1.0 Introduction to accounting

1.1 Accounting is concerned with

- recording → "Bookkeeping"
- analysing
- forecasting

the income and wealth of enterprises

"Bookkeeping": Keeping a record of the transactions entered into by a business during a particular period.

1.2 The aim of accounting is to provide information regarding the:

- Profitability
- Liquidity

of an enterprise for the users of accounts:

- directors
- shareholders
- bankers
- suppliers
- employees / trade unions
- tax authorities

as an aid for DECISION MAKING

1.3 Information is expressed in money terms - only transactions which can be measured in money are recorded (money measurement).

1.4 The accounting equation:

Every business has:

ASSETS what the business OWNS, e.g.
- Buildings
- Machinery
- Stocks
- Debtors
- Bank Deposits
- Cash

LIABILITIES what the business OWES, e.g.
- Creditors
- Bank overdraft
- Loans

The Accounting Equation says that:

ASSETS less LIABILITIES = CAPITAL

ASSETS → what the business owns

LIABILITIES → what the business owes

CAPITAL → the value of the business

E.G. I have a business, which has the following assets: a shop worth Lm50,000, stock worth Lm20,000 and cash amounting to Lm1,000. The business also has the following liabilities: bank loan Lm7,000 and creditors Lm4,000.

What is the capital of the business?

Assets – Liabilities = capital
71,000 11,000 = 60,000

ANSWER:

ASSETS	Shop	50,000	
	Stock	20,000	
	Cash	1,000	71,000
LIABILITIES	Loan	7,000	
	Creditors	4,000	11,000
CAPITAL (Assets minus liabilities)			60,000

The business is therefore worth Lm60,000. This is the CAPITAL which I have invested in my business.

This also means that the business "owes" Lm60,000 to me. If I close down the business, I would expect to receive Lm60,000 after the assets are sold and the liabilities are paid off.

CAPITAL means WHAT THE BUSINESS IS WORTH and WHAT THE BUSINESS OWES TO ITS OWNER.

2.0 Double-entry bookkeeping

2.1 Remember the accounting equation:

CAPITAL	=	ASSETS	minus	LIABILITIES
Owed by entity to owner(s)		Owned by the entity		Owed by entity to third parties

2.2 The Double entry principle

Each transaction carried out by an entity has a twofold effect:

RESOURCES COMING IN	**=**	**RESOURCES GOING OUT**
Stock <u>comes in</u> from supplier	*Lm100*	A *promise to pay* <u>goes out</u> to supplier
Asset + Lm100		Liability + Lm100

[redacted]

[redacted]

Bank loan is repaid	*Lm9,000*	Cash <u>goes out</u> to bank
Liability - Lm9,000		Asset - Lm9,000

2.3 Debit and Credit

When the twofold effect of a transaction is recorded in the books of account we use the terms of DEBIT and CREDIT.

DEBIT	**Value received**
CREDIT	**Value given**

Value received is always equal to value given.

Therefore, debit is always equal to credit.

2.4 Examples of double-entry bookkeeping

Bought goods for cash, Lm500:

Value received = Purchases

Value given = Cash

DR Purchases		**Lm500**	
	CR Cash		**Lm500**

Bought machinery on credit Lm2,000

Value received = Machinery

Value given = Promise to pay to Creditor

DR Machinery		**Lm2,000**	
	CR Creditor		**Lm2,000**

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2.5 Exercise 1 - The Double Entry

Capital 5,000 Cash Capital

2-Oct	John Borg started a trading business with a capital of Lm5,000, of which Lm4,000 were deposited at the bank.
3-Oct	Bought stock paying by cheque Lm3,500.
3-Oct	Bought stock from Trading Co Ltd, Lm1,500.
6-Oct	Paid advertising expenses in cash Lm200.
15-Oct	Paid warehouse rent by standing order, Lm500.
16-Oct	Sold goods to Abela Bros, Lm4,200.
21-Oct	Cash sales, Lm2,800.
26-Oct	Paid wages by cheque, Lm400.
27-Oct	Sent cheque to Trading Co Ltd for Lm1,000 in part settlement.
31-Oct	Received Lm2,000 from Abela Bros in part settlement of amount due.

Exercises: Favell p.11 Ex 2 Nos 1 - 5

p. 22 Ex 3 Nos 1 - 5

3.0 The Journal

3.1 Transactions carried out by a business are recorded, using DEBIT and CREDIT, in the JOURNAL.

The Journal is a book of prime entry, I.e. it is the place where a transaction is recorded by the business for the first time. The Journal is not the "books of account". The entries made in the Journal are posted to the books of account at periodic intervals.

3.2 The format of the Journal is as follows:

DATE	DETAILS	DR	CR

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3.3 Example of a Journal entry.

On 1st August 1999, I bought goods for cash, Lm100.

Value received = goods (purchases)
Value given up = cash

Therefore: DEBIT PURCHASES
CREDIT CASH

This is recorded in the Journal as follows:

DATE	DETAILS	DR	CR
1-Aug-99	Purchases	100	
	Cash		100
	being purchase of stock for cash		

date *debit entry* *credit entry* *narration*

3.4 When making an entry in the Journal:

- First ask, "what is being received?"
- The answer to that question is the account to be debited
- Enter the account to be debited first; then, the account to be credited
- Do not forget to enter the date and the narration
- Draw a line across the "details" column after the narration, as a sign that the journal entry has been completed.

Exercises: Draw up Journal entries:

Section 2, Exercise 1

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