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FRANK WOOD  
**BUSINESS  
ACCOUNTING**  
**VOLUME I**  
FOURTH EDITION

**Frank Wood**  
B.Sc. (Econ.), F.C.A.

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FOURTH EDITION

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# Business Accounting 1



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## Preface to the Fourth Edition

This textbook has been written so that a very thorough introduction to Accounting is covered in two volumes. The fact that this task has been split between two volumes is a recognition of the fact that, for many students, their grounding in the subject will not have to be as exhaustive as those who will carry on with professional examinations. Volume 1 fully covers the requirements of the General Certificate of Education at Ordinary level, as well as the first year examinations for many other examining bodies.

The questions set at the end of the relevant chapters are either from the examination papers of the above or have been specially devised. I have regarded it as a duty to ensure that all questions set can be answered by students who have worked through the text up to the chapter concerned. Questions involving needless complications have been avoided, emphasis being given to those which bring out a basic understanding of accounting.

Emphasis has been laid on the 'why' of accounting rather than merely to explain 'how'. In doing this the uses which management and others make of the accounting information are discussed. At the same time out-of-date methods have been mentioned but have not been used.

This edition varies from the third edition in various ways. Because of the changes in examination syllabuses some items have been moved from volume one to volume two. These are mainly the chapters on Bills of Exchange, Partnership Dissolution, Joint Ventures and Consignment Accounts. Conversely some new chapters have been added, these refer to Funds Flow Statements and Interpretation of Accounts. In addition chapters which I now consider were too long in the third edition have been broken down into shorter chapters, this makes assimilation of the information that much easier. In addition over 100 multiple choice questions are now included. These are now a basic ingredient in quite a few accounting examinations.

Anyone who has studied book-keeping or accounting previously may well question the validity of having assets on the left-hand side of the balance sheet and capital and liabilities on the right-hand side, as previously they used to be the opposite to that. However, the Companies Act 1981 lays it down that in two-sided balance sheets assets must be shown on the left-hand side of the balance sheet and capital and liabilities on the right-hand side. In the interest of standardisation, and to avoid confusion, the balance sheets for sole traders and partnership will also be drawn up in the same way. In fact the new method does make book-keeping and accounting much easier to learn than previously. It is however a point to bear in mind when looking at other textbooks which have not been updated.

Generally, the figures used for exhibits and for exercises have been kept down to relatively small amounts. This has been done deliberately to make the work of the user of this book that much easier. Constantly handling large figures does not add anything to the study of the principles of accounting, instead it simply wastes a lot of the student's time, and he/she will probably make far more errors if larger figures are used. It could lead to the author being accused of not being 'realistic' with the figures given, but I believe that it is far more important to make learning easier for the student.

I would like to extend my sincere thank to my former colleagues Eddie Cainen, A.C.C.A. and Joe Townsley, B.Com., F.C.A., for putting up with me for so many years, and for letting me pick their brains from time to time. Their help and encouragement has certainly improved the book. I also wish to acknowledge the permission to use past examination papers granted by the University of London, the Associated Examining Board, the London Chamber of Commerce and Industry, the Joint Matriculation Board, the Association of Certified Accountants, the Institute of Cost and Management Accountants, the Association of Accounting Technicians, the Chartered Institute of Secretaries and Administrators, the Association of Business Executives, and the Institute of Bankers.

Frank Wood  
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*Autumn 1983*

## VOLUME ONE

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## The Accounting Equation and the Balance Sheet

Accounting is often said to be the language of business. It is used in the business world to describe the transactions entered into by all kinds of organizations. Accounting terms and ideas are therefore used by people associated with business, whether they are managers, owners, investors, bankers, lawyers, or accountants. As it is the language of business there are words and terms that mean one thing in accounting, but whose meaning is completely different in ordinary language usage. Fluency comes, as with other languages, after a certain amount of practice. When fluency has been achieved, that person will be able to survey the transactions of businesses, and will gain a greater insight into the way that business is transacted and the methods by which business decisions are taken.

The actual record-making phase of accounting is usually called book-keeping. However, accounting extends far beyond the actual making of records. Accounting is concerned with the use to which these records are put, their analysis and interpretation. An accountant should be concerned with more than the record-making phase. In particular he should be interested in the relationship between the financial results and the events which have created them. He should be studying the various alternatives open to the business, and be using his accounting experience in order to aid the management to select the best plan of action for the business. The owners and managers of a business will need some accounting knowledge in order that they may understand what the accountant is telling them. Investors and others will need accounting knowledge in order that they may read and understand the financial statements issued by the business, and adjust their relationships with the business accordingly.

Probably there are two main questions that the managers or owners of a business want to know: first, whether or not the business is operating at a profit; second, they will want to know whether or not the business will be able to meet its commitments as they fall due, and so not have to close down owing to lack of funds. Both these questions should be answered by the use of the accounting data of the firm.



## The Accounting Equation

The whole of financial accounting is based on the accounting equation. This can be stated to be that for a firm to operate it needs resources, and that these resources have had to be supplied to the firm by someone. The resources possessed by the firm are known as Assets, and obviously some of these resources will have been supplied by the owner of the business. The total amount supplied by him is known as Capital. If in fact he was the only one who had supplied the assets then the following equation would hold true:

$$\text{Assets} = \text{Capital}$$

On the other hand, some of the assets will normally have been provided by someone other than the owner. The indebtedness of the firm for these resources is known as Liabilities. The equation can now be expressed as:

$$\text{Assets} = \text{Capital} + \text{Liabilities}$$

It can be seen that the two sides of the equation will have the same totals. This is because we are dealing with the same thing from two different points of view. It is:

Resources: What they are =	Resources: Who supplied them
(Assets)	(Capital + Liabilities)

It is a fact that the totals of each side will always equal one another, and that this will always be true no matter how many transactions are entered into. The actual assets, capital and liabilities may change, but the equality of assets with that of the total of capital and liabilities will always hold true.

Assets consist of property of all kinds, such as buildings, machinery, stocks of goods and motor vehicles, also benefits such as debts owing by customers and the amount of money in the bank account.

Liabilities consist of money owing for goods supplied to the firm, and for expenses, also for loans made to the firm.

Capital is often called the owner's equity or net worth.

## The Balance Sheet and the Effects of Business Transactions

The accounting equation is expressed in a financial position statement called the Balance Sheet. It is not the first accounting record to be made, but it is a convenient place to start to consider accounting.

## The Introduction of Capital

On 1 May 19-7 B. Blake started in business and deposited £5,000 into a bank account opened specially for the business. The balance sheet would appear:

**B. Blake**

*Balance Sheet as at 1 May 19-7*

Assets	£	Capital	£
Cash at bank	5,000		5,000
	<u>5,000</u>		<u>5,000</u>

## The Purchase of an Asset by Cheque

On 3 May 19-7 Blake buys a building for £3,000. The effect of this transaction is that the cash at bank is decreased and a new asset, buildings, appears.

**B. Blake**

*Balance Sheet as at 3 May 19-7*

Assets	£	Capital	£
Buildings	3,000		5,000
Cash at bank	2,000		
	<u>5,000</u>		<u>5,000</u>

## The Purchase of an Asset and the Incurring of a Liability

On 6 May 19-7 Blake buys some goods for £500 from D. Smith, and agrees to pay for them some time within the next two weeks. The effect of this is that a new asset, stock of goods, is acquired, and a liability for the goods is created. A person to whom money is owed for goods is known in accounting language as a creditor.

**B. Blake**

*Balance Sheet as at 6 May 19-7*

Assets	£	Capital and Liabilities	£
Buildings	3,000	Capital	5,000
Stock of goods	500	Creditor	500
Cash at bank	2,000		
	<u>5,500</u>		<u>5,500</u>

### Sale of an Asset on Credit

On 10 May 19-7 goods which had cost £100 were sold to J. Brown for the same amount, the money to be paid later. The effect is a reduction in the stock of goods and the creation of a new asset. A person who owes the firm money is known in accounting language as a debtor. The balance sheet now appears as:

#### B. Blake

#### Balance Sheet as at 10 May 19-7

<i>Assets</i>	£	<i>Capital and Liabilities</i>	£
Buildings	3,000	Capital	5,000
Stock of goods	400	Creditor	500
Debtor	100		
Cash at bank	2,000		
	<u>5,500</u>		<u>5,500</u>

### Sale of an Asset for Immediate Payment

On 13 May 19-7 goods which had cost £50 were sold to D. Daley for the same amount, Daley paying for them immediately by cheque. Here one asset, stock of goods, is reduced, while another asset, bank, is increased. The balance sheet now appears:

#### B. Blake

#### Balance Sheet as at 13 May 19-7

<i>Assets</i>	£	<i>Capital and Liabilities</i>	£
Buildings	3,000	Capital	5,000
Stock of goods	350	Creditor	500
Debtor	100		
Cash at bank	2,050		
	<u>5,500</u>		<u>5,500</u>

### The Payment of a Liability

On 15 May 19-7 Blake pays a cheque for £200 to D. Smith in part payment of the amount owing. The asset of bank is therefore reduced, and the liability of the creditor is also reduced. The balance sheet now appears:

**B. Blake**  
**Balance Sheet as at 15 May 19-7**

<i>Assets</i>	£	<i>Capital and Liabilities</i>	£
Buildings	3,000	Capital	5,000
Stock of goods	350	Creditor	300
Debtor	100		
Cash at bank	1,850		
	<u>5,300</u>		<u>5,300</u>

**Collection of an Asset**

J. Brown, who owed Blake £100, makes a part payment of £75 by cheque on 31 May 19-7. The effect is to reduce one asset, debtor, and to increase another asset, bank. This results in a balance sheet as follows:

**B. Blake**  
**Balance Sheet as at 31 May 19-7**

<i>Assets</i>	£	<i>Capital and Liabilities</i>	£
Buildings	3,000	Capital	5,000
Stock of goods	350	Creditor	300
Debtor	25		
Cash at bank	1,925		
	<u>5,300</u>		<u>5,300</u>

It can be seen that every transaction has affected two items. Sometimes it has changed two assets by reducing one and increasing the other. Other times it has reacted differently. A summary of the effect of transactions upon assets, liabilities and capital is shown below.

**Example of Transaction**

1. Buy goods on credit.	Increase Asset (Stock of Goods)	Increase Liability (Creditors)
2. Buy goods by cheque.	Increase Asset (Stock of Goods)	Decrease Asset (Bank)
3. Pay creditor by cheque.	Decrease Asset (Bank)	Decrease Liability (Creditors)
4. Owner pays more capital into the bank.	Increase Asset (Bank)	Increase Capital
5. Owner takes money out of the business bank for his own use.	Decrease Asset (Bank)	Decrease Capital
6. Owner pays creditor from private money outside the firm.	Decrease Liability (Creditors)	Increase Capital

Each transaction has therefore maintained the equality of the total of assets with that of capital and liabilities. This can be shown:

Number of transaction as above	Assets	Liabilities and Capital	Effect on balance sheet totals
1	+	+	Each side added to equally.
2	+	-	A plus and a minus both on the assets side cancelling out each other.
3	-	-	Each side has equal deductions.
4	+	+	Each side has equal additions.
5	-	-	Each side has equal deductions.
6		+	A plus and a minus both on the liabilities and capital side cancelling out each other.

#### Notes:

(i) Anyone who has studied book-keeping or accounting previously may well question the validity of having assets on the left-hand side of the balance sheet and capital and liabilities on the right-hand side, as previously they used to be the opposite to that. However, the Companies Act 1981 lays it down that in two-sided balance sheets assets must be shown on the left-hand side of the balance sheet and capital and liabilities on the right-hand side. In the interests of standardisation, and to avoid confusion, the balance sheets for sole traders and partnerships will also be drawn up in the same way.

In fact the new method does make book-keeping and accounting much easier to learn than previously. It is however a point to bear in mind when looking at other textbooks which have not been updated.

(ii) Generally, the figures used for exhibits and for exercises have been kept down to relatively small amounts. This has been done deliberately to make the work of the user of this book that much easier. Constantly handling large figures does not add anything to the study of the principles of accounting, instead it simply wastes a lot of the student's time, and he/she will probably make far more errors if larger figures are used.

It could lead to the author being accused of not being 'realistic' with the figures given, but I believe that it is far more important to make learning easier for the student.

## Exercises

At the end of most chapters you will find several multiple choice questions. They can be identified by the use of the prefix MC before each question, followed by the number of that particular question.

Each multiple choice question has four suggested answers letter (A), (B), (C), (D). You should read each question and then decide which choice is best, either (A) or (B) or (C) or (D). On a separate piece of paper you should then write down your choice. Unless the textbook you are reading belongs to you, you should not make a mark against your choice in the textbook.

**ANSWERS TO MULTIPLE CHOICE QUESTIONS ARE GIVEN ON PAGE 453 OF THIS BOOK.**

**MC1** Which of the following statements is incorrect?

- (A) Assets - Capital = Liabilities  
 (B) Liabilities + Capital = Assets  
 (C) Liabilities + Assets = Capital  
 (D) Assets - Liabilities = Capital.
- (A) & (D) is correct.*

**MC2** Which of the following is not an asset?

- (A) Buildings  
 (B) Cash balance  
 (C) Debtors  
 (D) Loan from K. Harris.
- (D) is liabilities*

**MC3** Which of the following is a liability?

- (A) Machinery  
 (B) Creditors for goods  
 (C) Motor Vehicles  
 (D) Cash at Bank.

**MC4** Which of the following is incorrect?

	Assets	Liabilities	Capital
	£	£	£
(A)	7,850	1,250	6,600
(B)	8,200	2,800	5,400
(C) ✓	9,550	1,150	8,200
(D)	6,540	1,120	5,420

**MC5** Which of the following statements is correct?

	Effect upon	
	Assets	Liabilities
(A) We paid a creditor by cheque	- Bank	- Creditors
(B) A debtor paid us £90 in cash	+ Cash	+ Debtors
(C) J. Hall lends us £500 by cheque	+ Bank	- Loan from Hall
(D) Bought goods on credit	+ Stock	+ Capital



## Exercises (other types of questions)

**Note:** Questions with the letter A shown after the question number do NOT have answers shown at the back of the book. Answers to the others are shown on pages 453 onwards.

**1.1** You are to complete the gaps in the following table:

Assets	Liabilities	Capital
£	£	£
(a) 12,500	1,800	?
(b) 28,000	4,900	?
(c) 16,800	?	12,500
(d) 19,600	?	16,450
(e) ?	6,300	19,200
(f) ?	11,650	39,750

**1.2A.** You are to complete the gaps in the following table:

Assets	Liabilities	Capital
£	£	£
(a) 55,000	16,900	?
(b) ?	17,200	34,400
(c) 36,100	?	28,500
(d) 119,500	15,400	?
(e) 88,000	?	62,000
(f) ?	49,000	110,000

**1.3.** Distinguish from the following list the items that are liabilities from those that are assets:

- Office machinery
- Loan from C. Shirley
- Fixtures and fittings
- Motor vehicles
- We owe for goods
- Bank balance.

**1.4A.** Classify the following items into liabilities and assets:

- Motor vehicles
- Premises
- Creditors for goods
- Stock of goods
- Debtors
- Owing to bank
- Cash in hand
- Loan from D. Jones
- Machinery.

1.5. State which of the following are shown under the wrong classification for J. White's business:

<i>Assets</i>	<i>Liabilities</i>
Loan from C. Smith	Stock of goods
Cash in hand	Debtors
Machinery	Money owing to bank
Creditors	
Premises	
Motor vehicles.	

1.6A. Which of the following are shown under the wrong headings:

<i>Assets</i>	<i>Liabilities</i>
Cash at bank	Loan from J. Graham
Fixtures	Machinery
Creditors	Motor vehicles
Building	
Stock of goods	
Debtors	
Capital	

1.7. A. Smart sets up a new business. Before he actually sells anything he has bought Motor Vehicles £2,000, Premises £5,000, Stock of goods £1,000. He did not pay in full for his stock of goods and still owes £400 in respect of them. He had borrowed £3,000 from D. Bevan. After the events just described, and before trading starts, he has £100 cash in hand and £700 cash at bank. You are required to calculate the amount of his capital.

1.8A. T. Charles starts a business. Before he actually starts to sell anything he has bought, Fixtures £2,000, Motor Vehicles £5,000 and a stock of goods £3,500. Although he has paid in full for the fixtures and the motor vehicle, he still owes £1,400 for some of the goods. J. Preston had lent him £3,000. Charles, after the above, has £2,800 in the business bank account and £100 cash in hand. You are required to calculate his capital.

1.9. Draw up A. Foster's balance sheet from the following as at 31 December 19-4:

	£
Capital	23,750
Debtors	4,950
Motor vehicles	5,700
Creditors	2,450
Fixtures	5,500
Stock of goods	8,800
Cash at bank	1,250

**1.10A.** Draw up Kelly's balance sheet as at 30 June 19-2 from the following items:

	£
Capital	13,000
Office machinery	9,000
Creditors	900
Stock of goods	1,550
Debtors	275
Cash at bank	5,075
Loan from C. Smith	2,000

**1.11.** Complete the columns to show the effects of the following transactions:

*Effect upon*  
**Assets    Liabilities    Capital**

- (a) We pay a creditor £70 in cash
- (b) Bought fixtures £200 paying by cheque
- (c) Bought goods on credit £275
- (d) The proprietor introduces another £500 cash into the firm
- (e) J. Walker lends the firm £200 in cash
- (f) A debtor pays us £50 by cheque
- (g) We return goods costing £60 to a supplier whose bill we had not paid
- (h) Bought additional shop premises paying £5,000 by cheque.

**1.12A.** Complete the columns to show the effects of the following transactions:

*Effect upon*  
**Assets    Liabilities    Capital**

- (a) Bought a motor van on credit £500
- (b) Repaid by cash a loan owed to P. Smith £1,000
- (c) Bought goods for £150 paying by cheque
- (d) The owner puts a further £5,000 cash into the business
- (e) A debtor returns to us £80 goods. We agree to make an allowance for them.
- (f) Bought goods on credit £220
- (g) The owner takes out £100 cash for his personal use
- (h) We pay a creditor £190 by cheque.

**1.13.** C. Sangster has the following items in his balance sheet as on 30 April 19-4:

Capital £18,900; Loan from T. Sharples £2,000; Creditors £1,600; Fixtures £3,500; Motor Vehicle £4,200; Stock of Goods £4,950; Debtors £3,280; Cash at Bank £6,450; Cash in Hand £120.

During the first week of May 19-4 Sangster:

- (i) Bought extra stock of goods £770 on credit.
- (ii) One of the debtors paid us £280 in cash.
- (iii) Bought extra fixtures by cheque £1,000.

You are to draw up a balance sheet as on 7 May 19-4 after the above transactions have been completed.