Complete Accounting for Cambridge IGCSE® & O Level
Cambridge O Level ‘Principles of Accounts’:

<table>
<thead>
<tr>
<th>Paper</th>
<th>Type</th>
<th>Content Description</th>
<th>Duration</th>
<th>Percentage of total marks</th>
</tr>
</thead>
<tbody>
<tr>
<td>Paper 1</td>
<td>Multiple choice</td>
<td>30 multiple choice questions covering content from the whole syllabus</td>
<td>1 hour</td>
<td>33.3%</td>
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<tr>
<td>Paper 2</td>
<td>Structured questions</td>
<td>4-6 compulsory questions covering content from across the syllabus. One of these questions will involve the preparation of financial statements for a manufacturing business or trading business</td>
<td>2 hours</td>
<td>66.6%</td>
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Cambridge IGCSE ‘Accounting’:

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<tbody>
<tr>
<td>Paper 1</td>
<td>Multiple choice and short-answer questions</td>
<td>8-12 multiple choice questions followed by 4-5 short-answer questions, all based on topics from the whole syllabus</td>
<td>1 hour 45 minutes</td>
<td>50%</td>
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<tr>
<td>Paper 2</td>
<td>Structured questions</td>
<td>4-6 compulsory questions covering content from across the syllabus</td>
<td>1 hour 45 minutes</td>
<td>50%</td>
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The following key skills will be assessed in the examination papers. The importance given to each skill in each examination paper is also shown in the table:

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<th>Assessment objectives</th>
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<td>Paper 1</td>
<td>Paper 2</td>
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<tr>
<td>Knowledge and understanding</td>
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<tr>
<td>• Show your knowledge and understanding of accounting terms, concepts, conventions, principles and techniques</td>
<td>70%</td>
<td>45%</td>
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<tr>
<td>• Show your understanding by using numeracy, literacy, presentation and comprehension skills</td>
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<tr>
<td>• Apply knowledge and information to a variety of accounting situations and problems</td>
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<tr>
<td>Analysis</td>
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<tr>
<td>• Select, analyse and present information in written, numerical and diagrammatic form</td>
<td>20%</td>
<td>30%</td>
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<tr>
<td>• Present appropriate information in an accepted accounting form</td>
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<tr>
<td>Evaluation</td>
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<td></td>
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<tr>
<td>• Interpret and evaluate accounting information</td>
<td>10%</td>
<td>25%</td>
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<tr>
<td>• Use accounting information to draw reasoned conclusions</td>
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*Complete Accounting* will help you master these skills.

**Best of luck with your studies!**
1

Basic accounting principles

Content at a glance

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<td>The purpose of accounting</td>
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<td>Documentary records</td>
<td>Business documents</td>
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<td>Books of prime (original) entry</td>
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<td>1.5</td>
<td>The cash book</td>
<td>Books of prime (original) entry – cash book Bank reconciliation</td>
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<td>1.6</td>
<td>The general journal</td>
<td>Books of prime (original) entry – general journal</td>
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<td>1.7</td>
<td>The ledger</td>
<td>The ledger</td>
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<td>1.8</td>
<td>The trial balance</td>
<td>The trial balance</td>
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<tr>
<td>1.9</td>
<td>Adjustments to ledger accounts</td>
<td>Other payables and other receivables Bad debts and provision for doubtful debts</td>
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Unit 1.1

The role of accounting

By the end of this unit you should be able to

- explain the difference between book-keeping and accounting
- state the purposes of measuring business profit and loss
- explain the role of accounting in providing information for monitoring progress and decision making
- state the benefits of ICT (information and communication technology) in book-keeping and accounting: accuracy, speed of processing information, ability to process high volumes of information, performing reconciliations, ease and capacity of information storage, security
Starting and running a business

Good financial management is vital if a business is to survive and be successful

Each of us needs to be able to manage our finances. We need to know how much we expect to receive in wages for the work we do and from other sources of income, and how much we need to pay our bills and living expenses. If we get these wrong and are unable to pay our bills the consequences can be serious; we may face legal action from the people or organisations we owe money to and we may even lose our jobs and our homes.

The same is true for people who start up, own and run businesses. These are organisations that provide goods or services to other people and organisations. Regardless of how big or small a business is its owners will want to know:

- how much it is earning from the provision of its goods or services
- how much it is spending providing those goods or services
- how much it owns of value including its premises, equipment and bank deposits (the assets of a business)
- how much it owes to other people and organisations (the liabilities of the business)
- whether they are making the best use of the money they have invested in their business.

Without this information the business owners will not know if their business is earning enough money to cover its costs, when to pay its debts on time or how much their business may be worth. They will not have this information unless they keep detailed financial records about all the activities of their business.

Privately owned business organisations aim to make a profit

A business that is unable to earn enough money from its activities to cover its costs will make a loss. This means the owners will be losing money on the amount they have invested in their business. To stop the business losing money they must either take actions that will increase its income and reduce its costs or close it down.

This is because the main objective of people who own and run businesses is to make a profit. This means earning more money from the activities of their business than it costs to run.

For example, Jamil is an entrepreneur. This means he is a person with business know-how who is willing to risk time and money setting up and running a business organisation. If he is successful he will be rewarded with profit. If he is not successful his business will make a loss.

His new business earns revenue from the sale of goods to customers. However, his business must first buy these goods from other businesses. He also has to pay other organisations to supply services such as electricity, telephone services, insurance, cleaning and many more. These are the day-to-day running costs or expenses of a business.
At the end of his first year in business Jamil added up how much income it had earned over the year and how much it had cost to run his business in order to earn that income. This is shown as:

The difference between the total income of Jamil’s business and its total costs was a healthy profit for the year of $20 000. Jamil was only able to calculate this because he had kept detailed records of all his business earnings and costs.

If, over the next year, the income from his business were to fall or its costs were to rise then his business may end up making a loss. However, with detailed information on his business income and costs and how these are changing over time he will be able take decisions that may prevent this from happening. For example, he might decide to buy and sell different products that customers are willing to pay a higher price for and change suppliers to those with lower prices to reduce his business costs.

**Starting-up and running a business involves the exchange of goods, services and money with other people and organisations**

Running a business involves the regular exchange of goods, services and money with many other people and organisations, including:

- **suppliers** who provide goods intended for resale to customers, or component parts and materials to make other goods
- **customers** who buy these goods
- **employees** who supply their labour to the business in return for wages or salaries
- suppliers of business services including electricity, telephone services, insurance and banking services, cleaning and maintenance and many others.

Every exchange is called a **business transaction** and the running of even the smallest business organisation can involve many hundreds or thousands of different business transactions each year. All of these must be accurately recorded if the owners of the business are to be able to manage its finances effectively and calculate the profit or loss from its activities.
ACTIVITY 1.1

Juanita has just finished her first three months in business, running a small shop that sells snacks and cold drinks to workers in nearby offices. She used her savings of $5 000 to set up her business in a small rented shop and to equip it with kitchenware and other equipment.

While Juanita is a good cook she is not very good at paperwork. At the end of her first three months she added up how much she had earned in sales revenue so far. The total amount of cash she had received from customers was $2 400 while the total amount she had spent from cash on cooking ingredients and food and drinks to sell during the same period was $1 600. This meant she still had $800 in cash. More than enough she thought to keep her business running for the next three months and to return a small profit.

But Juanita had forgotten to take account of other goods and services supplied to her by other business organisations that she had yet to pay for. The amounts she owed were:
- $350 for three months of electricity
- $250 for three months of telephone services
- $1 000 for three months of unpaid rent

She was horrified to realise that she couldn’t afford to pay all these debts. She also had no more savings she could draw from. Juanita therefore had no other option but to close her business and sell off the equipment she had purchased to pay off her debts.

1. How much capital did Juanita initially invest in her business?
2. How much did she spend on food, drinks and cooking ingredients to make goods for sale to her customers?
3. How much revenue did she earn from the sale of these goods?
4. What was the profit she earned from the sale of these goods?
5. Juanita also had expenses to pay. How much were her total expenses?
6. What was her profit or loss after deducting her total expenses?
7. Explain why Juanita was forced to close down her business.

Answers to all activities can be found on the website.

The difference between book-keeping and accounting

Book-keeping is the process of recording business transactions

To calculate profit or loss a business must be able to add up and summarise the values of all its transactions on a regular basis. This means keeping detailed and up-to-date records on business transactions: the date each one occurred, items received or supplied, who they were received from or supplied to and their total prices. Doing this is called **book-keeping**.

Book-keeping records are entered into books called **books of prime entry** and **ledger accounts**. Together they will provide a complete record of every transaction a business has made and every $1 it has earned and every $1 it has spent or owes to other people and organisations. ➤ 1.2

Accounting involves the preparation of financial summaries and statements from book-keeping records

Book-keeping records in the books of a business will provide a long list of details about its many different transactions over a period of time but unless these details are added together and summarised it will very difficult to tell if the business has made a profit or loss from them.
It will also be difficult to know how each transaction affected the business. For example, have the debts of the business increased over time or decreased? Does the business own more or less assets than it did a year ago?

It is therefore sensible to group together similar types of transaction, such as all the transactions that involved purchasing goods from suppliers, all cash sales to customers, all equipment purchases, all cleaning and maintenance expenses, total wages and salaries paid to employees and much more.

Using book-keeping records to prepare financial summaries involves **accounting**. This refers to both the skill and processes necessary to calculate and report key measures of the financial health and performance of a business from its book-keeping records, notably:

1. how much profit or loss it has made
2. how much of value it owns (its assets) and how much it owes to other people and organisations (its liabilities).

**The book-keeping and accounting process**

- Recording transactions
- Classifying and grouping transactions
- Summarising financial information
- Reporting and using financial information

**The purpose of accounting is to measure the profit or loss and value of a business**

The two most important financial summaries and reports produced by a business from its book-keeping records will be produced at the end of each accounting year. These are:

- The **income statement**: this summarises information about the income and different costs and expenses of the business, and therefore its profit or loss, over a 12-month period. ➤ 3.1

- The **statement of financial position**: this summarises financial information about the value of the business on the final day of an accounting year, notably how much of value the business owns and how much it owes to other people and organisations. ➤ 3.2

The **accounting year** of a business is the 12-month period covered by an income statement. Different businesses will have different accounting years. Some may produce an income statement at the end of every calendar year covering the period 1 January to 31 December.

However, most small businesses adopt accounting years beginning on the first day of the month in which they first started. So, for example, if a business began trading in June one year its accounting year will run from the start of June each year to the end of May the following year.
Accurate financial summaries and statements will help the owners of a business to make decisions about its future

Jamil made a healthy profit of $20 000 from his business during its first year of trading. He withdrew $5 000 of this profit for his personal use and spent the remaining $15 000 on new equipment to expand his business. He was able to make these decisions and calculate their effect on his business because he had kept detailed financial records. From these he was also able to forecast how much additional revenue the new equipment may help him generate in future.

If he had not kept good book-keeping records he would be unaware of how much profit his business was making over time. Without this knowledge he may have taken some very unwise decisions. For example, what if he had decided to withdraw $30 000 from his business for his personal use or decided to spend $30 000 on new equipment to expand his business? His business had only generated $20 000 so either of these decisions would mean withdrawing an additional $10 000 in cash from the business bank account to pay for day-to-day running costs.

Alternatively, what if Jamil had borrowed $50 000 to buy new premises? Without financial records and summaries he would not know whether his business would be able to earn enough revenue to pay the extra expense of loan repayments. It is also very unlikely that a bank would lend such a large sum of money to his business without evidence of its profit and ability to afford loan repayments.

Many different people and organisations connected with the business will also want information about its profitability

Financial statements are the most important documents a business can produce about its financial health and performance.

Many different groups of people will use them to make a judgment on the success or otherwise of the business and how its performance has changed over time. Here are some examples:

- Entrepreneurs who invest their time and money in starting and running businesses do so to make a profit. They will clearly want to know whether their aim is being met and by how much. That is, they will also want to know whether the profit from their business is more or less than they could have earned from other uses of their time and money. For example, could they have earned more from their money if they had saved it in a bank savings account instead?

- Suppliers who provide goods to the business on credit will want to know that it is capable of earning enough money to pay them on time and will continue to be successful so that it can make repeat purchases from them.

- A bank will want to know how much profit or loss a business is making before it decides whether or not to lend it money and on what terms. Business owners applying for a bank loan will need accounting information to demonstrate that their business will be able to meet future
loan repayments. A bank will also want to know whether the business owns sufficient items of value, such as premises and equipment, that could be sold off to repay a loan if the business were to fail and cease trading.

- Employees of a business will be dependent on its continued success for their jobs and payment of their wages and salaries. They too will also want to know whether it is profitable.
- The tax authorities of the government will want to check whether a business and its owners are paying the right amount of tax on their earnings or profits. ▶ 6.1

### Using information and communication technology (ICT)

**ICT can be a fast, easy and accurate way to record transactions and prepare accounts**

Recording details about the many transactions a business will make every day, month and year, grouping them into different categories, writing up ledger accounts and producing financial summaries can be very time consuming.

To save time and avoid errors most modern businesses use computer programs to record and store details of their transactions. From these they can produce regular financial statements of their income and financial position.

**ICT** refers to computer equipment, specialises computer programs or software used to perform different tasks, and the electronic methods of communication with customers and suppliers linked to the Internet. Together, they can provide high-quality, high-speed book-keeping and accounting systems for all types of businesses and organisations, whether big or small.

Businesses can use ICT to carry out a wide range of book-keeping and accounting tasks, including:

- building a database of customers’ and suppliers’ names and contact details
- creating business documents for different types of transaction ▶ 1.3
- recording payments received from customers and payments made to suppliers ▶ 1.5
- adding up amounts recorded in ledger accounts at the end of each week or month ▶ 1.7
- producing financial statements ▶ 3.1

**ACTIVITY 1.2**

Here are some popular computer software programs available to businesses in 2013 for their book-keeping and accounting. For each one investigate using computer magazines or the Internet:

- Is the software still available? (If not find some new ones.)
- How much does it cost?
- What functions and tasks can the software perform?
- Why do you think using the software will be better than manual book-keeping and accounting?
• calculating and paying wages and salaries to employees
• analysing financial data on the performance of a business

**ICT can provide a fast, accurate and secure way to record transactions and prepare accounts**

The use of ICT in a business for book-keeping and accounting offers a number of advantages:

- **Improved accuracy** – it is very important that the book-keeping records of a business are complete and accurate. As long as details are input correctly, computer programs can perform calculations and analyse transactions without error.

- **Increased speed of processing information** – computers can process information much more quickly than people can, as well as more accurately, helping to ensure that the book-keeping records are always up to date. Computers can also analyse financial data and produce reports at great speed, giving the owners of the business rapid access to the latest information they need to make decisions.

- **The ability to process high volumes of information** – the accuracy and speed of computers mean that they can record, analyse and summarise huge amounts of data faster than people would be able to. They can also be used to print out or email business documents in a matter of minutes. This is particularly important for larger businesses that have many thousands of transactions every day. It lets them work more quickly and save money by employing fewer people in their offices to record the transactions and produce financial accounts.

- **The ability to check errors and perform reconciliations** – it is easy for a business to record some of its transactions incorrectly and to forget to record others. Its records of transactions may therefore differ from those of its customers or suppliers. As a result it may overcharge a customer or underpay a supplier, leading to disputes over payments. A business may also find that after deducting what it has paid out, it has far less cash in its bank account at the end of a month than it had recorded it had received. Computers can be programmed to perform regular reconciliations quickly and automatically. These involve comparing and checking financial records to identify and correct any errors before producing financial statements. The process minimises the risk of any losses to the business and prevents the errors from happening again.

- **Flexible reporting** – computers can perform and produce a wide range of financial calculations and reports very quickly to meet the specific needs of a particular business at any time. For example, the owner of the business may want to know which customers owe the most money at the end of the month or those customers who have purchased fewer goods than usual. A computer system can be programmed to produce reports like this very quickly and accurately.
Ease and capacity of information storage – computerised information takes up much less space to store than paper documents and records. The information that can be stored on a single computer disk would require many filing cabinets to store if it were recorded on paper. Just as importantly, it is much easier to search for and retrieve computerised records when they are needed.

Improved security – computerised accounting records can be safer than manual records. They are still at risk to threats such as fire or theft, but back-up copies can be made, transported easily and stored securely in more than one place. Computerised records do need to be protected to make sure that only authorised users can access them, for example through the use of password protections, anti-virus software and firewalls to prevent hacking and damage from unauthorised users.

However, the use of ICT in book-keeping and accounting is not error free and ICT systems may be expensive to install and use

Despite the clear advantages of using ICT in business for book-keeping and accounting, all organizations still need to be aware of its possible downsides. These are:

- Computer equipment and specialised software can be costly to buy and install. Some ICT systems are expensive to buy and install. A system may also be costly to maintain, as hardware often needs to be upgraded or replaced and licenses for the use of some software need to be renewed. However, advances in technology has meant the cost of desktop and laptop computers has fallen significantly over time while their speed, computing power and performance has improved, allowing even the smallest business access to sophisticated equipment.

- Users may input data and program computers incorrectly. Computers may not make errors but their users still can. They may key in and save the wrong numbers and program computers to perform calculations incorrectly. Users may fail to check the calculations and analyses performed by computers as thoroughly than those undertaken manually.

- People need to be trained to use computers and to understand book-keeping and accounting. The owner of a business will need to find time to learn to use an ICT system properly and to train any staff who will need to use it. This is particularly important when a new system is installed or a new member of staff joins the business, but there is a continuing need to stay up to date with developments in computer equipment and accounting softwares and practices.

Overall, ICT can offer great benefits by speeding up and improving the accuracy and flexibility of its book-keeping and accounting systems. In order to achieve these benefits, the business must ensure that its computer system and software are suitable for its needs and the people who use ICT are properly trained to do so.
QUICK TEST

1. Why do the owners of a business need to keep proper financial records?

2. Explain three reasons why it is important to measure the profit or loss of a business.

3. A small business has received $45,000 in revenue from the sale of goods to its customers. The business was supplied these goods by another business at a cost of $20,000. The business owner also spent $8,000 on electricity, rent and other operating expenses during the same period in order to run his business and earn this revenue. How much profit did the business make?

4. Explain the difference between book-keeping and accounting.

5. Why would the owner of a business need accounting reports?

   (b) Explain two possible disadvantages of ICT use.