

# **PRINCIPLES OF BOOKKEEPING CONTROLS**

## **STUDY TEXT**

### **Qualifications and Credit Framework**

**Q2022**

This Study Text supports study for the following AAT qualifications:

AAT Level 2 Certificate in Accounting

AAT Level 2 Certificate in Bookkeeping

AAT Certificate in Accounting at SCQF Level 6

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# INTRODUCTION

## HOW TO USE THESE MATERIALS

These Kaplan Publishing learning materials have been carefully designed to make your learning experience as easy as possible and to give you the best chance of success in your AAT assessments.

They contain a number of features to help you in the study process.

The sections on the Unit Guide, the Assessment and Study Skills should be read before you commence your studies.

They are designed to familiarise you with the nature and content of the assessment and to give you tips on how best to approach your studies.

## STUDY TEXT

This study text has been specially prepared for the revised AAT qualification introduced in February 2022.

It is written in a practical and interactive style:

- key terms and concepts are clearly defined
- all topics are illustrated with practical examples with clearly worked solutions based on sample tasks provided by the AAT in the new examining style
- frequent activities throughout the chapters ensure that what you have learnt is regularly reinforced
- 'pitfalls' and 'examination tips' help you avoid commonly made mistakes and help you focus on what is required to perform well in your examination
- 'Test your understanding' activities are included within each chapter to apply your learning and develop your understanding.

## ICONS

The chapters include the following icons throughout.

They are designed to assist you in your studies by identifying key definitions and the points at which you can test yourself on the knowledge gained.



### Definition

These sections explain important areas of Knowledge which must be understood and reproduced in an assessment.



### Example

The illustrative examples can be used to help develop an understanding of topics before attempting the activity exercises.



### Test your understanding

These are exercises which give the opportunity to assess your understanding of all the assessment areas.



### Foundation activities

These are questions to help ground your knowledge and consolidate your understanding on areas you're finding tricky.



### Extension activities

These questions are for if you're feeling confident or wish to develop your higher level skills.

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Our Quality Co-ordinator will work with our technical team to verify the error and take action to ensure it is corrected in future editions.

# Double-entry bookkeeping

# 1

## Introduction

A sound knowledge of double-entry bookkeeping underpins many of the learning outcomes and skills required for Principles of Bookkeeping Controls. Double-entry bookkeeping is essential knowledge in order to pass this unit and candidates will be assessed on it in the examination. Although much of the content of this chapter should be familiar from Introduction to Bookkeeping, it is essential that it is covered in order to build upon this basic knowledge.

### ASSESSMENT CRITERIA

Produce journal entries to record bookkeeping transactions (3.1)  
Extract an initial trial balance (4.1)  
Redraft the trial balance following adjustments (4.2)

### CONTENTS

- 1 Principles of double-entry bookkeeping
- 2 Overview of the accounting system
- 3 Rules of double-entry bookkeeping
- 4 Double-entry – cash transactions
- 5 Double-entry – credit transactions
- 6 Balancing a ledger account
- 7 Ledger accounting and the trial balance

# 1

## Principles of double-entry bookkeeping

### 1.1 Introduction

Double-entry bookkeeping is based upon three basic principles:

- the dual effect principle
- the separate entity principle
- the accounting equation.

### 1.2 The dual effect



#### Definition – The dual effect principle

The principle of the dual effect is that **every** business transaction has **two** effects.

For example, if a business buys goods for cash then the two effects are:

- cash has decreased
- the business has purchased goods.

The principle of double-entry bookkeeping is that each of these effects must be shown in the ledger accounts by a **debit entry** in one account and an equal **credit entry** in another account.

Every transaction that a business undertakes has **two equal and opposite effects**.

### 1.3 The separate entity concept



#### Definition – The separate entity concept

The separate entity concept is that the business is a completely separate accounting entity from the owner.

Therefore if the owner pays personal money into a business bank account this money becomes the capital of the business, which is owed back to the owner. Similarly, if the owner takes money out of the business in the form of drawings, then the amount of capital owed to the owner is reduced.

The business itself is a completely separate entity from the owner of the business.

The accounting equation at the start would be:

$$\begin{array}{rcl} \text{Assets less liabilities} & = & \text{Capital} \\ \text{£20,000} - \text{£0} & = & \text{£20,000} \end{array}$$

**Required:**

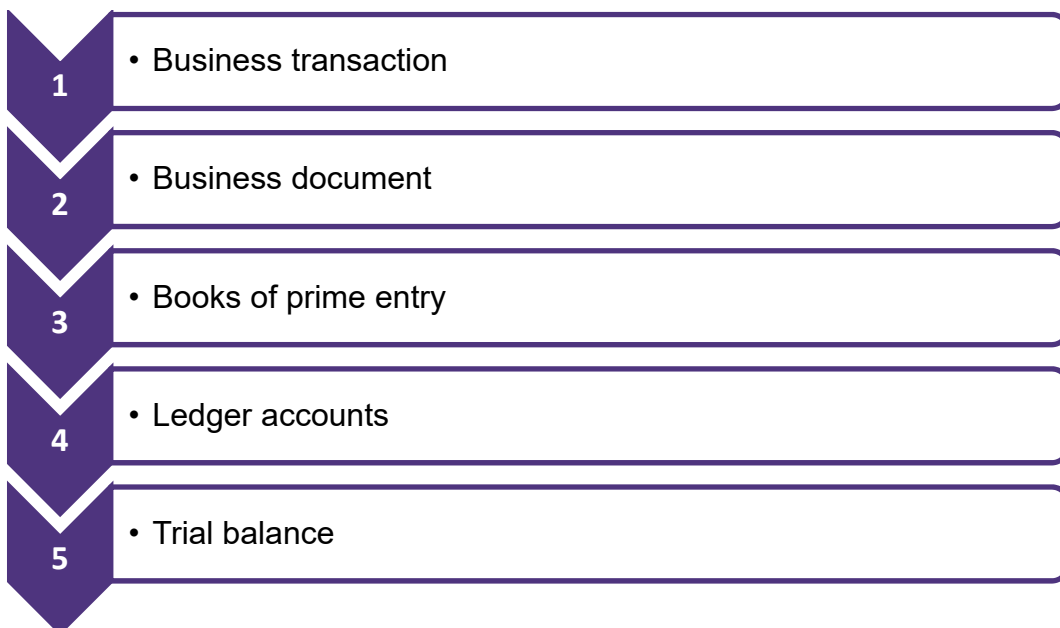
Update the accounting equation after all the transactions had taken place.

## 2 Overview of the accounting system

### 2.1 Overview of the accounting system

A business may enter into a large number of transactions on a daily basis. Keeping track of all these transactions can be a difficult process.

To ensure that a business manages to keep a record of all sales, purchases and expenses incurred, and the assets, liabilities and capital held at any point, the transactions are recorded in an accounting system.



- 1 Initially a **business transaction** will take place: a credit sale, a credit purchase, a cash sale, a cash purchase, another expense either paid from the bank or by cash, cash paid into the bank, withdrawal of cash from the bank and owner's drawings.
- 2 A **business document** will be produced e.g. an invoice.

- 3 The transaction and details from the business document will be entered into the **books of prime entry**. A book of prime entry is where a transaction is first recorded. There are several books of prime entry, which may also be referred to as 'day books'.
- 4 The totals in the books of prime entry are transferred into **ledger accounts** as part of the **general ledger** on a regular basis. Ledger accounts are used as part of the double-entry accounting system.
- 5 A **trial balance** is a list of all of the ledger accounts in the accounting system. The total of debits should equal the total of credits within a trial balance. The trial balance can be used as a control to check that transactions have been recorded correctly in the double-entry system prior to the preparation of the financial statements.

## 2.2 Books of prime entry

A book of prime entry is the place where the transaction (which is detailed on a business document) is first recorded in the books of the business. Books of prime entry may also be referred to as day books. There are several day books, which will be briefly reviewed in this chapter:



### Definition – Sales day book

The sales day book is a list of the credit sales invoices that are to be processed for a given period (e.g. a week).





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