

CHAPTER 7

Accounting concepts

This chapter continues coverage of material required for Achievement Standard 90976 (Accounting 1.1) 'Demonstrate understanding of accounting concepts for small entities'. It covers:

- explanation of accounting concepts
- application of accounting concepts.

At NCEA Level 1 Accounting, you are required to understand and apply the following six accounting concepts:

- accounting entity
- historical cost
- period reporting
- monetary measurement
- going concern
- accrual basis.

Each of these will now be discussed in turn.

Accounting entity

The financial affairs of the owner(s) of a business must be kept separate and distinct from the financial affairs of that business. The reason is that, for the purpose of accounting, a business is an entity – i.e. it is distinct from its owners. This means that only the business's assets and liabilities will be reported in the Statement of Financial Position, and only its incomes and expenses in the Income Statement.



This rule is the reason that we have Capital – to represent the investment of money or other assets by the owners into the business – and Drawings – to represent assets taken by the owners from the business for personal use.

Example

Henrietta owns *Henrietta's Hairworx* and during the year the business paid for some of Henrietta's personal cell-phone usage. In accordance with the **accounting entity** concept, this payment must be recorded as drawings in the business's Statement of Financial Position. The reason for this is that the cell-phone is not a business expense, so cannot be recorded in the Income Statement. Recording the payment as drawings keeps Henrietta's personal finances separate from her business finances.

Activity 7A – Accounting entity

1. Define the accounting entity concept.

2. Explain why Hui Ling may not record her personal car as an asset in her business.

3. Tracey owns *Tracey's Truckstop* and during the year Tracey used her business cheque account to pay electricity bills for both her business and her home. Explain fully how this payment would need to be recorded in the accounts of *Tracey's Truckstop*.

Historical cost

All transactions are recorded at the original acquisition cost to the business at the time of purchase.



This means that when preparing the Statement of Financial Position, the business must record the asset at the price it originally bought it for, NOT at what its current value is.

Example

In the Statement of Financial Position of *Henrietta's Hairworx*, Henrietta must record the shop buildings at a value of \$120 000, as this is the original acquisition cost to the business.

Activity 7B – Historical cost

1. Define the concept of historical cost.

2. Tracey's Truckstop has some equipment that was bought in 2007 for \$9 000. Tracey would receive \$3 000 for it if she sold it now. State what value the equipment should be recorded at in the Statement of Financial Position, and explain why, using an accounting concept.

Period reporting

The life of the business is broken up into periods of equal length for reporting purposes; for example, to calculate the profit for the year and make decisions using the information.

Businesses have a consistent financial period (usually the period is one year in duration, and it ends every year on 31 March). Having a fixed financial period means that businesses can compare results from one period to another to highlight improvements or problems and to help owners/managers make improvements in the following period (year).

Example

Henrietta's Hairworx's accountant prepares the financial statements on 31 March every year, so that the business's profit can be calculated. Henrietta can then see whether profit has improved from the previous year's, and make decisions on how to improve it in the following year.

Activity 7C – Period reporting

1. Hui Ling wants to prepare her financial statements at any time between 1 May and 31 July because this is when her shop is the quietest and she has the most time. Name the concept that prevents her from doing this, and then define the concept.

2. *Tracey's Truckstop's* accountant always prepares the business's Income Statement for the year ended 31 March. Explain why he does this.

CHAPTER 12

Cash journals

This chapter continues presenting the content required for Achievement Standard 90977 (Accounting 1.2) 'Process financial transactions for a small entity'. This chapter covers:

- the preparation of the cash receipts journal and the cash payments journal.

Cash receipts journal

This journal is used to record all money received, in whatever form the payment is made – for example, cash, EFTPOS, credit card transaction, cheque, electronic transfer or direct credit. The journal is the first book of entry and the information is usually taken from copies of receipts, till tape or cash register summary (CRS), EFTPOS dockets (EFT) or the bank statement (BS).

Cash receipts journal

Date	Particulars	F	SD	Receipts	Bank	GST			Other
							(Analysis columns)		

Notes:

Date – the date on which the transaction took place.

Particulars – the account name for the transaction (other than bank and GST). Not a description.

F – Folio – reference for the chart account number when posting to the ledger.

SD – Source document – the source document reference number or other reference code; e.g. ET (electronic transfer), BS (bank statement), EFT (EFTPOS), CRS (cash register tape).

Receipts (or unbanked column) – this column is like the till, where all common types of transaction that take place on a given day (or until banking is done) are entered and then subtotalled to the bank column. You need to group the cash transactions together, followed by EFTPOS transactions, and then credit card transactions. Create a subtotal for each type. Electronic transactions that do not go through the cash register but directly into the bank account do NOT get entered in this column.

Bank – the totals for the different types of transaction for the day, and any transactions that are directly entered into the bank account. This column should mirror the bank statement deposit column.

GST – the amount of GST in each transaction (if relevant).

Analysis columns – these include the GST and other commonly occurring accounts which can vary from business to business. Common headings include 'Sales' and 'Fees received'. The GST-exclusive dollar amount for each transaction is entered under the appropriate heading.

'Other' analysis column – this is used for dollar amounts that do not have a column heading under which they can be entered.

At the end of the period, the bank column and all the analysis columns are totalled. The bank column total should equal the total of all analysis columns.

Example

Henrietta's Hairworx had the following cash receipts for the first week in April. All transactions include GST where appropriate.



- April 1 Cash fees received for haircut \$460
Cash received from sales of shampoo \$92
EFTPOS receipts for fees received \$1 380
- April 2 Cash sales \$598
Cash received for haircuts \$621
Henrietta invested a cheque into the business, through the till, \$1 000; receipt no. 12
EFTPOS receipts for haircuts \$414
EFTPOS received for sales \$276
- April 5 Interest received from term deposit \$92 shown on the bank statement.
Credit card receipts from haircuts \$368
Sold old mirror and chair, paid by cheque, \$207
EFTPOS fees from haircuts \$161
Debtor paid account by internet transfer for family haircut \$184
- April 7 EFTPOS received from clients for haircuts \$736
Cash received for haircuts \$276
EFTPOS received for sales \$552
Cash received for haircuts \$368
Received dividend as direct credit \$138 shown on the bank statement.

Note: Often the numbers that you get when calculating the GST component of a price will not be whole numbers, and you need to indicate the cents – even if there are none. Round all numbers to two decimal places. See below.

Cash receipts journal – *Henrietta's Hairworx*

Date	Particulars	F	SD	Receipts	Bank	GST	Sales	Fees received	Other
Apr 1	Fees received		CRS	460.00		60.00		400.00	
	Sales		CRS	<u>92.00</u>	552.00	12.00	80.00		
	Fees received		EFT	<u>1 380.00</u>	1 380.00	180.00		1 200.00	
2	Sales		CRS	598.00		78.00	520.00		
	Fees received		CRS	621.00		81.00		540.00	
	Capital		#12	<u>1 000.00</u>	2 219.00				1 000.00
	Fees received		EFT	414.00		54.00		360.00	
	Sales		EFT	<u>276.00</u>	690.00	36.00	240.00		
5	Interest received		BS		92.00				92.00
	Fees received		CC	<u>368.00</u>	368.00	48.00		320.00	
	Furniture *		CRS	<u>207.00</u>	207.00	27.00			180.00
	Fees received		EFT	<u>161.00</u>	161.00	21.00		140.00	
	Fees received		BS		184.00	24.00		160.00	
7	Fees received		EFT	736.00		96.00		640.00	
	Sales		EFT	<u>552.00</u>	1 288.00	72.00	480.00		
	Fees received		CRS	276.00		36.00		240.00	
	Sales		CRS	<u>368.00</u>	644.00	48.00	320.00		
	Dividends		BS		138.00				138.00
					7 923.00	873.00	1 640.00	4 000.00	1 410.00

Note: Bank \$ 7 923 = total of GST + Sales + Fees received + other

* The sale of any property, plant and equipment assets (in this case furniture) is recorded in the 'other' column – it is not part of sales. The 'sales' column is used only for the recording of the sale of inventory purchased with the intention of resale.



Activity 12A

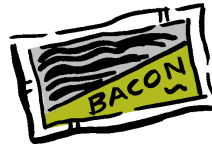
1. Complete the cash receipts journal below to record the following transactions for *Max's Music* for the first week in May 2013.

- 1 May Cash sales \$4 600
- 1 May Cash fees received \$1 840
- 2 May Interest on term deposit \$92 received by direct credit
- 2 May Cash sales \$1 380, EFTPOS sales \$1 840, cash fees received \$920
- 3 May Max invested \$10 350 by electronic transfer
- 3 May Cash fees received \$9 200, EFTPOS fees received \$5 520
- 4 May Cash sales \$1 380
- 4 May EFTPOS sales \$460 and fees received \$276
- 5 May Sold old office chair \$138 for cash

Cash receipts journal – *Max's Music*

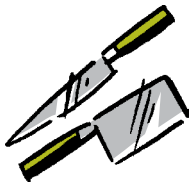
Date	Particulars	SD	Receipts	Bank	GST	Sales	Fees received	Other

2. Using your own paper, prepare the cash receipts journal for *Brent's Butchery*, using the headings given below, to record the following transactions.



Date	Particulars	F	SD	Receipts	Bank	GST	Sales	Interest received	Other
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- October 10 Sold meat for cash \$46
 Sold sausages and steak to local school, \$460 cheque received
 Chicken sales EFTPOS \$138
 Meat sales EFTPOS \$276
- October 12 Credit card receipts for sale of chicken \$1 380
 Credit card receipts for sale of beef \$621
 Cash and cheques banked for sales \$3 680
- October 14 Internet transfer from credit customer \$920 for sales of lamb
 Sold sausages for cash \$92
 Sold chicken for cash \$138
 Received cheques for beef and chicken sales \$460
 EFTPOS banking for sales of ham \$644
- October 18 Sold used meat cutter \$368, cheque received; receipt no. 219
 EFTPOS sales of sausages \$69
 EFTPOS sales of chicken \$276
 Interest received from cheque account \$23 direct credit



3. Complete the cash receipts journal to record the following transactions for *Sam's Superstore and Deliveries Services* for the first week in April 2016. Head up your own paper with the following headings.

Date	Particulars	F	SD	Receipts	Bank	GST	Sales	Fees received	Other
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- 1 April Cash sales \$8 700
- 2 April Cash fees received \$2 460
 Dividends received \$188
- 3 April Cash sales \$7 360, EFTPOS sales \$4 400
 Sam invested \$30 000 cash
- 4 April Cash fee received \$4 500, EFTPOS fees received \$2 450
 Cash sales \$5 600, EFTPOS sales \$1 800
- 5 April EFTPOS sales \$4 500 and fees received \$8 260
 Sold old delivery van \$6 300 cash, cash sales \$1 380
- 6 April Fees received \$1 800 for cash

Cash payments journal

This journal is used to record all money paid, in whatever form the payment is made – for example, cash, EFTPOS, credit card, electronic transfer, direct debit, automatic payment, telephone or internet payment, etc. The journal is the first book of entry and the information is usually taken from receipts, cheque butts, payment vouchers, computer printouts of internet transactions, or bank statements (BS).

Cash payments journal

Date	Particulars	F	SD	Bank	GST				Other
					Analysis columns				

Notes:

Date – the date the transaction took place.

Particulars – the account name for the transaction (other than bank and GST). Not a description.

F – Folio – reference for the chart account number when posting to the ledger.

SD – Source document – the source document reference number or other reference code; e.g. ET (electronic transfer), chq # (cheque number), BS (bank statement), DD (direct debit), AP (automatic payment), IT (internet transfer).

Bank – the amount of each payment made. This column should mirror the bank statement withdrawals column.

GST – the amount of GST in each transaction (if relevant).

Analysis columns – these include the GST and other commonly occurring accounts which can vary from business to business. Common headings include 'Purchases' or 'Supplies', 'Wages', 'Drawings'. The exclusive dollar amount for each transaction is entered under the appropriate heading.

Other analysis column – this is used for dollar amounts that do not have a column heading under which they can be entered.

At the end of the period, the bank column and all the analysis columns are totalled. The bank column total should equal the total of all analysis columns.

Example

Henrietta's Hairworx had the following cash payments for the first week in April. All transactions include GST where appropriate.

- April 1 Purchased shampoo and other inventory for resale \$460, Chq 222
Paid wages \$1 104 by direct credit payment
Paid electricity \$184, Chq 223
- April 2 Repaid loan by automatic payment \$500, and interest on loan \$184
Purchased supplies with Chq 224, \$414
Henrietta withdrew cash via internet transfer, \$460
Paid creditor's account for purchase of supplies \$621, by internet payment
Paid for equipment repairs \$276, Chq 225
- April 5 Purchased a new chair from *NZ Furniture* \$552, Chq 226
Paid \$138 for telephone, direct debit
Purchased more inventory for resale \$207, Chq 227
Cash drawings, \$161 via internet transfer
- April 7 Bank statement showed bank fees \$23
Paid wages top-up by direct credit payment \$276
Paid suppliers for supplies bought last month, by internet payment \$828
Paid rent by automatic payment \$368

Cash payments journal – Henrietta's Hairworx

Date	Particulars	F	SD	Bank	GST	Purchases	Supplies	Wages	Drawings	Other
Apr 1	Purchases		222	460.00	60.00	400.00				
	Wages		DC	1 104.00				1 104.00		
	Electricity		223	184.00	24.00					160.00
2	Loan		AP	500.00						500.00
	Interest on loan		AP	184.00						184.00
	Supplies		224	414.00	54.00		360.00			
	Drawings		IT	460.00					460.00	
	Supplies		IT	621.00	81.00		540.00			
	Repairs		225	276.00	36.00					240.00
5	Equipment *		226	552.00	72.00					480.00
	Telephone		DD	138.00	18.00					120.00
	Purchases		227	207.00	27.00	180.00				
	Drawings		IT	161.00					161.00	
7	Bank fees		BS	23.00						23.00
	Wages		DC	276.00				276.00		
	Supplies		IT	828.00	108.00		720.00			
	Rent		AP	368.00	48.00					320.00
				6 756.00	528.00	580.00	1 620.00	1 380.00	621.00	2 027.00

Note: The Bank total \$6 756.00 = sum of all the other headings, totalling \$6 756.00.

* The purchase of any property, plant and equipment assets (in this case equipment) is recorded in the 'other' column – it is not part of purchases. The 'purchases' column is used only for the recording of the purchase of inventory acquired with the intention of resale, and the 'supplies' column is used only for recording consumables that are used up in the delivery of a service.

CHECKPOINT ANSWERS

Note: Shortened answers to a selection of the questions from the text are provided here.

A full set of answers is available free as a pdf at www.esa.co.nz and as a printed booklet for purchase (details at www.esa.co.nz).

Chapter 1 – Nature of accounting and users of accounting

Activity 1C – Users of accounting information (p. 5)

4. a. Financial accountant: analysing and interpreting financial information to help with financial decision making, and giving financial advice.
- b. Auditor: checking the accuracy of financial systems and financial statements.
- c. Cost Accountant: calculating the cost of manufacturing a product, and preparing cost budgets.
- d. Accounting Technician: preparing accounting records (journals and ledgers), and possibly preparing financial statements, bank reconciliation statements, and some tax returns.

Chapter 2 – Financial elements and the accounting equation

Activity 2A – Financial elements of accounting (p. 8)

1. Soo Youn's Clothing Boutique

Assets	Expenses	Liabilities	Equity	Income
Bank Inventory Vehicle Equipment Shop fittings Furniture Cash on hand	Rent Stationery Advertising Electricity	Loan	Capital	Sales Discount received

Activity 2B – Transactions (p. 12)

1. Sam's Spa

	Assets			Liabilities		Equity
	Bank	Accounts receivable	Equipment	Accounts payable	Loan	Capital
a	+2 000					+2 000
b	+120					+120
c				+380		-380
d	-270					-270
e	-450				-400	-50
f		+140				+140
g			+2 000	+2 000		
h	-130					-130
i	-240			-240		

Activity 2E – Writing transactions (p. 16)

1. Gerald's Garden Services.
 - A. Gerald (owner) invested \$6 000 cash into his business.
 - B. Charged a customer \$300 for mowing lawns on credit / performed tree pruning on credit \$300.
 - C. Purchased office filing cabinet / computer using cash \$1 200.
 - D. Received \$150 cash from accounts receivable.
 - E. Purchased new truck costing \$10 000. Paid \$2 000 deposit and the rest on credit.
 - F. Paid \$1 200 off loan principal, and \$600 interest on loan.
 - G. Paid \$340 off accounts payable.
2. Clever Cleaners
 - A. Owner took \$500 cash for personal use / Cash drawings \$500 / Paid daughter's school camp \$500 (or any other personal expense paid)
 - B. Paid wages \$900, (or any other expense, but NOT account or bill)
 - C. Received \$130 cash from Account receivable
 - D. Received bank loan \$1 500
 - E. Received \$750 cash for cleaning client's apartment (or other cleaning example)
 - F. Cleaned windows on credit \$360 / Charged customer \$360 for cleaning carpets
 - G. Purchased new computer totalling \$1 500. Paid \$500 (or one-third. deposit and put the rest on credit
 - H. Received \$480 cash from Accounts receivable in full settlement of \$500 account; gave \$20 discount
 - I. Received electricity account/bill \$240 / Purchased stationery (or cleaning supplies etc.) on credit \$240

Chapter 3 – Financial elements of accounting

Activity 3A – Assets (p. 20)

2. The shelves are an asset for Books 4U because the shop will use the shelves to display books which customers will purchase and pay for in the future, increasing bank, which will generate income (in the form of sales) in the future. Books 4U paid for the shelves in the past, and the business's owners decide how the shelves are used – and have the exclusive right to use them.

Activity 3B – Liabilities (p. 21)

2. Accounts payable is a liability for Books 4U because it is a result of a past transaction – it was created when Books 4U purchased books and cards on credit in the past. Books 4U is now (at the present time) obliged to repay accounts payable to the amount stated on the invoice / statement, and there will be a future sacrifice of the asset 'bank' when payments to accounts payable are made in the future.

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