

***ALL* Accounting Formats and Formulas**

For 2026 Candidates sitting for O Level or IGCSE

Accounting 7707 and 0452

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Partnerships:

Partnership Appropriation Account

Detail	\$	\$	\$
Net profit			XXXX
Add interest on drawings: Partner A			XXXX
		Partner B	XXXX
Less interest on capital: Partner A			(XXXX)
		Partner B	(XXXX)
Less Partners salary: Partner A			(XXXX)
Profit to be shared			XXXX

Current Account

Detail	A	B	Detail	A	B
Balance b/d	XXX	XXX	Balance b/d	XXX	XXX
Drawings	XXX	XXX	Interest on capital	XXX	XXX
Interest on drawings	XXX	XXX	Salary	XXX	XXX
Loss	XXX	XXX	Profit	XXX	XXX
Balance c/d	XXX	XXX	Balance c/d	XXX	XXX

Control Accounts:

Sales ledger control Account	
Balance b/d	
Credit Sales	Return in
Interest charged to customer	Discount allowed
Dishonored cheque	Bank
	Bad debt
	Transfer/Set off
	Balance c/d
Purchase ledger control Account	
Discount received	Balance b/d
Bank	Credit Purchase
Return out	Interest charged by suppliers
Transfer/Set off	
Balance c/d	

Limited Company:

Statement of changes in equity (Limited companies)							
	Preference Share capital \$	Ordinary Share capital \$	Share premium \$	Revaluation reserve \$	General Reserve \$	Retained earnings \$	Total \$
Balance at start	XX	XX	XX	XX	XX	XX	XX
of year							
Share issue	XX	XX	XX				XX
Profit for the						XX	XX
year							
Revaluation				XX			XX
Transfer to					XX	(XX)	---
Reserve							
Preference						(XX)	(XX)
Dividends paid							
Ordinary						(XX)	(XX)
Dividends paid							
Balance at end	XX	XX	XX	XX	XX	XX	XX
of the year							

Balance Sheet (Limited Companies)

Appendix 2 – Alternative format for statement of financial position (Balance Sheet)

Statement of financial position as at

	\$m	\$m
ASSETS		
Non current assets:		
Property, plant and equipment	x	
Goodwill	x	
Investments	x	
	x	x
Current assets		
Inventories	x	
Trade and other receivables	x	
Prepayments	x	
Cash	x	
	x	x
Total assets		\$
EQUITY AND LIABILITIES		
Capital and reserves		
Issued capital	x	
Reserves	x	
Accumulated profits	x	
	x	x
Non current liabilities		
Loan notes		x
Current liabilities		
Trade and other payables	x	
Overdrafts	x	
Proposed dividends	x	
Tax provision	x	
		x
Total equity and liabilities		\$

Subscription Account

Balance b/d (Owing)	Balance b/d (Prepaid)
Income and Expenditure	Bank
Balance c/d (Prepaid)	Bad Debt
Balance c/d (Owing)	Balance c/d (Owing)

Trial Balance:

Detail	Debit	Credit
Capital		XXX
Drawings	XXX	
Incomes		XXX
Expenditure	XXX	
Revenue		XXX
Purchase	XXX	
Sales return	XXX	
Inventory	XXX	
Bankoverdraft		XXX
Trade Receivables	XXX	
Trade payable		XXX
General Exp	XXX	
Non-Current Assets	XXX	
Commission Received		XXX

Capital Account

Net Loss	Balance b/d
Drawings	Net profit
Balance c/d	Additional Capital
	Bank/Cash

Income Account

Balance b/d owing	Balance b/d advance
IS	Bank
Balance c/d advance	Balance b/d owing

Expense Account

Balance b/d advance	Balance b/d owing
Bank	IS
Balance c/d owing	Balance c/d advance

Manufacturing:

Manufacturing Account

Opening Stock of raw materials	XXX
Add purchase of raw materials	XXX
Add carriage in of raw materials	XXX
Less return out of raw materials	(XXX)
Less goods drawings of raw materials	(XXX)
Less Closing stock of raw materials	(XXX)
<hr/>	
Cost or Raw materials consumed	XXX
Add direct labor	XXX
Add direct expense	XXX
<hr/>	
Prime cost	XXX
Add factory overheads	XXX
Add depreciation	XXX
Add opening work in work in progress	XXX
Less closing work in progress	(XXX)
<hr/>	
Cost of production	XXX

The **income statement (trading and profit and loss account of a manufacturing business)** follows the same format as that of any other form of business, except that the trading account section includes the production cost of goods completed. The profit and loss section includes only office, selling and financial expenses

Name of manufacturing business			
Income Statement (Trading Account) for the year ended			
	\$	\$	\$
Sales			xxxx
Less Cost of sales			
Opening inventory (stock) of finished goods		xxxx	
Production cost of goods completed		xxxx	
Purchases of finished goods		<u>xxxx</u>	
		xxxx	
Less Closing inventory (stock) of finished goods		<u>xxxx</u>	<u>xxxx</u>
Gross profit			<u>xxxx</u>

The **balance sheet** of a manufacturing business follows the same format as that of any other business; however there may be three stocks rather than one.

Irrecoverable Debts :

Bad Debt	
Various Debtors	IS
Provision for Bad Debt	
Is (Decrease) Balance c/d	Balance b/d IS (Increase

Bank Reconciliation Statements and Updated Cash books

DR	Amended Cash Book	CR
	\$	\$
*Balance b/f (Cash at bank)	***	*Balance b/f (Bank overdraft) ***
Credit transfer	***	Standing order ***
Dividend received	***	Direct debit ***
Interest recieved	***	Bank charges ***
*Balance c/d (Bank overdraft)	***	Interest on overdraft ***
		Dishonoured cheque ***
		*Balance c/d (Cash at bank) ***
	***	***
*Balance b/d (Cash at bank)	***	*Balance b/d (Bank overdraft) ***

Bank Reconciliation Statement:

Method 1- Start with Bank Statement Balance

Balance as per bank statement (Debit – Negative / Credit – Positive)	***
Add Uncredited cheque / Lodgements	***
Less Unpresented cheque	(***)
Balance as per amended cash book	***

Method 2- Start with Updated Cash book Balance

Balance as per amended cash book	***
Less Uncredited cheque / lodgements	(***)
Add Unpresented cheque	***
Balance as per bank statement (Debit – Negative / Credit – Positive)	***

Sole Trader Income Statements and Balance Sheets:

(a) Financial Statements (Final Accounts) of a Sole Trader – Trading business

Sole Trader (Name)
Income Statement (Trading and Profit and Loss Account)
 for the year ended

	\$	\$	\$
Revenue (sales)			XXXX
Less Sales returns			<u>XXXX</u>
			XXXX
Less Cost of sales			
Inventory (opening stock)		XXXX	
Purchases	XXXX		
Less Purchases returns	<u>XXXX</u>		
	XXXX		
Less Goods for own use	<u>XXXX</u>		
	XXXX		
Carriage inwards	<u>XXXX</u>	<u>XXXX</u>	
		XXXX	
Less Inventory (closing stock)		<u>XXXX</u>	<u>XXXX</u>
Gross profit			XXXX
Add Other income			
Discount received			XXXX
Rent received			XXXX
Commission received			XXXX
*Profit on disposal of non-current (fixed) assets			XXXX
**Reduction in provision for doubtful debts			<u>XXXX</u>
			XXXX
Less Expenses			
Wages and salaries		XXXX	
Office expenses		XXXX	
Rent and rates		XXXX	
Insurance		XXXX	
Office expenses		XXXX	
Motor vehicle expenses		XXXX	
Selling expenses		XXXX	
Loan interest		XXXX	
*Loss on disposal of non-current (fixed) assets		XXXX	
**Provision for doubtful debts		XXXX	
Depreciation of fixtures and fittings		XXXX	
Depreciation of office equipment		XXXX	
Depreciation of motor vehicles		<u>XXXX</u>	<u>XXXX</u>
***Profit for the year (Net profit)			<u>XXXX</u>

- * If only one asset was sold during the year only one of these items will appear
- ** If the provision reduces, the surplus amount is added to the gross profit: if the provision increases, the amount required is included in the expenses
- *** If the expenses exceed the gross profit plus other income the resulting figure is described as a loss for the year (net loss)

Sole Trader (Name)
Balance Sheet at

	\$ Cost	\$ Depreciation to date	\$ Book value
Non-current (Fixed) assets			
Land and buildings	XXXX		XXXX
Fixtures and fittings	XXXX	XXXX	XXXX
Office equipment	XXXX	XXXX	XXXX
Motor vehicles	<u>XXXX</u>	<u>XXXX</u>	<u>XXXX</u>
	<u>XXXX</u>	<u>XXXX</u>	<u>XXXX</u>
Current assets			
Inventory (Stock)		XXXX	
Trade receivables (Debtors)	XXXX		
Less Provision for doubtful debts	<u>XXXX</u>	XXXX	
Other receivables (Prepayments)		XXXX	
Other receivables (Accrued income)		XXXX	
*Cash equivalents (Bank)		XXXX	
Cash		<u>XXXX</u>	
		XXXX	
Current liabilities			
Trade payables (Creditors)	XXXX		
Other payables (Accruals)	XXXX		
Prepaid income	XXXX		
*Bank overdraft	<u>XXXX</u>	<u>XXXX</u>	
Net current assets (Working capital)			<u>XXXX</u>
			XXXX
Less Non-current liabilities (Long term liabilities)			
Loan			<u>XXXX</u>
			<u>XXXX</u>
Financed by Equity (Capital)			
Opening balance			XXXX
**Plus Profit for the year (Net profit)			<u>XXXX</u>
			XXXX
Less Drawings			<u>XXXX</u>
			<u>XXXX</u>

* If the business has only one bank account only one of these items will appear
 ** If there is a loss for the year (net loss) this will be deducted rather than added

INCOME STATEMENT EXTRACT

Gross Profit	XYZ	
Add: Decrease in allowance for doubtful debts (Other Income)		<u>XYZ</u>
	XYZ	
Less: <u>Expenses:</u>		
Bad debts expense (if any)	(XYZ)	
Increase in allowance for doubtful debts (Expense)		<u>(XYZ)</u>
XXX		
Profit for the year	<u>XYZ</u>	

BALANCE SHEET EXTRACT

<u>Current Assets</u>		
Trade receivable		XYZ
Less: Provision for doubtful debts		<u>(XYZ)</u>
XYZ		
Net Receivables		<u>XYZ</u>

Service Business:

(b) Financial Statements (Final Accounts) of a Sole Trader – Service business

Sole Trader (Name)			
Income Statement (Profit and Loss Account)			
for the year ended			
	\$	\$	\$
Fees received			XXXX
Commission received			XXXX
Rent received			XXXX
Discount received			XXXX
*Profit on disposal of non-current (fixed) assets			XXXX
**Reduction in provision for doubtful debts			<u>XXXX</u>
			XXXX
Less Expenses			
Wages and salaries		XXXX	
Office expenses		XXXX	
Rent and rates		XXXX	
Insurance		XXXX	
Office expenses		XXXX	
Motor vehicle expenses		XXXX	
Selling expenses		XXXX	
Loan interest		XXXX	
Bad debts			
*Loss on disposal of fixed assets		XXXX	
**Provision for doubtful debts		XXXX	
Depreciation of fixtures and fittings		XXXX	
Depreciation of office equipment		XXXX	
Depreciation of motor vehicles		<u>XXXX</u>	<u>XXXX</u>
***Profit for the year (Net profit)			<u>XXXX</u>

* If only one asset was sold during the year only one of these items will appear

** If the provision reduces the surplus amount is added to the gross profit: if the provision increases the amount required is included in the expenses

*** If the expenses exceed the gross profit plus other income the resulting figure is described as a loss for the year (net loss)

The **balance sheet** of a sole trader in the service sector is presented in the same format as the balance sheet of a sole trader involved in a trading business.

Clubs and Societies / Non Trading Business:

(e) Financial Statements (Final Accounts) of a non-trading organisation

A summary of the cash book, known as a **receipts and payments account**, is prepared by the treasurer of a non trading organisation. All money received is shown on the debit side and all money paid out on the credit side. It is balanced in the same way as a cash account. A **trading account** may be prepared if a shop or café etc is operated by the organisation.

Non-trading Organisation (Name)			
Shop Trading Account for the year ended			
	\$	\$	\$
Sales			XXXX
Less Cost of sales			
Opening inventory (stock)		XXXX	
Purchases		XXXX	
		<u>XXXX</u>	
Less Closing inventory (stock)		<u>XXXX</u>	
Cost of goods sold		XXXX	
Add Shop expenses			
Wages of shop assistant	XXXX		
Shop rent and rates	XXXX		
Depreciation of shop fittings	<u>XXXX</u>	<u>XXXX</u>	<u>XXXX</u>
Profit on shop			<u>XXXX</u>

An **income and expenditure account** is also prepared - the equivalent of the profit and loss account of a business. The expenses of the organisation are deducted from the revenue and the resulting figure is a surplus or deficit, rather than a profit or loss.

Non-trading Organisation (Name)			
Income and Expenditure Account for the year ended			
	\$	\$	\$
Income			
Subscriptions			XXXX
Profit on shop			
Competition – entrance fees		XXXX	
less expenses		<u>XXXX</u>	<u>XXXX</u>
Interest received			XXXX
*Profit on disposal of non-current (fixed) assets			<u>XXXX</u>
			XXXX
Expenditure			
General expenses		XXXX	
Rates and insurance		XXXX	
Repairs and maintenance		XXXX	
Loan interest		XXXX	
*Loss on disposal of non-current (fixed) assets		XXXX	
Depreciation of equipment		<u>XXXX</u>	<u>XXXX</u>
**Surplus for the year			<u>XXXX</u>

* If only one asset was sold during the year only one of these items will appear
 ** If the expenditure exceeds the income the resulting figure is described as a deficit

OPENING ACCUMULATED FUND

	\$	\$
OPENING ASSETS		
Cash / Bank	XYZ	
Inventory of refreshment	XYZ	
Equipment	XYZ	
Subscription in arrears	XYZ	
Prepaid Expense	XYZ	

Premises	XYZ	XYZ
Less: OPENING LIABILITIES		
Subscription in advance	XYZ	
Accrued/Owings to supplier	XYZ	
Overdraft / Loan	XYZ	(XYZ)
Opening Accumulated fund		XYZ

Statement of Financial Position as at 31 December 2022

Assets	\$	\$	\$
Non-Current Assets	Cost	Acc Dep	NBV
Land	XYZ	-	XX
Building	XYZ	(XX)	XX
Equipment	XYZ	(XX)	XX
			XYZ
Current Assets			
Inventory		XYZ	
Subscriptions in Arreas / Owing	XYZ	XYZ	
Prepaid Expense		XYZ	
Bank		XYZ	
Cash		XYZ	XYZ
Total Assets			XYZ
Total Liabilities			
Opening Accumulated Fund		XYZ	
Add Surplus / Less (Defecit)		XX/(XX)	
Add: Donations (Capital) / Legacy / Gift		(XYZ)	
Add: Long term loan etc		XYZ	XYZ
Current Liabilities			
Trade payables / Creditors		XYZ	
Bank O/D (Over Draft)		XYZ	
Accrued Expenses		XYZ	
Subscriptions Advance / Prepaid		XYZ	XYZ
Total Liabilities			XYZ

The first section of the **balance sheet of a non-trading organisation** follows the same format as that of a sole trader. The second section of the balance sheet has to be modified so that it shows the accumulated fund and the surplus or deficit.

Non-trading Organisation (Name)			
Extract from Balance Sheet at			
	\$	\$	\$
Accumulated fund			
Opening balance			XXXX
*Plus surplus for the year			<u>XXXX</u>
			<u>XXXX</u>

* If there is a deficit this will be deducted from the accumulated fund

ERRORS AND SUSPENSE:

Important rules to keep in mind:

<u>DOUBLE ENTRY FOR DEPRECIATION</u>		
Income statement	xyz	
Provision for depreciation		xyz
(To record the depreciation expenses for the year)		
<u>DISPOSAL ENTRIES</u>		
1) To write off cost of an asset		
Disposal account	xyz	
Machine/Vehicle/Equipment		xyz
(To write off an assets account on its disposal)		
2) To write off total depreciation charged from the date of purchase to date of sale.		
Accumulated Dep / Provision for depreciation	xyz	
Disposal Account		xyz
(To write off the total deprecation of the asset sold)		
3) To record the cash or cheque receipt on disposal		
Cash/Bank/Debtor		xyz
Disposal account	xyz	
(To record the cash or cheque received on sale)		
4) To record the Gain or loss on disposal (Gain Entry)		
Disposal Account	xyz	
Income Statement (Gain)		xyz
(To record the gain on disposal)		
(Loss Entry)		
Income Statement (Loss)	xyz	
Disposal Account		xyz
(To record the loss on Disposal)		

!Only Put Suspense if the question says :

“XYZ Has decided to create a Suspense Account”

Otherwise follow the rules above ↑

There are two types of categories of errors:

- (1) Effecting trial balance
- (2) Not effecting trial balance

Errors not effecting trial balance

There are seven errors which does not affect trial balance

Error of Omission – the transaction is completely omitted from the books

Error of Commission – the error is made between two items on the same side either debit or credit

Error of Original entry – the total amount of the transaction is being made wrong on both debit and credit sides

Error of reversal entry – it is when the debit transaction is being made credit and credit as debit – in this case double the amount to correct the transaction

Compensating Error – It is when two errors on opposite sides cancel each other

Error of Principles – When asset is taken as expense or liability is taken as income.

Errors effecting trial balance – When an error is single sided, it will effect the accuracy of trial balance.

Open a suspense account – post the difference in trial balance on the smaller side with respect of trial balance, and post the transactions of correction

Statement of Corrected profit for the year

- Start from profit before correction (CR)
- Add sales and income (CR)
- Less expenses (DR)
- Result will be profit after correction

Depreciation and Disposal Accounts:

Asset Account (Equipment / Machine / Vehicle / Building)

Opening balance b/d	xxx	Disposal	xxx
Bank / Liability (Addition)	<u>xxx</u>	Closing balance c/d	<u>xxx</u>
	xxx		xxx
Opening balance b/d	xxx		

Provision for Dep / Accumulated Dep (Machine / Vehicle / Building)

Disposal	xyz	Opening balance b/d	xyz
Closing balance c/d	<u>xyz</u>	Income Statement	
	xyz	(Current Year Depreciation)	<u>xyz</u>
			xyz Opening
		balance b/d	xyz

Disposal Account

(Machine / Vehicle / Building)	xyz	Provision for Dep / Acc Dep	xyz
Income Statement (Gain)	<u>xyz</u>	Bank / Cash / Debtor	xyz
	xyz	Income Statement (Loss)	<u>xyz</u>
			xyz

Inventory Valuation:

Cost & Net Realisable Value

What is the cost and net realisable value of inventory?

- The **cost** of inventory is the **total cost** to the business of **obtaining goods**
 - The **purchase cost** of the goods
 - **Plus** the cost for **carriage inwards**
- The **net realisable value** (NRV) of inventory is the net amount the business is **likely to receive** when **selling the goods**
 - The **selling price** of the inventory
 - **Minus** any **selling expenses**
 - Such as the cost of repairing damaged goods

What is the basis for the valuation of inventory?

- Inventory is valued at the **lower value** between:
 - The cost
 - The net realisable value
- This method of valuation complies with the **accounting principle of prudence**
 - The value of the **inventory** (asset) is **not overstated**
 - The **profit** is **not overstated**
- For **most** inventory, the **cost will be the lower of these values**; however, there are some exceptions
 - **Damaged goods** might need to be **repaired before they can be sold**
 - Goods that are **close to their expiration date** might need to be **sold at a lower price**
 - The business might use **lower prices to promote new products**

Capital and Revenue Expenditure:

Capital Expenditure

What is capital expenditure?

- **Capital expenditure** is **money** that is **spent** on **non-current assets** for the long-term benefit of the business
- Capital expenditure includes:
 - The **purchase** of non-current assets
 - The **delivery** of non-current assets
 - The **installation** of non-current assets
 - The **legal costs** incurred with the non-current asset purchases
 - The **decoration** of new non-current assets
 - The **extension** of non-current assets
 - e.g. increasing the size of a storage warehouse
- Capital expenditure is included in the **statement of financial position** under the **non-current assets** section
 - It is **not included** in the **income statement**

Revenue Expenditure

What is revenue expenditure?

- **Revenue expenditure** is **money** that is **spent** on the **day-to-day running costs** of the business
- Revenue expenditure includes:
 - The **purchase of goods** for resale
 - **General expenses**
 - **Insurance**
 - **Training costs**
 - **Repairs** of non-current assets
 - **Redecoration** of existing non-current assets

Effects of Incorrect Treatment of Expenditure:

What happens when you incorrectly treat **Capital Expenditure** as **Revenue Expenditure**?

Incorrectly treating capital expenditure as revenue expenditure will affect the financial statements

- It will incorrectly appear as an expense on the income statement.
- The expenses will therefore be overstated.
- This means the profit for the year will be understated.
- It will not appear as a non-current asset on the statement of financial position.
- The non-current assets will therefore be understated.
- The capital will be understated because of the understated profit.

What are the effects of treating revenue expenditure as capital expenditure?

Incorrectly treating revenue expenditure as capital expenditure will affect the financial statements

- It will not appear on the income statement.
- The expenses will therefore be understated.
- This means the profit for the year will be overstated.
- It will incorrectly appear on the statement of financial position.
- The non-current assets will therefore be overstated.
- The capital will be overstated because of the overstated profit.

How do I treat low-valued non-current assets?

Some non-current assets have a small cost to the business

- Calculators
- Staplers
- Waste bins

The accounting principle of materiality means that a business should treat these items as expenses

- Rather than non-current assets
- These will appear on the income statement.
- These will **not** appear as non-current assets on the statement of financial position.

Accounting Principles:

What are accounting principles?

- These are the **rules, principles** and **guidelines** used when preparing the financial statements of a business
- These are **used by all accountants** internationally
- Accountants must comply with these principles so that:
 - Financial statements can be **accurately compared** with those of similar businesses
 - The owner(s) of a business can **compare the year-by-year performance** of the business
- The ten accounting principles are:
 - Business entity
 - Money measurement
 - Going concern
 - Historic cost
 - Materiality
 - Duality
 - Consistency
 - Matching
 - Realisation
 - Prudence

The accounting concepts are the rules that are applied in recording transactions and preparing the Trading and Profit and Loss account and the Balance sheet.

1. Business Entity Concept:

This rule states that only the transactions of the business should be recorded and NOT the owner's private transactions.

Example: the owner buys himself groceries will Not be recorded

2. Money Measurement Concept

Only transactions that can be expressed in monetary terms are to be recorded.

Example: the motivational level and skills of the employees will NOT be recorded

3. Historic Cost Concept

All transactions are recorded at their cost to the business.

Example: a machine bought for a bargain at 50% less than what it is worth, will still be recorded at the cost paid and not at the higher value it may be worth.

4. Realisation Concept

Profits are realized (actually earned) when cash or a debtor replaces the goods or services. A transaction is NOT realized when an order is received or when a debtor pays his debt.

Example: A sale is considered to be realized when a customer takes ownership of the good or service regardless of whether money is received straight away.

5. Dual Aspect Concept (duality)

Every transaction will affect two items in the business – this is represented by both a debit AND a credit entry in the ledger. Example: A transaction is considered to have a giving and taking effect so the purchase of stock for cash will reduce the cash amount in the balance sheet and increase the stock of goods.

6. Consistency Concept

Transactions of a similar nature should always be recorded in the same (or consistent) way. This is to ensure that the Profit and Loss Accounts and Balance Sheets can be meaningfully compared each year.

Example: keeping the percentage rate of depreciation the same every year

7. Materiality Concept

This concept implies that you should not waste time recording transactions that are trivial (involving very small amounts of money).

Example: Depreciation on a cheap waste paper bin

Paper clips left over at the end of the year to be used the following year

BE CAREFUL: what is trivial to a large business could be material to a small business.

8. Accruals (Matching) Concept

The Trading and Profit and Loss Account should only include the income earned and expenses incurred for the current financial year.

Example: rent still owing at the end of the year should be included in this year's expenses.

9. Prudence Concept

This concept states that profits must not be overstated and the value of Assets must not be shown to be too high. The accountants' duty is to ensure that the readers of the final accounts get a true and proper picture of the financial state of the business.

Example: writing off a bad debt even though there is a small chance that the debtor may still pay.

10. Going Concern Concept

It is assumed that a business will continue to exist for a long period of time.

Example: on the last day of the financial year, the government passes a law which prevents us from selling our product. We should still continue to draw up the final accounts.

Ratio Analysis:

What are profitability ratios?

- **Profitability ratios** assess a company's ability to earn profits from sales, operations or assets
 - They **compare** profits to other values such as revenue, costs and capital employed
- The main profitability ratios are:
 - Gross margin
 - Mark-up
 - Profit margin
 - Return on capital employed

Gross Margin

What is the gross margin?

What is the formula?	$\frac{\text{Gross profit}}{\text{Revenue}} \times 100$
How should the value be written?	Write as a percentage (X%)
How should the value be rounded?	Round to two decimal places
What does the value mean?	The value represents the proportion of the revenue that is turned into gross profit
How can the ratio be improved?	<ul style="list-style-type: none">▪ Increase the selling price of the goods▪ Buy the goods from a cheaper supplier

- If the **gross margin decreases** then this suggests that:
 - The goods are being **sold at a cheaper price** than in previous years
 - Allowing **more trade discounts** has the same effect
 - The **costs of goods have increased** but their selling price has remained the same

What is the mark-up?

What is the formula?	$\frac{\text{Gross Profit}}{\text{Cost of sales}} \times 100$
How should the value be written?	Write as a percentage (X%) This can be bigger than 100%
How should the value be rounded?	Round to two decimal places
What does the value mean?	The value represents the percentage of the cost of sales that is added to the costs to form the selling price
How can the ratio be improved?	<ul style="list-style-type: none"> ▪ Increase the selling price of the goods ▪ Buy the goods from a cheaper supplier

- The mark-up is normally a **fixed percentage** applied to the cost of the goods
 - The **percentage can be raised** to increase profits

EXAMINER TIP

The mark-up can be bigger than 100% so do not worry if your answer is bigger than 100%.

Profit Margin

What is the profit margin?

What is the formula?	$\frac{\text{Profit for the year}}{\text{Revenue}} \times 100$
How should the value be written?	Write as a percentage (X%)
How should the value be rounded?	Round to two decimal places

What does the value mean?	The value represents the proportion of the revenue that is turned into profit for the year
How can the ratio be improved?	<ul style="list-style-type: none"> ▪ Increase the gross profit <ul style="list-style-type: none"> ▪ Increase selling prices ▪ Buy goods from cheaper suppliers ▪ Increase income from other sources ▪ Reduce expenses such as staff salaries, marketing or administrative costs

- A **decreasing profit margin** suggests that:
 - **Gross profit** has **decreased** from previous years
 - The business is **paying more for expenses**
 - The business is **not earning as much other income** as in previous years

WORKED EXAMPLE



Kaley is a sole trader. She provides the following information for the year ended 31 December 2023.

	\$
Revenue	128 000
Gross profit for the year	74 000
Other income	9 000
Expenses	46 000

Calculate Kaley's profit margin. Your answer should be correct to **two** decimal places.

Answer

- Calculate the profit for the year
 - Gross profit + Other income - Expenses
 - \$74 000 + \$9 000 - \$46 000 = \$37 000
- Calculate the profit margin

- $\frac{\text{Profit for the year}}{\text{Revenue}} \times 100$
 - $\frac{37\,000}{128\,000} \times 100 = 28.90625$
- Round to two decimal places
 - Profit margin = 28.91%

Return on Capital Employed (ROCE)

What is the return on capital employed (ROCE)?

What is the formula?	$\frac{\text{Operating profit for the year}}{\text{Capital employed}} \times 100$ <p>Capital employed = Equity (or capital) + Non-current liabilities</p>
How should the value be written?	Write as a percentage (X%)
How should the value be rounded?	Round to two decimal places
What does the value mean?	The value represents the proportion of the capital employed that is turned into profits
How can the ratio be improved?	<ul style="list-style-type: none">▪ Increase the profit for the year<ul style="list-style-type: none">▪ Increase income▪ Decrease expenses▪ Reduce non-current liabilities such as bank loans

- A business aims to **increase the return on capital employed**
 - The business should consider whether it can use more short-term sources of finance rather than long-term loans

Example:

EXAMINER TIP

Notice that this profitability ratio uses the operating profit rather than the profit for the year. This means you need to use the profit before finance costs (loan interest or debenture interest).

WORKED EXAMPLE

The equity and liabilities of Khazam Ltd at 31 December 2023 are listed below.

	\$
Ordinary share capital	140 000
General reserve	40 000
Retained earnings	50 000
5% Debentures	30 000
Trade payables	25 000

The profit for the year ended 31 December 2023 was \$35 000 **after** charging debenture interest.

Calculate the return on capital employed for the year ended 31 December 2023. The calculation should be correct to **two** decimal places.

Answer

- Calculate the debenture interest for the year
 - $5\% \times \$30\,000 = \$1\,500$
- Calculate the operating profit for the year
 - Add the debenture interest back onto the profit for the year
 - $\$1\,500 + \$35\,000 = \$36\,500$
- Calculate the capital employed
 - Equity (Share capital + Reserves + Retained earnings) + Non-current liabilities
 - $\$140\,000 + \$40\,000 + \$50\,000 + \$30\,000 = \$260\,000$
- Calculate the return on capital employed
 - $$\frac{\text{Operating profit for the year}}{\text{Capital employed}} \times 100$$
 - $\frac{36\,500}{260\,000} \times 100 = 14.0384\dots$
- Round to two decimal places
- ROCE = 14.04%

Profitability:

Evaluating Profitability

How do I evaluate the profitability of a business?

- It is best to look at **multiple profitability ratios** together to get a better understanding
 - The **gross margin** might be **high** but the **profit margin** might be **low**
 - This suggests that gross profit is not an issue
 - The business needs to look at other income and expenses
 - The **difference** between the **gross margin** and **profit margin** is the **proportion** of revenue that is **spent on expenses** after deducting other income
 - A **smaller difference** indicates that a business has **better control of expenses**
- Consider actions which have a **positive and negative effect**
 - For example, if a business finds a **cheaper supplier**:
 - The **gross margin** might increase as a result of **lower cost of sales**
 - However, the quality of the goods might not be as good, which could cause customers to shop elsewhere, **reducing sales revenue**

How do I compare the profitability of a business between years?

- **Compare** the ratios to the same ratios from **previous years**
- For each ratio
 - Make a **general** comment
 - State whether it has **improved** or gotten **worse**
 - State the **percentages**
 - Give possible **reasons** for the **change**
- Calculate the **difference** between the **gross margin** and the **profit margin** to see if the business has **gotten better at controlling expenses**

Example:

Sana and Taz are business partners. They provide information for the financial years ending 31 December 2022 and 31 December 2023.

	Year ended	
	31 December 2022	31 December 2023
Gross margin	32.25%	43.75%
Profit margin	9.43%	10.31%
Return on capital employed	21.08%	10.45%

Comment on the performance of the business over the two years.

Answer

- Comment on the gross margin

The gross margin has improved from 32.25% to 43.75%. This could be because Sana and Taz increased the selling prices of their goods. They could have decreased the cost of sales by changing to a cheaper supplier.

- Comment on the profit margin

The profit margin has improved from 9.43% to 10.31%. This could be due to a higher gross profit, but it could also be due to an increase in other income.

- Comment on the differences between the gross and profit margins

In 2022, the difference between the gross and profit margins was 22.82%. In 2023, this difference was 33.44%. The difference worsened, which could be because Sara and Taz had worse control over their expenses.

- Comment on the return on capital employed

The return on capital employed worsened from 21.08% to 10.45%. This could be due to an increase in the capital employed. This may have involved more capital being introduced by the partners or a long-term loan.

Liquidity Ratios:

What are liquidity ratios?

- **Liquidity ratios** are ways to measure how **quickly** a business can **convert assets into cash**
 - They **compare** the current assets to the current liabilities
- The liquidity ratios are:
 - Current ratio
 - Liquid (acid test) ratio

Current Ratio

What is the current ratio?

- The current ratio is also known as the **working capital ratio**
 - **Working capital** is current assets minus current liabilities

What is the formula?	$\frac{\text{Current assets}}{\text{Current liabilities}}$
How should the value be written?	Write as a ratio (X : 1)
How should the value be rounded?	Round to two decimal places
What does the value mean?	The value represents the amount of current assets available to cover each \$1 of current liability
How can the ratio be increased?	<ul style="list-style-type: none">▪ Increase current assets by introducing capital or selling non-current assets▪ Reduce current liabilities, such as overdrafts and trade payables

- A ratio close to **2:1** is generally good
 - If it is **less than 1:1** then the business **does not have enough current assets** to cover its current liabilities
 - If it is **too high** then the business could have **too much inventory or trade receivables**
 - They need to improve their inventory control
 - They need to encourage credit customers to pay faster

Liquid (Acid Test) Ratio

What is the liquid (acid test) ratio?

- The liquid ratio is also known as the **acid test** or the **quick ratio**
- It measures how well current liabilities are covered by the **more liquid forms of current assets**—cash and trade receivables

What is the formula?	$\frac{\text{Current assets} - \text{Inventory}}{\text{Current liabilities}}$
How should the value be written?	Write as a ratio (X : 1)
How should the value be rounded?	Round to two decimal places
What does the value mean?	The value represents the amount of cash and receivables available to cover each \$1 of current liability
How can the ratio be increased?	<ul style="list-style-type: none">▪ Increase current assets, especially cash, by introducing capital or selling non-current assets▪ Reduce current liabilities, such as overdrafts and trade payables

- A ratio close to **1:1** is generally good
 - If it is **above 1:1** then the business has **enough current assets** to cover its short-term debts even if the inventory cannot be sold
 - If it is **too high** then the business could be owed too much by **trade receivables**
 - They need to encourage credit customers to pay faster

Rate of Inventory Turnover

What is the rate of inventory turnover?

What is the formula?	$\frac{\text{Cost of sales}}{\text{Average inventory}}$
How should the value be written?	Write as the number of times per year (X times)
How should the value be rounded?	Round to two decimal places
What does the value mean?	The value represents the number of times a business is able to fully sell and replace its inventory in a year

How can the ratio be improved?	<ul style="list-style-type: none"> ▪ Increase the volume of sales ▪ Reduce the amount of inventory that is held by the business
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- It can be easier to think of the rate in terms of **how long it takes** for a business to **fully sell its inventory** without replacing it
 - If the rate of inventory is 2 then this means it takes the business half a year to fully sell its inventory without replacing it
 - You can divide 365 days by the rate to find the number of days it takes to fully sell the inventory without replacing it
- A business aims to **sell its inventory quickly**
 - This prevents the inventory from going out of date or out of season

Trade Receivables Turnover

What is the trade receivables turnover?

What is the formula?	$\frac{\text{Trade receivables}}{\text{Credit sales}} \times 365$
How should the value be written?	Write as the number of days (X days)
How should the value be rounded?	Round up to the next whole day
What does the value mean?	The value represents the average number of days it takes a business to receive full payment for goods sold to credit customers
How can the ratio be improved?	<ul style="list-style-type: none"> ▪ Encourage credit customers to pay quickly <ul style="list-style-type: none"> ▪ Offer cash discounts ▪ Charge interest for late payments ▪ Reduce the amount owed by customers <ul style="list-style-type: none"> ▪ Enforce a credit limit ▪ Require a cash deposit

- A business will aim to **receive payment** from customers **as quickly as possible**
- A business might **offer credit** to customers:
 - To get ahead of the competitors

Trade Payables Turnover

What is the trade payables turnover?

What is the formula?	$\frac{\text{Trade payables}}{\text{Credit purchases}} \times 365$
How should the value be written?	Write as the number of days (X days)

How should the value be rounded?	Round up to the next whole day
What does the value mean?	The value represents the average number of days it takes a business to fully pay for goods purchased from credit suppliers
How can the ratio be increased?	<ul style="list-style-type: none"> ▪ Take advantage of any interest-free periods <ul style="list-style-type: none"> ▪ This helps the business keep their cash for as long as possible in case of emergencies
How can the ratio be decreased?	<ul style="list-style-type: none"> ▪ Pay for goods using cash when possible ▪ Pay invoices quicker

- There are **benefits** to paying for **goods using credit**:
 - The business can keep its cash for as long as possible in case of emergencies
 - The business can wait until it receives payment from customers before paying its suppliers
- There is **no optimal value** for the **trade payables turnover**
 - The value should **not be too high** otherwise the business might be charged interest or late fees
 - The value should **not be too low** otherwise the business will have a low working capital

Single Entry and Incomplete Records:

The following formulae might be used to find missing figures:

Capital = Assets - Liabilities

Opening Capital = Opening Assets - Opening Liabilities

Closing Capital = Closing Assets - Closing Liabilities

Alternative Formula For Closing Capital:

-> Opening Capital + Net Profit + New Capital Introduced - Drawings = CL Capital

Calculation of Sales:	\$
Received From Customer(Trade Rec)	xxx
Add: Return Inwards	xxx
Bad Debt	xxx
Discount Allowed	xxx
Closing Trade Receivable	xxx
Less: Opening Trade Receivable	(xxx)

Credit Sale	xxx
Add: Cash Sale	xxx
Sales not banked (drawing/expense)	xxx

Total Sale	xxx

Calculation Purchases:	\$
Paid to Supplier(Trade Pay)	xxx
Add: Return Outwards	xxx
Discount Received	xxx
Closing Trade Payable	xxx
Less: Opening Trade Payable	(xxx)

Credit Purchases	xxx
Add: Cash Purchases	xxx

Total Purchases	xxx

Note: Profit/Loss on disposal = Sold value - Net book value

Depreciation = Opening NBV + New Pur - Disposal (NBV) -CL NBV

Expense/Income -->	Closing		Opening
	Owing (+)		Prepaid (+)
	Prepaid (+)		Owing (-)

Note For Balance Sheet!!!

Balance Sheet contains all closing assets & liabilities, except Capital. To find opening capital, we use opening asset & op liability.

Books of Prime Entry:

What are books of prime entry?

- **Books of prime entry** are used to **record the details** of a **transaction**
 - Older terminology for these books includes
 - Subsidiary books
 - Books of original entry
 - Daybooks
- Information is **taken from the business documents** and entered into the books of prime entry
- The details are **then transferred** from the books of prime entry **to the ledger accounts**
- The seven books of prime entry are:
 - Sales journal
 - Purchases journal
 - Sales returns journal
 - Purchases returns journal
 - Cash book
 - Petty cash book
 - General journal

What are the advantages of using books of prime entry?

- **Books of prime entry** are another stage which can be used to **check for errors**
 - They can help in the **preparation of control accounts** to check the accuracy of the ledger accounts
- Each book of prime entry collects the **same type of transaction**
 - The books allow **managers** to see the **totals** for different types of transactions easily
 - Therefore, there are **fewer entries** in some of the ledger accounts
- Bigger businesses may have **multiple book-keepers**
 - Different book-keepers can be **responsible for different books** of prime entry without any risk of work being duplicated or missed

Sales Journal

What is the sales journal?

- The **sales journal** is a record of all **credit sales**
 - **Cash sales** are **not recorded** in the sales journal
 - They are recorded directly into the **cash book**
- It contains:
 - The dates of sales
 - The names of the credit customers
 - The amounts for each of the sales
 - The amounts should be **after trade discounts** have been applied to the list prices
- The book-keeper uses the **sales invoices** to enter the information into the sales journal
- The **totals** are transferred to the **ledger accounts** at regular intervals
 - **Credit** the **sales account** with the total
 - Call this entry "Sales journal"
 - **Debit** the individual **trade receivables accounts**

Sales Returns Journal

What is the sales returns journal?

- The **sales returns journal** is a record of all the **returns from credit customers**
- It contains:
 - The dates of the returns
 - The names of the credit customers
 - The amounts for each of the returns
- The book-keeper uses the **credit notes** that were **issued** to enter the information into the sales returns journal
- The **totals** are transferred to the **ledger accounts** at regular intervals
 - **Debit** the **sales returns account** with the total
 - Call this entry "Sales returns journal"
 - **Credit** the individual **trade receivables accounts**

Purchases Journal

What is the purchases journal?

- The **purchases journal** is a record of all **credit purchases**
 - **Cash purchases** are **not recorded** in the purchases journal
 - They are recorded directly into the **cash book**
 - **Purchases of non-current assets** are **not recorded** in the purchases journal
 - They are recorded directly into the **cash book**
- It contains:
 - The dates of the purchases
 - The names of the credit suppliers
 - The amounts for each of the purchases
- The book-keeper uses the **purchases invoices** to enter the information into the purchases journal
- The **totals** are transferred to the **ledger accounts** at regular intervals
 - **Debit** the **purchases account** with the total
 - Call this entry "Purchases journal"
 - **Credit** the individual **trade payables accounts**

EXAMINER TIP

If a purchases journal is used, only one entry is made to the purchases account at the end of a given period rather than separate entries for each individual purchase.

If a question does not mention a purchases journal, enter the individual transactions into the purchases account and label them with the names of the trade payables.

The Cash & Petty Cash Books

What are the cash book and the petty cash book?

- The **cash book** and **petty cash book** are books of prime entry
- They record all transactions which involve the **exchange of cash**
 - **Petty cash** is used for **small valued transactions**
- The book-keeper gets the information from:
 - Receipts
 - Cheques & cheque counterfoils
 - Paying-in slips
 - Bank statements
 - Petty cash vouchers
- The cash book and petty cash book are **also part of the double entry system**
 - This is different to the other books of prime entry

The General Journal

What is the general journal?

- The **general journal** is also referred to as, simply, "the journal"
- The journal is used to record all transactions that do **not go into the other books** of prime entry, such as:
 - Opening balances when a business is first created
 - Introducing capital
 - Taking drawings
 - Purchasing a non-current asset
 - Selling a non-current asset
 - Correcting errors

How do I make a journal entry for a transaction?

- **STEP 1**
Enter the **date**
 - **STEP 2**
Enter the **name of the account(s)** that need to be **debited** in the **details column**
 - It is conventional to enter the debit accounts before the credit accounts
 - **STEP 3**
Enter the **corresponding values** in the **debit column**
 - **STEP 4**
Enter the **name of the account(s)** that need to be **credited** in the **details column**
 - It is conventional to leave an indent for the credit entries
 - **STEP 5**
Enter the **corresponding values** in the **credit column**
 - Make sure the total debit amount is equal to the total credit amount
 - **STEP 6**
Write a **narrative** for the journal entry
 - This is a brief explanation of the transaction
 - This is especially useful for non-regular transactions and for correction of errors
- Read the question carefully to see whether a narrative is required. If in doubt, you should include a narrative.

Business Documents:

Purpose of Business Documents

What are business documents?

- **Business documents** are used to **keep records** of all transactions
- They are used as **sources of information**
 - The amounts are then entered into the **books of prime entry**
 - They can be used to **check potential errors**

What business documents do I need to know?

- Invoices
- Debit notes
- Credit notes
- Statements of account
- Cheques
- Cheque counterfoils
- Receipts
- Paying-in slips
- Bank statements
- Petty cash vouchers

Trade Discount

What is a trade discount?

- A **trade discount** is a **reduction in the selling price** of goods or services
- Trade discount might be offered
 - If the customer **buys in bulk**
 - If the customer is a **loyal and regular customer**
- Trade discount is **applied before** a transaction takes place
- The **discounted amount** is the value that is entered into the books of prime entry
 - The **value of the trade discount** is **not entered** into the books of prime entry
 - Trade discount is **not part of the double entry system**

Cash Discount

What is a cash discount?

- A **cash discount** is offered to credit customers for **early repayment** of an invoice
- The supplier will state the **deadline for payment** in order to claim the cash discount
- The **amount before the cash discount** is entered into the books of prime entry
- When the customer pays early and claims the cash discount
 - The amount of **cash discount is recorded** in the books of prime entry

Invoices

What is an invoice?

- An **invoice** is used as a **record** of a **credit sale** or **credit purchase**
- The **supplier issues** an invoice to the **credit customer**
 - The **customer** might refer to this as a **purchases invoice**
 - The **supplier** will keep a copy
 - They might refer to it as a **sales invoice**
- An entry is made in the **books of prime entry** when an invoice is issued or received for goods or services
 - The **customer** enters the value in the **purchases journal**
 - The **supplier** enters the value in the **sales journal**
- If the invoice is for a **non-current asset** then the book of original entry is the **journal**

What information is contained in an invoice?

- The **date** of the transaction
- The **details** of the **supplier**
 - Name and address
- The **details** of the **customer**
 - Name and address
- The **details** of the **goods or services**
 - The quantity
 - The price of each item
- **Trade discount**
 - This is deducted before the total amount is stated
- The **total amount owed**
- **Terms** for eligibility of **cash discount**

Statements of Account

What is a statement of account?

- A **statement of account** is used to show **all transactions** between a credit customer and a supplier **within a given time frame**
- A statement of account is **issued on a regular basis** by the supplier
- **No entries** are recorded in the **books of prime entry** when a statement of account is issued or received
 - This is because **no new transactions** have taken place
 - The customer can **check the balance** on the statement with the balance in their purchases ledger account
- There is usually a **balance column** which shows the **balance after each transaction**
- The statement of account is written from the **point of view of the supplier**
- Transactions which **increase the customer's balance** will be labelled as a **debit**
- Transactions which **decrease the customer's balance** will be labelled as a **credit**

What information is contained in a statement of account?

- The **date** that the statement is issued
- The **details** of the **supplier**
 - Name and address
- The **details** of the **customer**
 - Name and address
- The **opening balance**
- The date and amount of any **purchases** by the customer
 - These will correspond to **invoices** that were issued
- The date and amount of any **returns** by the customer
 - These will correspond to **credit notes** that were issued
- **Payments** made by the customer
- **Cash discounts** received by the customer
- The **closing balance**

Business Documents for Cash Transactions

Receipts

What is a receipt?

- A **receipt** is used as a **record** of a **cash payment**
- A **supplier issues** a receipt to a customer when they pay for goods using **physical cash**
 - Sometimes a receipt is issued when the customer pays using money in their bank account
 - Other business documents may also be used to record these transactions

Cheques & Cheque Counterfoils

What is a cheque?

- A **cheque** is a form of payment
- It is **written by the customer** and **given to the supplier**
- The supplier takes the **cheques** they receive **to the bank** and **deposits them** into the business bank account
- A cheque will contain:
 - The details of the customer's bank account
 - The name of the supplier
 - The amount to be paid
 - The date on which the cheque is written
 - The customer's signature
- The supplier will use the cheque as the **business document** for payments
 - When the customer pays by cheque

What is a cheque counterfoil?

- **Cheques** are attached to **counterfoils** in a chequebook
- When a customer writes a cheque they also fill in some basic details on the counterfoil
 - The name of the person who is being paid
 - The amount to be paid
 - The date that the cheque is written
- The **customer tears off the cheque** and hands it to a supplier as payment
- The customer **keeps the cheque counterfoil**
 - This is used as a **record** of the payment

Petty Cash Vouchers

What is a petty cash voucher?

- A **petty cash voucher** is a document used when paying for **small valued purchases** using petty cash
 - This is usually done when a cheque would not be appropriate due to the low value
- The customer pays the supplier using **money from the petty cash till** and records the details on a voucher
- The information from the vouchers is then **transferred** to the **petty cash book**

Paying-In Slips

What is a paying-in slip?

- A **paying-in slip** is a document used when depositing cash and/or cheques into a bank account
- The paying-in slip is kept by the business as a **record** of the deposit
- It contains:
 - The total amount from **cash**
 - The total amount from **cheques**
 - The **total amount** being deposited
 - The **date**

Bank statements

What is a bank statement?

- A **bank statement** is issued regularly by a bank
- It details all the bank transactions within a given period
 - It shows **money that goes in and out** of the business' bank account
- It shows the **opening** and **closing balances** for that period
- A bank statement is used as a business document to identify and reconcile:
 - Payments by credit transfer
 - Payments by telephone transfer
 - Payments by direct debit
 - Payments by standing order
 - Bank charges and interest

What is a direct debit?

- A **direct debit** is used by a business to make **recurring bank transfer payments** to a person or another business
- The direct debit is **set up by the person** or business **receiving the payments**
 - The business that makes the payment needs to agree to the terms
- The payments can **change**
 - The **dates** of the payments
 - The **amounts** of the payments

What is a standing order?

- A **standing order** is used by a business to make **recurring bank transfer payments** to a person or another business
- The standing order is **set up by the business making the payments**
- The payments are **fixed**
 - The **dates** are **determined in advance**
 - It could be the same day each month

A Summary of Business Documents for Transactions

Transaction	Business document for the customer	Business document for the supplier
The customer buys goods on credit from the supplier	Purchases invoice	Sales invoice
The customer returns goods to the supplier	Credit note received	Credit note issued
The customer pays a supplier using cash	Receipt	Receipt
The customer pays a supplier using petty cash	Petty cash voucher	Receipt

The customer pays a supplier using a cheque	Cheque counterfoil	Cheque
The customer pays the supplier by credit transfer, telephone transfer, direct debit or standing order	Bank statement	Bank statement
The supplier deposits the cash and cheques into their bank	None	Paying-in slip

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