Financial Accounting

Financial Accounting:

From Its Basics to Financial Reporting and Analysis

By

Simeon Spiteri

Cambridge Scholars Publishing

Financial Accounting:
From Its Basics to Financial Reporting and Analysis

By Simeon Spiteri

This book first published 2020

Cambridge Scholars Publishing

Lady Stephenson Library, Newcastle upon Tyne, NE6 2PA, UK

British Library Cataloguing in Publication Data
A catalogue record for this book is available from the British Library

ISBN (10): 1-5275-4726-4
ISBN (13): 978-1-5275-4726-1

Dedicated to
my family.
Thanks Marija!
You provided the first critical support!

TABLE OF CONTENTS

List of Figures ... xv

Part 1: Overview

Chapter 1 ... 2
Introduction

Part 2: The Double Entry System

Chapter 2 ... 4
Accounting for the Organisation's Assets, Liabilities and Capital
- 2.1 Definition of the Term Accounting ... 4
- 2.2 Process of Recording Transactions ... 4
  - 2.2.1 Meaning of Assets, Liabilities and Capital ... 5
- 2.3 Main Users of Accounting Information ... 7
- 2.4 Recording Transactions that affect Assets, Liabilities and Capital... 8

Chapter 3 ... 16
Accounting for Stock
- 3.1 Different Types of Inventory Accounts ... 16
- 3.2 Accounting for Purchases, Sales, Returns Out and Returns In ... 17

Chapter 4 ... 22
Accounting for Revenue and Expenses
- 4.1 Difference between Revenue and Expenses ... 22
- 4.2 Recording Revenue and Expenses in the Accounts ... 22
- 4.3 Capital and Revenue Expenditure ... 24
- Review Questions ... 25

Chapter 5 ... 27
Balancing Off the Accounts
- 5.1 Balancing the Accounts ... 27
- Review Questions ... 28

Chapter 6 31
Accounting for VAT
6.1 Value Added Tax 31
6.2 Input VAT and Output VAT 31
6.3 VAT on Assets and Liabilities 32
6.4 VAT on Expenses and Revenue 34
Review Questions 36

Part 3: Preparing the Final Accounts

Chapter 7 40
The Trial Balance
7.1 Introduction 40
7.2 Uses of the Trial Balance 40
7.3 Why the Trial Balance may not Agree 43
Review Questions 44

Chapter 8 47
The Final Accounts of a Sole Trader
8.1 Introduction 47
8.2 The Trading Account and The Income Statement 47
8.2.1 The Trading Account 47
8.2.2 The Income Statement 48
8.2.3 Carriage Inwards and Carriage Outwards 49
8.3 The Statement of Financial Position 51
Review Questions 53

Part 4: The Books of Original Entry and Accounting Controls

Chapter 9 58
The Books of Original Entry
9.1 Stage when Transactions are Reflected in the Books of Original Entry 58
9.2 The Books of Original Entry 59
9.3 The Subsidiary ledgers 60
9.4 The Sales Journal 60
9.5 Posting Credit Sales to the Subsidiary Ledgers 62
9.6 The Purchases Journal 63
9.7 Posting Credit Purchases to the Subsidiary Ledgers 64
9.8 The Returns Journal 64
9.9 Posting Returns to the Subsidiary Ledgers 66

9.10 The Journal 67
9.10.1 Purchase and Sale of Non-Current Assets on Credit 67
9.10.2 Opening Entries 68
9.11 Process of Recording Transactions 70
Review Questions 71

Chapter 10 73
The Cash Book and the Petty Cash Book
10.1 The Importance of Cash and the Role of the Cash Book 73
10.2 Recording Transactions in the Two-Column Cash Book 74
10.3 The Three-Column Cash Book 75
10.3.1 The Subsidiary Accounts 76
10.4 The Petty Cash Book 77
10.4.1 The Imprest System 78
Review Questions 80

Chapter 11 82
The Bank Reconciliation Statement
11.1 Introduction 82
11.2 Main Features of a Bank Statement 83
11.3 Definition of Main Terms 84
11.4 Differences between the Cash Book and the Bank Statement 84
11.5 Procedure for preparing the Bank Reconciliation Statement 85
Review Questions 90

Chapter 12 94
The Control Accounts
12.1 Introduction 94
12.2 Advantages of the Control Accounts 94
12.3 Form of the Control Accounts 95
12.3.1 The Control Accounts, Trade Discount and Cash Discounts 96
Review Questions 99

Part 5: Year-End Adjustments

Chapter 13 104
The Accounting Concepts
13.1 The Key Accounting Concepts 104
13.1.1 The Prudence Concept 104
13.1.2 The Accruals Concept 104

13.1.3 The Materiality Concept ... 105
13.1.4 The Consistency Concept ... 105
13.1.5 Substance over Form ... 105
13.1.6 The Going Concern Concept ... 106
13.2 Objectivity and Subjectivity ... 106
Review Questions ... 107

Chapter 14 ... 108
Accounting for Depreciation
14.1 Introduction ... 108
14.2 Depreciation of the Non-Current Assets ... 109
14.3 The Causes of Depreciation ... 109
14.4 Depreciation Methods ... 109
14.4.1 The Straight-Line Method ... 110
14.4.2 The Reducing Balance Method ... 113
14.4.3 The Revaluation Method ... 116
14.5 Disposal (Selling) of Non-Current Assets ... 117
Review Questions ... 124

Chapter 15 ... 127
Accounting for Bad Debts and Provision for Doubtful Debts
15.1 Bad debts and Provision for Doubtful Debts ... 127
15.2 Double Entry for Bad Debts ... 127
15.3 Provision for Doubtful Debts ... 129
15.4 Accounting for the Provision for Doubtful Debts ... 130
15.5 Increase in the Provision for Doubtful Debts ... 131
15.6 Decrease in the Provision for Doubtful Debts ... 132
15.7 The Provision for Doubtful Debts Remains the Same ... 134
15.8 The Bad Debts Recovered ... 134
Review Questions ... 138

Chapter 16 ... 140
Accounting for Accruals and Prepayments ... 140
16.1 Accruals and Prepayments ... 140
16.2 Accounting Treatment for Accrued Expenses ... 142
16.3 Prepayments ... 144
16.4 Accounting Treatment for Prepaid Expenses ... 144
16.5 Accruals and Prepayments at the Same Time ... 146
16.6 Accounting Treatment for Accrued Revenue ... 148
16.7 Accounting Treatment for Prepaid Revenue ... 150
16.8 Accrued and Prepaid Revenue at the Same Time ... 152

Review Questions 154

Chapter 17 156
Errors Not Identified by the Trial Balance
17.1 Errors not Revealed by a Trial Balance 156
17.1.1. Error of Omission 156
17.1.2. Error of Commission 157
17.1.3. Error of Principle 158
17.1.4. Complete Reversal of Entries 158
17.1.5. An Error of Original Entry 159
17.1.6. Transposition Error 160
17.1.7. Compensating Errors 161
Review Questions 162

Chapter 18 164
The Suspense Account
18.1 Errors which Affect the Trial Balance 164
Review Questions 169

Part 6: Final Accounts of Different Types of Organisations

Chapter 19 172
Final Accounts of a Departmental Organisation
6.1 Department Stores 172
6.2 Uses of Departmental Accounts 172
6.3 Allocation and Apportionment of Revenue and Expenditure 173
Review Questions 180

Chapter 20 185
Final Accounts of a Manufacturing Firm
20.1 Key Information Provided by the Manufacturing Account 185
20.2 Different Types of Costs 186
20.2.1 Fixed and Variable Costs 186
20.2.2 Prime Cost and Production Overheads 186
Review Questions 193

Chapter 21 197
Final Accounts of a Partnership
21.1 Sole Trader versus Partnership 197
21.2 Partnership Agreement or Deed 198
21.3 Partnership Capital and Current Accounts 198

21.4 Profit and Loss Appropriation Accounts.................................. 198
Review Questions 202

Chapter 22 205
Financial Statements of Companies
22.1 Main Features of Limited Companies...................................... 205
22.2 Distinction between Limited Companies and Partnerships...... 206
22.3 Distinction between Public and Private Companies.................. 206
22.4 The Income Statement of Limited Companies.......................... 207
22.5 The Statement of Financial Position of Limited Companies.... 210
22.5.1 Distinction between Provisions, Reserves and Liabilities 214
22.5.2 The Dividend Policy... 214
22.5.3 Debentures.. 214
Review Questions 215

Chapter 23 218
Accounting for Non-Profit Making Organisation
23.1 The Non-Profit Making Organisation 218
23.2 Main Financial Reports of the Non-Profit Making
Organisations.. 219
23.3 Members' Subscriptions Account 219
23.4 Donations 221
Review Questions 225

Chapter 24 228
Firms with Incomplete Accounting Records
24.1 Type of Information Given by Firms with Incomplete Accounting
Records.. 228
24.2 Main Steps for Preparing the Final Accounts 229
Review Questions 241

Part 7: Interpretation of Accounts

Chapter 25 246
The Annual Report and the Financial Statements
25.1 The Annual Report... 246
25.1.1 Highlights 246
25.1.2 The Chairman's Statement 247
25.1.3 The Directors' Report... 248
25.1.4 Promotional Material.. 249
25.1.5 The Corporate Governance Report................................. 249

25.1.6 The Independent Auditor's Report 250
25.1.7 The Financial Statements 251
25.1.8 Accounting Policies and Explanatory Notes 253
25.2 Advantages of the Financial Statements 254
25.3 Main Limitations of the Financial Statements 255
Review Questions 256

Chapter 26 257
Accounting Ratios
26.1 Main Techniques to Analyse an Organisation 257
26.2 Explanation and Illustration of Accounting Ratios 258
26.2.1 Profitability Ratios 259
26.2.2 Liquidity Ratios 263
26.2.3 Efficiency Ratios 264
26.2.4 Long Term Solvency Ratios 265
26.2.5 Investors' Ratios 266
26.3 Limitations of Ratio Analysis 291
Review Questions 291

Model Answers 295
Part 2: The Double Entry System 295
Chapter 2 – Accounting for the Organisation's Assets, Liabilities and Capital 295
Chapter 4 – Accounting for Revenue and Expenses 303
Chapter 5 – Balancing Off the Accounts 307
Chapter 6 – Accounting for VAT 314
Part 3: Preparing the Final Accounts 320
Chapter 7 – The Trial Balance 320
Chapter 8 – The Final Accounts of a Sole Trader 330
Part 4: The Books of Original Entry and Accounting Controls 336
Chapter 9 – The Books of Original Entry 336
Chapter 10 – The Cash Book and the Petty Cash Book 338
Chapter 11 – The Bank Reconciliation Statement 340
Chapter 12 – Control Accounts 343
Part 5: Year-End Adjustments 346
Chapter 13 – Accounting Concepts 346
Chapter 14 – Accounting for Depreciation 348
Chapter 15 – Accounting for Bad Debts and Provision for Doubtful Debts 356
Chapter 16 – Accounting for Accruals and Prepayments 361
Chapter 17 – Errors not Identified by the Trial Balance 363

Chapter 18 – The Suspense Account 366
Part 6: Final Accounts of Different Types of Organisations........... 369
Chapter 19 – Final Accounts of a Departmental Organisation 369
Chapter 20 – Final Accounts of a Manufacturing Firm 377
Chapter 21 – Final Accounts of a Partnership 384
Chapter 22 – Financial Statements of Companies 389
Chapter 23 – Accounting for Non-Profit Making Organisations...... 395
Chapter 24 – Firms with Incomplete Accounting Records............... 402
Part 7: Interpretation of Accounts.. 407
Chapter 25 – The Annual Report and the Financial Statements 407
Chapter 26 – Accounting Ratios... 409

Bibliography 423

Index 424

LIST OF FIGURES

Figure 1 Robin Enterprises: Return on Capital Employed 274
Figure 2 Robin Enterprises: Margin 275
Figure 3 Robin Enterprises: Operating Profit Margin 276
Figure 4 Robin Enterprises: Net Profit Margin 277
Figure 5 Robin Enterprises: Current Ratio 278
Figure 6 Robin Enterprises: Acid Test Ratio... 279
Figure 7 Robin Enterprises: Cash Ratio 280
Figure 8 Robin Enterprises: Asset Turnover 281
Figure 9 Robin Enterprises: Days Sales Inventory 282
Figure 10 Robin Enterprises: Receivables and Payables 283
Figure 11 Robin Enterprises: Gearing 284
Figure 12 Robin Enterprises: Interest Cover 285
Figure 13 Robin Enterprises: Earnings per share 286
Figure 14 Robin Enterprises: Price-Earnings Ratio 287
Figure 15 Robin Enterprises: Dividend per share 288
Figure 16 Robin Enterprises: Dividend Cover 289
Figure 17 Robin Enterprises: Dividend Yield 290
Figure 18 CompuTech Limited: Return on Capital Employed 413
Figure 19 CompuTech Limited: Operating Profit Margin 414
Figure 20 CompuTech Limited: Net Profit Margin 414
Figure 21 CompuTech Limited: Current Ratio 415
Figure 22 CompuTech Limited: Acid Test Ratio 416
Figure 23 CompuTech Limited: Days Sales Inventory 417
Figure 24 CompuTech Limited: Receivables and Payables 418
Figure 25 CompuTech Limited: Gearing 419
Figure 26 CompuTech Limited: Interest Cover 420
Figure 27 CompuTech Limited: Earnings per share 420

PART 1:

OVERVIEW

CHAPTER 1

INTRODUCTION

Accounting is divided into two main areas, which are financial accounting and management accounting. This book focuses on financial accounting, which mainly comprises the preparation and examination of financial statements in order to help external users like ordinary shareholders, lenders and suppliers to take economic decisions. Management accounting is directed towards management by providing detailed information in order to help them to take routine and non-routine decisions. Financial accounting reflects past events that are portrayed in the financial statements. Management accounting comprises past events present in the management accounts and also forecasts that appear in the functional and master budgets.

The objective of this book is to help individuals understand key aspects of financial accounting, such as recording business transactions, accounting for year-end adjustments, utilising accounting controls, preparing financial reports, understanding the key aspects of the annual report and the financial statements, and interpret the financial statements. A practical perspective is adopted in this book. Techniques used by accountants and financial analysts in practice are unveiled.

This book is ideal for individuals who have very limited knowledge of financial accounting and also for practitioners. Basic principles and techniques of financial accounting are explained, and illustrative examples are used in order to help the reader understand these principles and techniques. Furthermore, exercises are given at the end of each chapter where the reader can test his/her learning. Model answers are provided at the end of the book. Thus, this book facilitates the understanding of basic principles and techniques of financial accounting, which are useful for individuals with very limited knowledge of financial accounting, such as students and entrepreneurs who have not studied accounting.

PART 2:

THE DOUBLE ENTRY SYSTEM

CHAPTER 2

ACCOUNTING FOR THE ORGANISATION'S ASSETS, LIABILITIES AND CAPITAL

Objectives

After you have read this chapter you should be able to:

- Understand the term accounting;
- See the process used in order to record business transactions;
- Know the meaning of assets, liabilities and capital;
- Understand the accounting equation;
- Identify the main users of accounting information and their information needs; and
- Record transactions by using the double entry system for assets, liabilities and capital.

2.1 Definition of the Term Accounting

Accounting can be defined as the process of recording, classifying, reporting and interpreting financial information for interested users in order to help them in their economic decisions. This indicates that accounting is a process of four key stages, which are recording, classifying, reporting and interpreting financial information. In this chapter emphasis is placed on the recording of business transactions and the identification of the main users of accounting information to whom financial information is provided.

2.2 Process of Recording Transactions

Accounting can be considered as a process because the four stages noted above are performed in a sequential operation. These consist of recording business transactions, classifying the transactions in the appropriate accounts, reporting financial information at the end of the year and interpreting the financial information to interested users.

The best method that a lot of organisations utilise to record business transactions is the double entry system. The double entry system is based on the philosophy that every transaction has a give (-) and take (+) situation for the organisation. However, before explaining further this system let us define three important items in accounts.

2.2.1 Meaning of Assets, Liabilities and Capital

The resources owned by the firm are acquired in order sustain the operations of the business enterprise. Examples of these resources are stock, cash at bank, machinery and motor vehicles. These resources are called Assets. There are two types of assets, which consist of non-current assets and current assets. Non-current assets are assets that are expected to provide economic benefits to the organisation for a long period of time, which is normally in excess of one year. Examples of non-current assets are buildings, plant and machinery, and motor vehicles. Current assets comprise assets whose value alter frequently. Current assets are also in the form of cash or are quickly translated into cash. Examples of current assets consist of stock, trade receivables, bank and cash.

Someone must contribute for the business enterprise to buy these assets. There are two separate individual/entities that provide finance to the organisation. These are the owner of the organisation and third parties. The assets financed by the owner are called Capital, while those financed by third parties comprise Liabilities. For example, the €1,500 cash contributed by the owner will be considered as capital. A loan of €5,000 will be classified as a liability.

There are two types of liabilities, which consist of non-current and current liabilities. Non-current liabilities, such as a loan are liabilities that take more than one financial year to be paid. Current liabilities are liabilities that will be paid in the near future, which is less than the firm's financial year. Examples of current liabilities are trade payables and bank overdraft.

One can derive the following accounting equation from these variables:

Assets = Capital + Liabilities

If we apply the philosophy of the double entry system, the take situation is the assets, while the give situation is the capital and liabilities. Capital and liabilities are debts that the organisation is required to pay in future.

Example: Application of the Accounting Equation

An organisation incurred the following transactions during the month:

1. The owner deposited €10,000 into the business bank account.
2. A motor vehicle was bought costing €5,000 on credit from Muscat Motors.
3. The organisation repaid Muscat Motors the amount due of €5,000 by cheque.
4. The firm purchased stock of €1,500, which were immediately paid by cheque.

Situation	Assets €	Capital €	Liabilities €
1	10,000 (Bank)	10,000 (Owner)	-
2	5,000 (Motor Vehicle)	-	5,000 (Muscat Motors)
3	-5,000 (Bank)	-	-5,000 (Muscat Motors)
4	1,500 (Inventories) -1,500 (Bank)	-	-

The impact of these transactions on assets, capital and liabilities is outlined below:

1. The owner deposited €10,000 into the business bank account.
   Take situation: €10,000 deposited in the bank account (+ assets).
   Give situation: in the future the firm has to pay the owner €10,000 (+ capital).
2. The firm purchased a motor vehicle costing €5,000 on credit from Muscat Motors.
   Take situation: motor vehicle of €5,000 are acquired by the organisation (+ assets).
   Give situation: in the future the organisation has to pay Muscat Motors €5,000 (+ liabilities).
3. The firm repaid Muscat Motors the amount due of €5,000 by cheque.
   Take situation: the debt with Muscat Motors is settled (- Liabilities).

Give situation: the firm had to use €5,000 from the bank account to settle the debt (- assets).

4. The firm purchased stock of €1,500 paying immediately by cheque.
   Take situation: the enterprise purchased stock of €1,500 (+ assets).
   Give situation: the organisation had to use €1,500 from the bank account to purchase this stock (- assets).

The key principle is that in every transaction there is a take and give situation. The take situation is either increasing assets or decreasing capital or liabilities. The give situation is either decreasing assets or increasing capital or liabilities.

2.3 Main Users of Accounting Information

There are internal and external users of accounting information. In this section emphasis is placed on external users because the aspects of financial accounting are considered in this book.

The main external users of accounting information and their information needs are stated below:

Investors: investors consist of the individuals who invest in the organisation and become the respective owners. In a company the investors are known as the ordinary shareholders. Investors are interested in the profitability made by the organisation. This shows the direct return that they can get from the firm. Moreover, investors consider the investment risk in the organisation, which is the risk that the firm goes bankrupt or that they are unable to achieve the anticipated return. Thus, attention is given to the liquidity and long term solvency of the organisation.

Lenders: comprise individuals who lend money to the organisation. Such money is repayable after more than one year. Lenders are interested in the liquidity of the organisation in order to assess its ability to pay interest and the loan when it matures. Furthermore, they will consider the long term stability of the organisation to assess the risk that the organisation goes bankrupt.

Trade Payables: consist of individuals who sell goods to the organisation on credit. Like lenders trade payables are interested in the liquidity of the organisation to evaluate the firm's ability to pay the debts on time. They also consider the firm's long term stability to assess the possibility that the organisation can be a client for the long run. However, lower emphasis is placed on long term stability than lenders because the amount due is payable in the short term.

The Government: the government is interested in the profit generated by the organisation. This helps to examine if the company paid the correct amount of taxation. The government is also interested in the long term solvency of the organisation to evaluate the risk that the company may go insolvent. This affects the unemployment rate especially if it is a large organisation.

Customers: customers are interested in the long term solvency of the firm in order to evaluate the risk that it goes bankrupt. If the company becomes insolvent it can adversely impact the after sales service that the customer is entitled to. Furthermore, the customer may be unable to purchase additional products from the organisation. This is important especially for brand loyal customers.

General Public: the general public is also interested in the long term solvency of the organisation because it influences the rate of unemployment in the community.

2.4 Recording Transactions that affect Assets, Liabilities and Capital

The double entry system is based on the give and take situation, as already remarked. The take situation (+) is called the debit side, while the give situation (-) is called the credit side. Business transactions need to be recorded on the debit side and the credit side in accordance to this principle. Business transactions also lead to the creation of accounts. Different accounts are opened to reflect the asset acquired or disposed and the liabilities incurred. One account is opened only for the assets invested by the owner, which is called the capital account. The drawings account is opened when the owner takes resources from the organisation for his/her personal use.

The layout of an account is as follows:

Name of Account

Date	Debit	€	Date	Credit	€

As you can see the debit is on the left-hand side, while the credit is on the right-hand side.

Example: **Recording Business Transactions**

Money Deposited by the Owner:

1st January 2019: The owner deposited €15,000 into the business bank account.

Take: the firm received €15,000 in the bank account.

Give: in the future the organisation needs to pay the owner €15,000.

Bank Account

<table>
<tr><th>Date</th><th>Debit</th><th>€</th><th>Date</th><th>Credit</th><th>€</th></tr>
<tr><td>1/1/19</td><td>Capital*</td><td>15,000</td><td></td><td></td><td></td></tr>
<tr><td colspan="6">Capital Account</td></tr>
<tr><td></td><td></td><td></td><td>1/1/19</td><td>Bank*</td><td>15,000</td></tr>
</table>

*The narration reflects the other account in order to explain in what account was the other entry passed. Remember that in practice numerous accounts are opened to reflect all the business transactions incurred by the organisation.

Acquisition of Furniture on Credit and Repayment at a Later Date:

18th January 2019: The organisation purchased furniture of €3,500 on credit from Combi Ltd.

Take: the firm received furniture of €3,500.

Give: in the future the organisation needs to pay €3,500 to Combi Ltd.

26th January 2019: The firm paid the debt of Combi Ltd. by cheque.

Take: the debt is settled, which leads to a decline in liabilities of €3,500.

Give: €3,500 from the business bank account had to be used.

Furniture Account

Date	Debit	€	Date	Credit	€
18/1/19	Combi Ltd.	3,500			
		Combi Ltd. Account			
26/1/19	Bank	3,500	18/1/19	Furniture	3,500
		Bank Account			
			26/1/19	Combi Ltd.	3,500

Purchase of Motor Vehicle by Cheque:

30th January 2019: The firm acquired a motor vehicle of €6,000, which was paid immediately by cheque.

Take: the firm received a motor vehicle of €6,000.

Give: €6,000 from the business bank account had to be used to purchase the motor vehicle.

Motor Vehicle Account

Date	Debit	€	Date	Credit	€
30/1/19	Bank	6,000			
		Bank Account			
			30/1/19	Motor Vehicle	6,000

Transferred Money from the Bank Account to the Cash Account:

1st February 2019: Took €250 from the business bank account and deposited it into the cash till.

Take: the firm's cash in hand increased by €250.

Give: the balance in the bank account decreased by €250.

Cash Account

Date	Debit	€	Date	Credit	€
1/2/19	Bank	250			
		Bank Account			
			1/2/19	Cash	250

Received a Loan:

3rd February 2019: Alex Smith provided a loan of €20,000, which was deposited in the bank account.

Take: the firm received money of €20,000, which was deposited in the bank account.

Give: there is a liability of €20,000, which is payable to Alex Smith.

Bank Account

Date	**Debit**	**€**	**Date**	**Credit**	**€**
3/2/19	Loan: Alex Smith	20,000			
		Loan: Alex Smith Account			
			3/2/19	Bank	20,000

Money Taken by the Owner:

8th February 2019: The owner took €1,000 cash from the business bank account.

Take: the liability to the owner decreased by €1,000.

Give: the balance in the bank account declined by €1,000.

Drawings Account

Date	**Debit**	**€**	**Date**	**Credit**	**€**
8/2/19	Bank	1,000			
		Bank Account			
			8/2/19	Drawings	1,000

Paid Part of the Loan Due to Alex Smith:

26th February 2019: Paid part of Alex Smith's loan of €2,500 by cheque.

Take: the liability payable to Alex Smith decreased by €2,500.

Give: the balance in the bank account diminished by €2,500

Loan: Alex Smith Account

Date	Debit	€	Date	Credit	€
26/2/19	Bank	2,500			
Bank Account					
			26/2/19	Loan: Alex Smith	2,500

Review Questions

Question 1

Complete the following table by using the accounting equation:

	Assets €	Liabilities €	Capital €
1	20,000	5,000	
2	13,500		6,000
3		2,500	12,000
4	18,000	3,000	
5	16,900		10,000
6	11,000	6,000	

Question 2

Identify the assets from the following:

- Motor Vehicles
- Insurance
- Plant and Equipment
- Loan – M. Buttigieg
- Discount Received
- Premises
- Accounts Receivable
- Inventory
- Accounts Payable
- Cash at Bank

Question 3

Distinguish the following items into assets and liabilities:

- Accounts Payable
- Cash in hand
- Building
- Office Equipment
- Bank Overdraft
- Accounts Receivable
- Inventory

Question 4

What is the main difference between capital and a liability?

Question 5

Antoine Vella decided to start a business enterprise. Initially before starting any trading he acquired office equipment costing €3,500 and a motor van costing €6,000. He bought inventory costing €4,000 and paid suppliers €1,000. The remaining was provided on a 30-day credit. Antoine also bought premises costing €100,000. These were financed by capital and a loan of €60,000. Calculate the capital that Antoine invested in the organisation.

Question 6

James Mifsud started a business enterprise and performed the following transactions in the first month:

- The owner deposited €15,000 into the business bank account.
- Transferred €500 from the bank account into the cast till.
- Bought office equipment costing €3,500 by cheque.
- Bought goods for re-sale costing €500 by cheque.
- Bought goods for re-sale on credit from A. Micallef costing €1,000.
- Sold goods to a customer of €600 who paid immediately by cash.
- The owner took €1,000 from the business bank account.
- Sold €2,000 worth of goods to a customer on credit.
- Returned goods to A. Micallef of €20.

Record these transactions in the following table:

Assets	Capital	Liabilities

Question 7

Record the following transactions by using the double entry system:

Sep. 1	The owner started a business by depositing €4,000 in the bank account.
Sep. 2	Bought office equipment costing €300 by cheque.
Sep. 5	Deposited €250 bank into the cash till.
Sep. 9	Bought motor vehicle €3,000 on credit from Motors Inc.
Sep. 15	The owner deposited an additional €1,500 in the bank account.
Sep. 23	Paid Motors Inc. the amount due of €3,000 by cheque.
Sep. 28	Bought more office equipment of €200 paying by cash.

Question 8

Reflect the following transactions in the respective accounts:

Oct. 1	Started business with €5,000 in the business bank account.
Oct. 3	Bought motor vehicle costing €2,200, which was immediately paid by cheque.
Oct. 4	Bought office furniture costing €400 by cheque.
Oct. 5	Returned faulty office furniture of €50. A refund was provided, which was deposited in the cash till.
Oct. 11	Bought machinery costing €950, which was purchased on credit from Novitex.