

Chapter 1

Introduction to accounting

Exercises
Suggested solutions

1.1

Objectives of accounting: summary

1 to provide information for decision making

- by communicating:
 - financial figures
 - written reports
- used by interested parties to make decisions

2 to assist in discharging accountability

- 'accountable' means to be responsible
- control measures:
 - to reduce theft
 - to improve accuracy of figures
- protection device for all honest people in any organisation
- controls lead to accountability
- allows interested parties to rely on the information produced

3 to help evaluate performance

- internally
- financial reports: identification, measurement, interpretation, analysis and communication of financial information
- to allow a business to assess its performance based on past performance, using for example a cash budget
- externally:
 - lenders
 - investors
- to compare performance with targets, previous years and competitors.

1.2

a

- | | | |
|------------|--------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| i | Who? | Anyone can consider themselves an 'accountant' as the term is not protected by the requirement to hold specific qualifications as is the case for electricians and plumbers. |
| ii | What? | To be a member of CPA Australia you must: <ul style="list-style-type: none"> • have a relevant degree • have satisfactory, supervised work experience over a number of years • complete the CPA program, which usually takes three years • continue to have professional development after being admitted as a CPA. All of this continuous training ensures that members of CPA Australia offer the best and latest advice. |
| iii | When? | Accountants would be consulted when help or advice is required on a range of accounting, taxation, business planning and management issues. |
| iv | Where? | CPAs work in government departments, in the private sector in industry and commerce, and also as public accountants. |
| v | How? | If the expert help or advice of a trained professional accountant is required, a person with the designation 'CPA' should be chosen as this designation is protected. |
| vi | Other | Chartered accountant and member of the Institute of Chartered Accountants in Australia (ICAA). |

b

Word	Meaning
Mandatory	Compulsory
Auditing	The process of examining financial records and statements by a qualified accountant
Business plan	A plan detailing the establishment and all facets of operation of a business
Profitability	The position reached when revenues exceed expenses
Stability	The state where a firm is in a steady but profitable position
Equity funds	Money obtained by a company by selling its shares to institutions and members of the public
Stock	Inventory, goods for sale
Cash flow	Movement of cash both in and out of a business
Regimes	Systems
Compliance	Doing what is required or demanded
Corporations law	The law relating to companies
Designation	Unique, registered name

1.3

‘Warning: is your accountant an “accountant”?’

The public can ensure they are using the services of a qualified accountant by being familiar with the logos and designations of the major professional bodies. The public need to seek out accountants who are members of one of the three professional bodies. In this way, they have some assurance of the quality of service and advice they can expect. Anyone can call themselves an accountant. While, generally, a person who has completed further study and joined one of the professional bodies is likely to call themselves an accountant, there is no law that prevents anyone from ‘putting up their shingle’, calling themselves an accountant and offering their services to the public.

1.4

Research answer.

1.5

Survey answer.

1.6

In the Australian accounting profession, although accountants do similar work in all sectors, they can work in very different roles. Accountants may work in the private, public or government sectors. Private accountants are employed by enterprises and provide financial services to those enterprises. Public accountants offer independent, professional services to the public, particularly in the areas of taxation, audit and management advice. They may be employed by enterprises or may work independently. Government accountants are employed within the various levels of government institutions and provide financial services to this sector. The range of employment options for accountants today is more varied than ever, with the addition, to the traditional areas of auditing, taxation, cost accounting, finance and budgeting, of the newer services of management advice, information technology, e-business, international accounting and forensic accounting.

1.7

- a** Who? In order to become a forensic accountant you would be a university graduate who has met the requirements of the relevant body (for example CPA Australia or ICAA) in order to be admitted as a member; and then you would undertake training in the workplace in the area of forensic accounting.
- b** What? To give 'expert evidence' is to provide evidence as an expert witness in a court of law. This requires a high level of training in the field, if the person giving the information is to be considered an expert.
- c** When? They are required when an allegation of fraud or a claim for loss of profits has been made.
- d** Where? 'Forensic' comes from the same Latin root as the word 'forum'.
- e** Why? The parties to the divorce would usually have shared financial interests and may have been in a business firm together. The service of a forensic accountant may be needed to determine a value for a business in a marital court settlement.
- f** How? Technology assists the work of forensic accountants in the following ways:
- in research, particularly through the use of the internet
 - as a tool to help in organising figures, comparing results by tables or graphs.

1.8

'Integrity' is a quality where one is respected for their honesty and sincerity. A person who acts with integrity is likely to approach tasks in their professional life in a straightforward manner, always making ethical choices.

'Objectivity' is about acting with fairness and not allowing prejudice or bias to affect one's professional decision making.

1.9

Internet research answer.

1.10

Research answer.

1.11

The accounting entity assumption presumes that a business enterprise (entity) has an existence separate from the private affairs of its owner. This means that the owner and the business are separate and the owner's financial affairs do not appear in the accounting records of the business. The accounting perspective is therefore quite different from the legal perspective of the owner and the business.

1.12

- a** The accounting records apply the accounting entity assumption correctly because the personal financial affairs of Jane should be kept separate from the records of the business.
- b** The accounting entity assumption has not been followed in this instance. William should only record his owner's equity for the business as \$100 000 because his personal financial information of home ownership should not be recorded in the books of the business.
- c** The accounting entity assumption has not been followed in this instance. The value of a private vehicle should not be listed as an asset of the business.
- d** Daniel is correctly applying the accounting entity assumption when he lists the vehicle he brought into the business as part of his investment (owner's equity) in the firm. This vehicle belongs to the business as it is used in the operation of the entity.

1.13

To: s6211101@theschool.qld.edu.au
From: sophiemiley@bigpond.com
Subject: Missed class: accounting entity versus legal entity

Hi Alyssa,

The work you missed in accounting today was about the difference between an accounting entity and a legal entity. I'll try to catch you up!

The accounting assumption states that, for accounting purposes, the owner is treated as being an entity separate from that of the business. For accounting purposes, all businesses are considered to be accounting entities and, therefore, the personal financial transactions of the owner are not included in the records of the business. Thus, if a sole trader sold his own home, the sale would not be recorded in the accounts of the firm. Sole traders, partnerships and companies are all accounting entities.

However, when you consider the entity from the legal perspective, well, that's different.

In the eyes of the law, companies are considered to be legal entities, and so can enter into contracts, sue and be sued in the name of the company. Sole traders and partnerships are not legal entities, so the owners personally must enter into contracts and are personally liable for all of the debts of the business.

I hope this helps. It's all in the textbook, but give me a call if you need some more advice. I'll see you tomorrow at netball.

Sophie

1.14

A sole trader is a person who is the only owner of a business. One advantage of the sole trader organisation is that the set-up costs are much less than those incurred by the establishment of other types of organisation, such as a partnership or a company. The process of establishment is simple, with the only requirement being the registration of a firm's name if the sole trader does not wish to use his or her own name as the business name. Two of the major advantages of the sole trader organisation are that the owner can make all decisions and is entitled to all profits. The major disadvantage is the owners have unlimited liability. They are not recognised by law as separate legal entities, and so must enter into all contracts in their own names and are personally liable for all debts of the firm. If a business makes a loss, this too must be borne by the owner.

1.15

Business	Some possible trading goods
a Sports shop	Sporting equipment such as tennis racquets and cricket bats Sports clothes
b Bathroom renovation centre	Vanity basins, bath and spa tubs, cabinets
c Pet shop	Animals, birds, cages, pet toys
d Gardening centre	Plants, pots, soil, gardening implements, hoses
e Hardware store	Nails, nuts, bolts, tools, wire, electrical fittings, plumbing fittings, building materials, paints
f Stationery shop	Writing paper, copy paper, envelopes, folders, pens, account books, cardboard, printer cartridges
g Motor vehicle dealer	Motor vehicles
h Music store	Musical instruments, sheet music, CDs
i Electrical store	Electrical appliances such as refrigerators, washing machines, video recorders, CD players, television sets, kettles, electric frypans, and woks and hairdryers
j Hairdresser	Shampoo, conditioner, hair spray
k Sewing specialist	Sewing machines
l Surf shop	Surfboards, wet suits, clothing
m Fashion store	Clothes, shoes, hats, handbags

1.16

	Business	Some possible services
a	Sports shop	Aerobic exercise classes
b	Bathroom renovation centre	Design consultants
c	Pet shop	Vacation care for pets
d	Gardening centre	Landscaping advice
e	Hardware store	Handyman/building services
f	Stationery shop	Personalised stationery designed and printed
g	Motor vehicle dealer	Maintenance and regular service for vehicles
h	Music store	Music lessons
i	Electrical store	Installation services
j	Hairdresser	Cutting and styling hair
k	Sewing specialist	Dressmaking; repairs to garments
l	Surf shop	Maintenance of boards
m	Fashion store	Alterations to clothing

1.17

Owned by the business	Owed by the business	Owner's investment
Patent for new design of a light fitting	Amounts owing to other businesses	Owner's cash contribution
Bank account	Loan due to be repaid next year	
Cash in a petty cash tin	Loan from finance company	
Office equipment		
Holden ute (registration number: AAB-998)		
Office building		
Vacant block purchased for new store development		
Debentures in ZZZ Co.		
Amounts owing to the business		
Equipment		
Computerised security system		
Computer equipment		
Copyright of a musical score		
Newspaper masthead		
Cash in hand		
Float of cash held in a cash register		

1.18

- a** $O_e = A - L$
- b** O_e (owner's equity) represents the owner's investment in the business. This equals the net worth of the business. Net worth is calculated by subtracting liabilities (L) from assets (A).

1.19

What the business owns (assets) equals what it owes to external creditors (liabilities) plus what it owes back to the owner (owner's equity).

1.20

From: henry@bigpond.com.au
To: Zachary@oputushouse.com.au
Date: (Today's date)
Subject: Types of accounts and the accounting equation

I am sorry to hear you've been crook and hope that you'll be back at footy soon. As you are worried about the accounting you have missed, I am sending this email to give you the information we have covered to date. I hope you'll find it helpful.

We've learnt that the accounting entity assumption states that the records of the business should be kept separate from those of the owner. Consequently, the owner's investment in the business is recorded by the business as a debt which it must repay if the business closes. At the start of a business, therefore, we have an equation: $\text{Assets} = \text{Owner's equity}$. As the business grows and borrows money from creditors to purchase more assets, total assets will equal total liabilities (both those of external parties as well as the amount owed to the owner) and the equation is then extended to: $\text{Assets (A)} = \text{Liabilities (L)} + \text{Owner's equity (Oe)}$. This is known as the accounting equation. As with all equations, this equation can be expressed in more than one way:

- | | | |
|---|--------------|---------------------------------------------------------------------------------------------------|
| 1 | $A = L + Oe$ | Total assets equal total liabilities: both external liabilities (L) and internal liabilities (Oe) |
| 2 | $Oe = A - L$ | Owner's equity or the net worth of the business equals assets minus liabilities |
| 3 | $L = A - Oe$ | External liabilities equal total assets minus owner's equity |

We've learnt that there are five types of account: asset, liability, owner's equity, revenue and expense. An account is a record of all transactions relating to one item, for example to cash in a bank account. Summarising like transactions into one record provides management with useful information for the day-to-day operation of the business, for example the amount of cash in our bank account, or how much we owe a specific accounts payable.

Next the five types of account were explained to us. Assets are items owned by a business, for example motor vehicles, furniture, machinery and inventories. Liabilities are the debts owed by the business such as accounts payable, loans and mortgages. The owner's investment in the business is called owner's equity. The inflow of resources into the business (income) is recorded in revenue accounts such as sales, rent revenue, commission revenue and interest revenue. The costs incurred in earning this revenue are recorded in expense accounts. Examples of expense accounts are cost of goods sold, electricity, telephone, postage and wages.

These are all the concepts that you have missed. I hope that you now understand the types of account and the accounting equation.

Hope to see you back at school soon!

Henry

1.21

Assets		=	Liabilities		+	Owner's equity	
Account	Amount \$		Account	Amount \$		Account	Amount \$
a Bank	33 000	=			+	Capital	33 000
b Bank	163 000	=	Good Lending Bank Ltd	130 000	+	Capital	33 000
c Bank	63 000	=	Good Lending Bank Ltd	130 000	+	Capital	33 000
Freehold premises	100 000						
	<u>163 000</u>	=		<u>130 000</u>	+		<u>33 000</u>
d Bank	63 000	=	Good Lending Bank Ltd	130 000	+	Capital	33 000
Freehold premises	100 000		Aussie Technical Pty Ltd	12 000			
Video equipment	12 000						
	<u>175 000</u>	=		<u>142 000</u>	+		<u>33 000</u>
e Bank	63 000	=	Good Lending Bank Ltd	130 000	+	Capital	33 000
Freehold premises	100 000		Aussie Technical Pty Ltd	12 000			
Video equipment	12 000		Mackay Furniture	10 000			
Furniture	10 000						
	<u>185 000</u>	=		<u>152 000</u>	+		<u>33 000</u>
f Bank	68 000	=	Good Lending Bank Ltd	130 000	+	Capital	53 000
Freehold premises	100 000		Aussie Technical Pty Ltd	12 000			
Video equipment	12 000		Mackay Furniture	10 000			
Furniture	10 000						
Vehicle	15 000						
	<u>205 000</u>	=		<u>152 000</u>	+		<u>53 000</u>
g Cash at bank	60 000	=	Good Lending Bank Ltd	130 000	+	Capital	53 000
Freehold premises	100 000		Aussie Technical Pty Ltd	12 000			
Video equipment	12 000		Mackay Furniture	10 000			
Furniture	10 000						
Vehicle	15 000						
Computer equipment	8 000						
	<u>205 000</u>	=		<u>152 000</u>	+		<u>53 000</u>

1.22

	Assets \$	=	Liabilities \$	+	Owner's equity \$
a	8 000	=	6 000	+	2 000
b	50 000	=	0	+	50 000
c	780 000	=	80 000	+	700 000
d	650 000	=	150 000	+	500 000
e	456 900	=	0	+	456 900
f	100 000	=	43 000	+	57 000
g	256 000	=	78 000	+	178 000
h	87 000	=	70 800	+	16 200
i	135 500	=	50 000	+	85 500
j	755 000	=	600 000	+	155 000
k	78 800	=	55 100	+	23 700
l	728 600	=	453 100	+	275 500

1.23

- a Owner invested \$20 000 cash into the business.
- b Bank lent the business \$82 000 cash.
- c Paid accounts payable \$25 000.
- d Bought furniture for cash \$10 000.
- e Bought equipment worth \$35 000 on credit. An initial payment of \$15 000 was made so that \$20 000 remains owing to accounts payable.
- f Sold furniture on credit \$12 000.
- g Bought land for cash \$90 000.
- h Bought bonds for cash \$50 000.
- i Withdrew \$30 000 cash from the bank account and placed it in a Cash management fund.
- j Owner introduced the following assets into the business: furniture \$30 000, accounts receivable \$10 000, equipment \$50 000 and motor vehicle \$40 000.

1.24

Transaction	Accounts involved	Increase or decrease?	Dr or Cr
a J Wong begins business by depositing \$20 000 cash into a bank account for the business	Bank Capital, J Wong	Increase Increase	Dr Cr
b Bought furniture and fittings for the business on credit from Fitters Fit Ltd for \$12 000	Furniture and fittings Accounts payable (Fitters Fit Ltd)	Increase Increase	Dr Cr
c Paid cash for office equipment \$4 900	Bank Office equipment	Decrease Increase	Cr Dr
d Borrowed cash from ANX Banking Corp \$40 000	Bank ANX Banking Corp	Increase Increase	Dr Cr
e Purchased a vehicle for the business valued at \$39 900 and paid by cheque (cash)	Vehicle Bank	Increase Decrease	Dr Cr
f Bought land valued at \$190 000. Organised a mortgage for this purchase from ANX Banking Corp	Land Mortgage	Increase Increase	Dr Cr
g J Wong contributed another \$40 000 to the business	Bank Capital, J Wong	Increase Increase	Dr Cr

1.25

Jean's Bridal Boutique

Date	Transaction	Accounts involved	Account type	Nature of the account	Inc. or dec.	Same or opposite to nature?	Debit \$	Credit \$
2007								
Mar 4	Jean deposited \$150 000 cash into a bank account to begin business	<i>Bank Capital – J Phillips</i>	A Oe	Dr Cr	Inc. Inc.	Same Same	150 000	150 000
11	Paid cash for equipment for sewing \$15 000	<i>Equipment Bank</i>	A A	Dr Dr	Inc. Dec.	Same Opp.	15 000	15 000
12	Borrowed 100% of the value of premises worth \$200 000 from Resi Business Loans	<i>Bank Resi Business Loans</i>	A L	Dr Cr	Inc. Inc.	Same Same	200 000	200 000
16	Finalised contract for premises and signed a cheque for \$200 000	<i>Premises Bank</i>	A A	Dr Dr	Inc. Dec.	Same Opp.	200 000	200 000
19	Purchased motor vehicle on credit from Mooloolaba Motors \$45 000	<i>Motor vehicle Accounts payable – Mooloolaba Motors</i>	A L	Dr Cr	Inc. Inc.	Same Same	45 000	45 000
27	Paid North Coast Fitters \$10 000 for Display fittings and fixtures	<i>Display fittings and fixtures Bank</i>	A A	Dr Dr	Inc. Dec.	Same Opp.	10 000	10 000
30	Withdrew \$200 from the bank to use as business's float. Record as cash on hand	<i>Bank Cash on hand</i>	A A	Dr Dr	Dec. Inc.	Opp. Same	200	200
31	Invested some residual cash reserves of \$10 000 into debentures in Holey Kow Company	<i>Debentures – Holey Kow Company Bank</i>	A A	Dr Dr	Inc. Dec.	Same Opp.	10 000	10 000

1.26

Answer	Workings																		
a At 31 March, Jean has \$114 800 in the firm's bank account	<table> <tr> <td><i>Debits</i></td> <td><i>less</i></td> <td><i>Credits</i></td> </tr> <tr> <td>\$150 000</td> <td></td> <td>\$15 000</td> </tr> <tr> <td>\$200 000</td> <td></td> <td>\$200 000</td> </tr> <tr> <td></td> <td></td> <td>\$10 000</td> </tr> <tr> <td></td> <td></td> <td>\$200</td> </tr> <tr> <td></td> <td></td> <td>\$10 000</td> </tr> </table>	<i>Debits</i>	<i>less</i>	<i>Credits</i>	\$150 000		\$15 000	\$200 000		\$200 000			\$10 000			\$200			\$10 000
<i>Debits</i>	<i>less</i>	<i>Credits</i>																	
\$150 000		\$15 000																	
\$200 000		\$200 000																	
		\$10 000																	
		\$200																	
		\$10 000																	
b Premises and motor vehicle																			
c Jean's sources of finance have been a loan from Resi Business Loans and credit extended by Mooloolaba Motors																			
d Price = net worth + \$30 000																			
	= Owner's equity + \$30 000																		
	= \$150 000 + 30 000 = \$180 000																		

1.27

E Duncan

Date	Accounts involved	Account type	Nature of the account	Inc. or dec.	Same or opposite to nature?	Debit \$	Credit \$
2007							
Feb 2	Accounts receivable – T Chapman Premises Equipment Furniture Accounts payable – Y Salton Mortgage on premises Capital – E Duncan	A A A A L L Oe	Dr Dr Dr Dr Cr Cr Cr	Inc. Inc. Inc. Inc. Inc. Inc. Inc.	same same same same same same same	20 000 180 000 5 000 12 000	35 000 64 000 118 000
4	Bank Loan from National Bank	A L	Dr Cr	Inc. Inc.	same same	120 000	120 000
11	Motor vehicle Bank	A A	Dr Dr	Inc. Dec.	same opposite	45 000	45 000
18	Equipment Accounts payable – J Hogan	A L	Dr Cr	Inc. Inc.	same same	22 000	22 000
27	No transaction would be recorded, because the property is not for use in the business						

1.28

Gerard O'Dempsey

Date	Accounts involved	Account type	Nature of the account	Inc. or dec.	Same or opposite to nature?	Debit \$	Credit \$
2007							
May 4	Motor vehicle Bank Capital G O'Dempsey	A A Oe	Dr Dr Cr	Inc. Inc. Inc.	Same Same Same	24 900 40 000	64 900
5	Motor vehicle Accounts payable – Great Deals Pty Ltd Bank	A L A	Dr Cr Dr	Inc. Inc. Dec.	Same Same Opp	25 000	19 500 5 500
9	Bank Loan from S Puri	A L	Dr Cr	Inc. Inc.	Same Same	150 000	150 000
14	Equipment Accounts payable – AWA Markets Pty Ltd	A L	Dr Cr	Inc. Inc.	Same Same	11 000	11 000
23	Accounts payable – Great Deals Pty Ltd Bank	L A	Cr Dr	Dec. Dec.	Opposite Opposite	19 500	19 500

1.29

Ebony Berrell

Date	Accounts involved	Account type	Nature of the account	Inc or dec	Same or opposite to nature?	Debit \$	Credit \$
2007							
Mar 2	Accounts receivable – M Smeltzer	A	Dr	Inc.	Same	200 000	
	Accounts payable – A Petoulis	L	Cr	Inc.	Same		350 000
	Land and buildings	A	Dr	Inc.	Same	560 000	
	Mortgage on land and buildings	L	Cr	Inc.	Same		460 000
	Furniture and fittings	A	Dr	Inc.	Same	350 000	
	Equipment	A	Dr	Inc.	Same	312 000	
	Capital – E Berrell	Oe	Cr	Inc.	Same		612 000
4	Bank	A	Dr	Inc.	Same	1 000 000	
	Loan from Good Onya Finance Co.	L	Cr	Inc.	Same		1 000 000
18	Furniture	A	Dr	Inc.	Same	125 000	
	Accounts payable – J Malone	L	Cr	Inc.	Same		125 000
20	Motor vehicle	A	Dr	Inc.	Same	58 000	
	Bank	A	Dr	Dec.	Opposite		10 000
	Accounts payable – Ciaran's Car Sales	L	Cr	Inc.	Same		48 000
27	No entry would be made because the transaction is not related to the business						
31	Land and buildings	A	Dr	Inc.	Same	250 000	
	Bank	A	Dr	Inc.	Same	125 000	
	Capital – E Berrell	Oe	Cr	Inc.	Same		375 000

1.30

K Treeby

Revenue	Expense	Asset	Liability	Owner's equity
Consultancy fees	Motor vehicle registration	Computer	Bank loan	Drawings
	Rent of premises	Cash in hand	Bank overdraft	
	Wages of personal assistant	Motor vehicle		
	Postage	Accounts receivable – A Williams		

1.31

- a Bank increase; fees revenue increase
- b Rent revenue increase; bank increase
- c C Rollings increase; sales revenue increase
- d Supplies expense increase; Big Top Stationery increase
- e P Pope increase; furniture decrease
- f Bank increase; bank loan increase
- g Drawings increase; bank decrease
- h Wages increase; bank decrease

1.32

- a Accounts receivable are clients who owe the firm money. Accounts payable are suppliers to whom the firm owes money.
- b Capital is the owner's investment in the business and may consist of cash and other assets such as a motor vehicle. It is increased by profits and reduced by losses. Bank is the actual cash in the firm's bank account.
- c Motor vehicle is an asset and will aid in earning revenue for several years. Motor vehicle expenses do not provide the firm with an asset or with an addition to any asset, but represent an outgoing which is consumed in the current accounting period.
- d A bank loan is the principal of the amount lent by the bank and is a liability to the firm because it usually does not have to be repaid for several years. Interest is the charge made by the bank to provide this loan and is an expense because it is a cost incurred for borrowing the money which must be paid at regular intervals.
- e Sales revenue is obtained by selling goods which had been purchased for the purpose of resale at a profit. Fees revenue is earned by providing a service such as delivery of goods, painting of premises, and vehicle maintenance.

1.33

	Name of business	Nature of business	Name of major revenue source	Possible expense
a	Balanced Educational Toys Company	Trading	Sales of toys	Purchases of toys
b	Mowers R Us	Trading	Sales of mowers	Advertising
c	Lynch Crane Hire Service	Service	Hire fees revenue	Maintenance
d	Southside Beauty	Service/trading	Service revenue	Purchases of supplies
e	K P Meaney – Accountant	Service	Service revenue	Stationery
f	S Sylvania & Associates Lawyers	Service	Service revenue	Telephone
g	Toowong Orthodontic Practice	Service	Dental fees revenue	Purchase of dental supplies
h	Ooloomooloo Veterinary Practice	Service	Service revenue	Purchases of medical supplies
i	Madeleine's Medical Supplies	Trading	Sales	Wages of sales assistants
j	Goode-O Car Sales	Trading	Sales	Car detailing
k	Johnston and Johnston Employment Consultancy	Service	Service revenue	Rent of premises
l	'Woodora' Horse Stud Farm	Trading	Sales	Veterinary expenses

1.34

Double-entry bookkeeping does not mean that the same accounts are written down twice. It means that for each transaction recorded, the total of the amounts entered on the debit side must equal the total entered on the credit side. For example, if a business buys furniture for \$900 from R Totty and pays a deposit of \$200, the debit would be Furniture for \$900 and the two credit entries would be Accounts payable – R Totty \$700 and Bank \$200 – a total credit of \$900. Your misconception has been based on a layman's understanding of the words 'double' and 'entry' because in accounting terminology the words 'double entry' have a very special meaning. A fundamental accounting concept, the accounting entity assumption, states that the personal records of the owner must be kept separate from the records of the business. This assumption led to a fundamental principle: the accounting equation. The concept of double entry is derived from the accounting equation:

$$A = L + Oe$$

Any change in one side of the equation must result in a corresponding change in the other side, and since assets are of a debit nature, whereas liabilities and owner's equity are of a credit nature, total debits must always equal total credits. Therefore, each transaction must affect at least two elements of the equation, resulting in the recording of a debit and credit. I can see how you could be confused by the term 'double entry', because the same account is not written twice, but two different accounts are recorded, one debit and one credit.

1.35

- | | |
|----------|----------|
| a Debit | e Credit |
| b Credit | f Debit |
| c Debit | g Debit |
| d Credit | h Credit |

1.36

(Today's date)

Mr Scott Patterson
235 Cambridge Parade
MANLY QLD 4179

Dear Scott

Thank you for your letter. I am pleased to note that you understand the relationship between assets, liabilities, owner's equity and the accounting equation. The other two types of account are revenue accounts and expense accounts.

Revenues are income earned by a business and expenses are the costs incurred in earning this revenue in the normal operations of an entity. For example, if a business was set up to hire videos to members of the public, the hiring fees received would be revenue to the business, and the rent of the premises and wages of employees would be costs incurred in earning this revenue. As the owner of the business is entitled to all income and is responsible for all costs, revenue will increase owner's equity and expenses will decrease it. Revenue and expenses therefore impact on the accounting equation by increasing or decreasing the element, owner's equity.

I hope that this explanation has answered the question asked in your letter and has given you an understanding of revenue and expense accounts and their impact on the accounting equation.

Yours faithfully

Shevaun Shaw

Additional solutions A1.1 to A1.19