analysis and Interpretation

Capital Employed =

Owner's capital + Non-current liabilities

OR

Non-current assets + Working capital



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Return on capital employed (ROCE) =

$$\frac{\text{Profit for the year}}{\text{Capital employed}} \times 100$$

For LLC:

$$\frac{\text{Operating profit}}{\text{Capital employed}} \times 100$$

Gross profit as a percentage of sales (Gross profit margin) =

$$\frac{\text{Gross profit}}{\text{Sales}} \times 100$$

Net profit as a percentage of sales (Profit margin) =

$$\frac{\text{Profit for the year}}{\text{Sales}} \times 100$$

Current ratio = Current assets : Current liabilities

Quick ratio = (Current assets – Inventory) : Current liabilities

Rate of inventory turnover (days) =

$$\frac{\text{Average inventory}}{\text{Cost of goods sold}} \times 365$$

Collection period for trade receivables (days) =

$$\frac{\text{Trade receivables}}{\text{Credit sales}} \times 365$$

Payment period for trade payables (days) =

$$\frac{\text{Trade payables}}{\text{Credit purchases}} \times 365$$