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Revision Guide for Edexcel IGCSE

Accounting (4AC1)

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Accounting Notes

DISCLAIMER: THESE NOTES ARE BEST SUITED FOR THOSE WHO ARE TAKING EXAMS UNDER PEARSON EDEXCEL 4AC1. VALUES THAT ARE MENTIONED IN () HAVE THE IMPLIED MEANING THAT IT IS SUBTRACTED.

Topics Covered

- Income Statement
- Statement of Financial Position
- Depreciation and its accounts
- Control Account
- Books of Original Entry
- Accounting Concepts
- Bank Reconciliation Statement
- Irrecoverable Debts
- Partnerships and their respective financial statements and ledgers
- Manufacturing companies and their respective financial statements and ledgers
- Incomplete Records

Income Statement:

- Prepared **at the end of fiscal year** (Annual Income Statement) or **end of month** (Monthly Income Statement)
- Only contains **Nominal Accounts** (Income and Expenses).
- Made by **passing closing entries** of the specified accounts.
- Usually made from **a trial balance**, but **opening and closing balances of a sole trader** are usually given in the **boards**.

	$	$
Revenue	XXX	
Revenue Returns	(XXX)	
Net Revenue		**XXX**
Cost of Goods Sold		
Opening Inventory	XXX	
Purchases	XXX	
Purchase Return	(XXX)	
Carriage Inwards	XXX	
Goods Drawn for Personal Use	(XXX)	
Shipment fee (if there is)	XXX	

	$	$
Closing Inventory	(XXX)	
		(XXX)
Gross Profit / Loss		**XXX / (XXX)**

Other Income		
Other Receivables	XXX	
Rental Revenue (Rent Received)	XXX	
A Decrease in the Provision for Irrecoverable Debt	XXX	
Profit from Disposal of Non Current Asset	XXX	
Commission Earned	XXX	
Salary Received	XXX	
		XXX
Expenses		
Other Payables	XXX	
Rent	XXX	
Wages and Salary	XXX	
An Increase in the Provision for Irrecoverable Debt	XXX	
Loss from Disposal of Non Current Asset	XXX	
Commission	XXX	
Depreciation Charge of Non Current Asset	XXX	
		(XXX)
Net Profit / Loss		**XXX / (XXX)**

Note: Closing Balance will always be given in the notes section of a Trial Balance. Any Real Accounts will be present in the Balance Sheet

Statement of Financial Position (SOFP) or Balance Sheet:

- Based off the accounting equation: Assets = Liabilities + Capital
- It shows the current state of a business at any given point in time.
- It lists all the Assets, Liabilities and Capital of the business at any point of time.
- The total net assets should be equal to the total of Liabilities and Capital. *(Accounting Equation)*

	$	$
ASSETS		
NON CURRENT ASSETS		
Land and Machinery	XXX	
Provision for Depreciation - Land and Machinery	(XXX)	

	$	$
Motor Vehicle	XXX	
Provision for Depreciation - Motor Vehicle	(XXX)	
		XXX
CURRENT ASSETS		
Closing Inventory	XXX	
Cash in hand	XXX	
Cash in bank	XXX	
Trade Receivables	XXX	
Other Receivables (Expense Advance/Income Pending)	XXX	
Provision for Irrecoverable Debts	(XXX)	
		XXX
Total Assets (**Net Assets**)		XXX
CAPITAL		
Total Capital at XX/XX/XX	XXX	
Drawings	(XXX)	
Net Profit/Loss	XXX /(XXX)	
		XXX
LIABILITIES		
NON CURRENT LIABILITIES		
Long Term Loan	XXX	
		XXX
CURRENT LIABILITIES		
Trade Payables	XXX	
Other Payables (Expense Owing/Income Prepaid)	XXX	
		XXX
Total Capital and Liabilities		XXX

Depreciation and its accounts:

- Depreciation is the **reduction of the current value of a non-current asset.**
- Factors of Depreciation includes **Passage of Time**, **Wear and Tear**, **Obsolescence** and **Depletion.**
- There are 2 methods of Depreciation which include **Straight Line Method** and **Reducing Balance Method**
- Once an asset is depreciated using one of the above methods, **the method used will not change due to Consistency Concept.**

- **Profit value and value of Non-current assets will be overstated** if non current assets are **not depreciated.** This breaks the concept of **Prudence.**

a) Straight Line Method:

- Depreciation Charge is **constant** during the **lifetime of the asset**
- Usually given at **20% per annum**, wxhich is **5 years.**
- To calculate the charge for depreciation using this method is as follows:

$$D = \frac{C - S}{T}$$

  In which D is the Depreciation Charge, C being the cost of the asset, S being the Salvage value or Scrap value and T being the lifetime of the asset in years
- Straight Line Method is preferred for **assets that are expected to earn revenue evenly during their lifespan**

Note: Salvage Value or Scrap Value refers to the estimated amount that will be received when the asset is sold at the end of its useful life.

b) Reducing Balance Method:

- Depreciation Charge **reduces** during the **lifetime of the asset**
- Usually given at **20% per annum**, which is **5 years**
- There is **no specific formula**, but it can be explained as follows:
  1. **Cost x Percentage of Depreciation** = **A** (Depreciation Charge)
  2. **Cost - A** = **B** (Book Value of Asset)
  3. Repeat accordingly to question
- This method is preferred for **assets in which their working power will decrease as they get older**

c) Provision for Depreciation Account:

Date	Narrative	$	Date	Narrative	$
Sold Date	Disposal (Accumulated Depreciation of Sold Asset)	XXX	Opening Date	Bal b/d (Value of Provision at the beginning)	XXX
End of Year	Bal c/d	XXX	End of Year	Income Statement (Value depends on method)	XXX
		XXX			**XXX**

d) Disposal of Non Current Asset Account:

Date	Narrative	$	Date	Narrative	$
Purchase Date	Bal b/d (Cost of Sold Asset)	XXX	Sold Date	Provision for Depreciation (Disposal value)	XXX

Date	Narrative	$	Date	Narrative	$
			Sold Date	Bank/Cash (Selling Price)	XXX
End of Year	Income Statement (Profit)	XXX	End of Year	Income Statement (Loss)	XXX
		XXX			**XXX**

e) Calculating the Income Statement Value in the Provision for Depreciation Account:

① Straight Line Method:
- Find value of **unsold asset** *(Total asset value - sold asset value)*
- **Value of Unsold x Depreciation Percentage** = **Income Statement**

② Reducing Balance Method:
- Find **accumulated depreciation** of **sold asset**
- **Accumulated Depreciation - Provision for Depreciation** = **A**
- **Unsold - A** = **B**
- **B x Depreciation Percentage** = **Income Statement***

Note: Majority of questions based on Depreciation has this lines that says: "Depreciation is done at the year of purchase but none at the year of disposal". This simply means that you'll be depreciating until the year before the sale of the asset.

Control Accounts:

- Also known as **memorandum accounts** or **self-balancing accounts**
- It acts as a **summary** for all the transactions that relate to **payables** and **receivables**
- Are of 2 types: **Trade Receivables Ledger Control Account** and **Trade Payables Ledger Control Account**
- Relates to **credit customers** and **suppliers**
- Used to **check for any arithmetical errors and fraud**, **amounts due to the Trade Payables** and **Receivables** can be extracted easily and can also be **used for references.**

a) Trade Payables Ledger Control Account:

- Relates to **credit suppliers**
- Also known as **Purchases Control Ledger Account**
- Opening Balance is on the **credit side** as it is a **liability**
- Its **setoff** is on the **debit side**

Date	Narrative	$	Date	Narrative	$
	Discount Received	XXX	Start of Year	Bal b/d	XXX
	Bank (Payments to credit suppliers)	XXX		Purchases (which are on credit)	XXX
	Purchase Return	XXX		Interest	XXX
	Contra / Set-off	XXX		Bank / Cash (refunds)	XXX

Date	Narrative	$	Date	Narrative	$
End of Year	Bal c/d	XXX			
		XXX			**XXX**
			Start of Next Year	Bal b/d	XXX

b) Trade Receivables Ledger Control Account:

- Also known as **Sales Ledger Control Account**
- Relates to **Credit Customers**
- Opening Balance is on the **Debit Side** as it is **an asset**
- **Set off** is on the **credit side**

Date	Narrative	$	Date	Narrative	$
Start of Year	Bal b/d	XXX		Sales Return	XXX
	Sales	XXX		Bank (Receipts from credit customers)	XXX
	Dishonoured Cheque	XXX		Irrecoverable Debts	XXX
	Interest	XXX		Contra / Set-off	XXX
				Discount Allow	XXX
			End of Year	Bal c/d	XXX
		XXX			**XXX**
Start of next Year	Bal b/d	XXX			

Books of Original Entry:

- In accounting, there are **7 books of original entry:**
  1. Purchase Day Book (Purchase Journal)
  2. Purchase Return Day Book (Purchase Return Journal)
  3. Sales Day Book (Sales Journal)
  4. Sales Return Day Book (Sales Return Journal)
  5. Cash Book
  6. Petty Cash Book
  7. Journal (General Journal)
- Only **credit transactions** are recorded in the books of original entry, **except** for **cash book and petty cash book***

a) Purchase and Purchase Return Day Book:

- Any **credit purchases** are recorded in the **Purchase Day Book** while any **credit purchase returns** are recorded in the **Purchase Return Day Book**

b) Sales and Sales Return Day Book:

- Any **credit sales** are recorded in the **Sales Day Book** while any **credit sales returns** are recorded in the **Sales Return Day Book.**

c) Cash and Petty Cash Book:

- All **cash transactions** are recorded in these 2 books.
- Petty Cash book has all the **small expenses** the business makes.
- Cash Book has **all the cash transactions** the business makes.

Cash Book

Date	Narrative	Discount Allowed	Bank	Cash	Date	Narrative	Discount Received	Bank	Cash

- Cash books are used to identify any **cash frauds**, to keep **a record on the transactions made by the business** and **reduces** the workload.
- Can be used as an **alternative to a cash account**

Petty Cash Book

Receipts	Date	Narrative	Voucher Number	Total	Stationery	Travel	Postage	Ledger Account

- Petty Cash books are used to **remove any small repetitive transactions** in the cash book which reduces the undue load on the cash book.
  d) Journal:
- **Other credit transactions** are recorded here

Accounting Concepts:

- In accounting, there are **9 concepts all accountants should follow:**
  1. Business Entity
  2. Money Measurement
  3. Consistency
  4. Matching
  5. Realization
  6. Prudence
  7. Going Concern
  8. Duality
  9. Materiality

a) Business Entity:

- Owner and a business are **2 different persons.**
- Reason why the **owner is a trade payable** to the business and the owner's capital is recorded in the capital a/c

b) Money Measurement:

- Things that have **monetary value** are recorded into the books

c) Consistency:

- **Always prefer** using **the same method** of recording accounting in the business

d) Matching:

- **Profit of the year** = **Revenues - Expenses**
- All **income and expenses** relating to the **fiscal year or financial period** should be taken into account **without regard to the date of receipt or payment**
- That is why **expenses should be shown in the Profit/Loss a/c as they have been incurred.**

e) Realization:

- **Profit** is only recorded **when it actually happens**

f) Prudence:

- **Profits** should **not be overstated** and any **losses** should be **provided for as soon as they have been realized.**

g) Going Concern:

- Business will continue for an **indefinite period of time.**
- Final accounts of the business are made on the basis that there is **no intention of closing down the business.**

h) Duality:

- **Every** transaction has **2 aspects**, that is **debit and credit.**

i) Materiality:

- Transactions of **real importance** are recorded in the financial statements.

Bank Reconciliation Statement

- Made by the **book keeper** and not by **the Bank**, the Bank makes the Bank Statement
- At the end, majority of the time **the balance of the bank column of the cash book and the balance of the bank statement will not match.**
- Bank Reconciliation is made to **match those balances.**
- The following reasons are why the balances don't match:
  1. **Timing Differences**

② **Cheque has been deposited**, but has **not been recognized by the bank**
③ **Unpresented** Cheques

a) Things to note when making Bank Recon. Statement:

① **Bank** is always **right**
② Check the information given to you
③ **Transactions that are not present in the cash book** has **to be added in the updated cash book.**
④ **Transactions that are present in the cash book** but not in the bank statement **will be present in the Bank Reconciliation Statement**.

	$
Balance as per Updated Cash Book	XXX
Add: Unpresented Cheque	XXX
Less: Outstanding Logements / Cheque Logements	(XXX)
Balance as per Bank Statement	**XXX**

Note: They sometimes give the bank statement balance in the question, if the bank recon. balance is the same as the Bank Statement balance, the created Bank Recon. is right.

Irrecoverable Debt

- When a **customer owes you**, but if they **can't pay you back**, its known as an **irrecoverable debt**.
- It is considered as an **expense** and a provision is created if this expense is recurring.
- Provisions are **funds set aside** based on the **estimated amount for a recurring expense.**
- It follows the concept of **Prudence.**

Date	**Narrative**	**$**	**Date**	**Narrative**	**$**
	Bal c/d	XXX		Bal b/d	XXX
				Income Statement	XXX
		XXX			**XXX**

a) Calculating Income Statement Value:

① Trade Receivables - Bad Debt = A
② A x % = B
③ B - Opening Balance = Income Statement

Note: If the income statement value is negative, it will appear in the debit side of the provision. It also means that it is a decrease in the provision for irrecoverable debt. An Increase in the provision for irrecoverable debts is an expense. Moreover, the provision itself will appear on the Balance Sheet under current assets as a deduction.

Things to Remember in Accounting

a) DEADCLIC Mnemonic:

Debit
Expenses
Assets
Drawings

Credit
Liabilities
Income
Capital

b) Golden Rules of Accounting (Duality Concept):

① Personal Accounts:
Debit the **Receiver**
Credit the **Giver**

② Real Accounts:
Debit what **comes in**
Credit what **goes out**

③ Nominal Accounts:
Debit all **Expenses/Losses**
Credit all **Income/Profits/Gains**

c) Types of Accounts:

① Personal Accounts:
Businesses, customers, any person in the business field are classified as personal accounts

② Real Accounts:
All assets and liabilities are real accounts

③ Nominal Account
All Income, Expenses, Profits and Losses are Nominal Accounts

d) The Accounting Equation:

Assets = Liabilities + Capital
Capital = Liabilities - Assets
Liabilities = Assets - Capital

e) Errors not affecting the trial balance

Transposition
Omission
Principle
Commission
Original Entry
Complete reversal of entries
Compensation

f) Cash Book Tip:

"**Banked Cash**" => **CBBC** "**Cash Bank Bank Cash**"

Partnerships and their respective financial statements and ledgers

SECTION A: CHARACTERISTICS AND NATURE OF PARTNERSHIPS

- A type of **business organization** that consists of **2 - 20 owners**.
- Depending on the liability of the partners, partnerships are categorized into 2 types:
  1. **Limited Partnerships:** A type of partnership **where 1 member has unlimited liability** while the **other members have limited liability**.
  2. **Unlimited Partnerships:** A type of partnership where **all members have unlimited liability**.
- A partnership has its advantages and disadvantages, which is listed below:
  1. Advantages:
     - More Capital is invested into the business.
     - Easier to set up compared to a limited company
     - More partners means more expertise brought into the business
     - Responsibility can be shared among partners, meaning less stress compared to a sole proprietorship.
  2. Disadvantages:
     - Profit is shared among the partners, meaning low profit.
     - Partnership is dissolved when 1 of the partners die.
     - Higher rate of conflicts.
     - Some partners might be responsible for the debt's of other partners.
- The characteristics of a partnership is as such:
  1. It is formed to **make profits**
  2. In the UK, it must obey the law as set out in the **UK's Partnership Act 1980**. Limited Partnerships must comply with the **Limited Liability Act 2000**.
  3. There can be a **minimum of 2** to a **maximum of 20 partners**. Each partner, excluding limited partners, must pay his or her share of the debts that the partnership is unable to pay, rendering each partner **personally liable**. If needed, the partner can pay off the debt by **selling his personal possessions to cover the debt** (This type of partner is known as an **Unlimited Partner**).
- During the **formation of a partnership**, **a partnership deed is created** and is **signed by all the partners**. It lists the **sharing ratios of profit and loss**, **percentage of interest on capital** and **drawings** and the **value of salaries** entitled to the partners.
- If no partnership deed is present during the formation of the partnership, the partnership deed is as such. (Section 24 of the Partnership Act 1980 is followed):
  1. **Profits and losses** are to be **shared in the ratio 1:1** (as in, in **equal amounts**)
  2. There is **no interest allowed on equity** (as in, interest on capital)
  3. **No salary** is entitled to any partner.
  4. If a partner decided to **invest money that is in excess of the capital** he or she originally invested, he or she has agreed to be entitled **5% interest on that advance per annum.**

SECTION B: FINANCIAL STATEMENTS AND LEDGERS

- Partnerships follow the same financial statements as those of a sole proprietorship, that is the **Income Statement and Statement of Financial Position**
- There is an additional section in the income statement of a partnership, which is known as the **Profit and Loss Appropriation Account**.
- The Profit and Loss Appropriation Account **shows how the profit or loss is shared between the profits** and is below the income statement, after the Net Profit or Loss.
- It also shows the following values:
  1. **Interest on Drawings**
  2. **Interest on Capital**
  3. **Salaries** (If any)

Format of the Profit and Loss Appropriation Account

XYZ Company
Profit and Loss Appropriation Account for the year ended DD/MM/YY

		$	$	$
	Net Profit/Loss			**XXX/(XXX)**
Add:	**Interest on Drawings**			
	Partner X		XXX	
	Partner Y		XXX	
	Partner Z		XXX	XXX
Less:	**Interest on Capital**			
	Partner X	XXX		
	Partner Y	XXX		
	Partner Z	XXX	XXX	
Less:	**Salaries**			
	Partner X	XXX		
	Partner Y	XXX		
	Partner Z	XXX	XXX	(XXX)
	Residual Profit/Loss			**XXX/(XXX)**
	Sharing of Profit/Loss			
	Partner X		XXX	
	Partner Y		XXX	
	Partner Z		XXX	
			XXX	

Ledger Accounts related to Partnerships

- There are 2 types of ledgers that are created when the Capital is either **fixed** or **fluctuating.**
- When the capital is **fixed**, the ledger that is created is known as **the Capital a/c**.

- When the capital is **fluctuating**, the ledger that is created is known as the **Current a/c**.
- These 2 ledgers show how much the **capital is worth at the opening and closing of the year**.

Format of Capital a/c when it is fixed or Current a/c

Date	Narrative	A ($)	B ($)	Date	Narrative	A ($)	B ($)
	Interest on Drawings	XXX	XXX	Opening of the Year	Balance b/d	XXX	XXX
	Drawings	XXX	XXX		Interest on Capital	XXX	XXX
					Salaries	XXX	XXX
Closing of the Year	Residual Loss	XXX	XXX	Closing of the Year	Residual Profit	XXX	XXX
Closing of the Year	Balance c/d	XXX	XXX				
		XXX	**XXX**			**XXX**	**XXX**

Format of Capital a/c when it is fluctuating

Date	Narrative	A ($)	B ($)	Date	Narrative	A ($)	B ($)
Closing of the Year	Balance c/d	XXX	XXX	Opening of the Year	Balance b/d	XXX	XXX
					Cash/Bank (Additional Capital)	XXX	XXX
		XXX	**XXX**			**XXX**	**XXX**

Note: Always bring down the closing balances to the next year; brought down balances will appear on the opposite side.

Manufacturing Companies and their respective financial statements and ledgers

- Manufacturing Companies are companies that **manufacture their own goods**.
- These include companies like **Boeing, Toyota, Foxconn and the likes**.
- There are **3 types of inventories** that are present when a company manufactures their own goods:
  1. **Inventory of Raw Materials**: This is the total value of unprocessed goods.
  2. **Inventory of Work In Progress**: This is the total value of goods that are being processed.
  3. **Inventory of Finished Goods**: This is the total value of processed goods.
- These types of business **accumulate costs over specific stages**. These costs are mentioned in the **Manufacturing Account of the Business**.
- Manufacturing Accounts are made **annually**.
- There are **2 types of costs** that are related to a manufacturing business:

① **Direct Costs**: These are the costs that can be **easily linked to the production process** and includes **Direct Materials, Direct Wages or Labour and Direct Expenses.**

② **Indirect Costs**: These are the costs that **can't be easily linked to the production process** and includes **Indirect Wages or Labour and Indirect Expenses**. All Indirect Costs are mentioned under **Factory Overheads**.

- The **total of all the direct costs** is known as the **Prime Costs**.
- The total of the **Prime Cost, Indirect Costs** (**also known as Factory Overheads**) **and the deduction of the Net Inventory of Work In Progress** (**Opening - Closing**) is known as the **Production Cost or Cost of Production**.

Format of the Manufacturing Account

XYZ Manufacturing Company
Manufacturing Account for the year ended DD/MM/YY

	$	$
Opening Inventory of Raw Materials	XXX	
Purchases of Raw Materials	XXX	
Purchase Returns of Raw Materials	(XXX)	
Carriage Inwards of Raw Materials	XXX	
Closing Inventory of Raw Materials	(XXX)	
Direct Materials		**XXX**
Direct Expenses		XXX
Direct Wages		XXX
Prime Cost		**XXX**
FACTORY OVERHEADS		
Indirect Expenses	XXX	
Indirect Wages	XXX	
Rent, Rates, Insurance	XXX	
Electricity	XXX	
Insurance	XXX	
Depreciation - Factory Machinery	XXX	**XXX**
Opening Inventory - Work In Progress	XXX	
Closing Inventory - Work In Progress	(XXX)	(**XXX**)
Production Cost / Cost of Production		**XXX**

Incomplete Records

- Some businesses does not maintain a complete set of records.
- These types of businesses extract their information using a range of methods.

- Instead of creating a Statement of Financial Position, these businesses create a Statement of Affairs (which follows the same format as the Statement of Financial Position).
- Credit Sales and Credit Purchases are calculated by creating a Total Receivables Ledger and a Total Payables Ledger respectively.

Total Receivables Ledger a/c

Date	**Narrative**	**$**	**Date**	**Narrative**	**$**
Opening of the Year	Balance b/d	XXX		Cash Book	XXX
	Sales Day Book	XXX	Closing of the Year	Balance c/d	XXX
		XXX			**XXX**

Total Payables Ledger a/c

Date	**Narrative**	**$**	**Date**	**Narrative**	**$**
	Cash Book	XXX	Opening of the Year	Balance b/d	XXX
Closing of the year	Balance c/d	XXX		Purchases Day Book	XXX
		XXX			**XXX**

Note: Questions regarding Incomplete Records will not give the values of Sales and Purchases. By creating these ledgers with the given information, the balancing figure is the value of Sales or Purchases (depending on the account made.).

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