Level 3

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Unit Details

Work Area 4 Finance

3.8 Perform more complex accounting/financial transactions

- **LO3.28 Demonstrate ability to operate customer and supplier accounts manually or using an electronic accounting system that conforms to national norms and procedures**
- **LO3.29: Demonstrate ability to describe the basic concepts of accounting (for example Debit and Credit entries)**

Route Map

Introduction to the basic concepts of Accounting

Accounts

Statement

Bookkeeping

Introductory discussion

24 hour Recall

Take 10 minutes and write down everything you have spent the last 24 hours.
EVERY CENT OF IT!

After that introduce your self and:

- Share the outcome with the group (don't have to share financial details if you don't want)
- Was it difficult to recall everything?
- Were you aware of the amount before writing it down.
- Could this be helpful for organizing your financial?

What is accounting?

- Accounting is an information system that provides quantitative, financial information to stakeholders about the economic activities and condition of a business in order for them to make economic/business decisions.

- Accounting is the language of Business and its main goal is to measure Economic Activity

Introduction to basic Concepts of Accounting

How can Accounting help you?

- Help you prepare a budget and keep on target.
- Realize how much cash you have and if there is enough to pay bills.
- Uncover places where costs can be cut.

Introduction to the basic concepts of Accounting

Objectives of Accounting

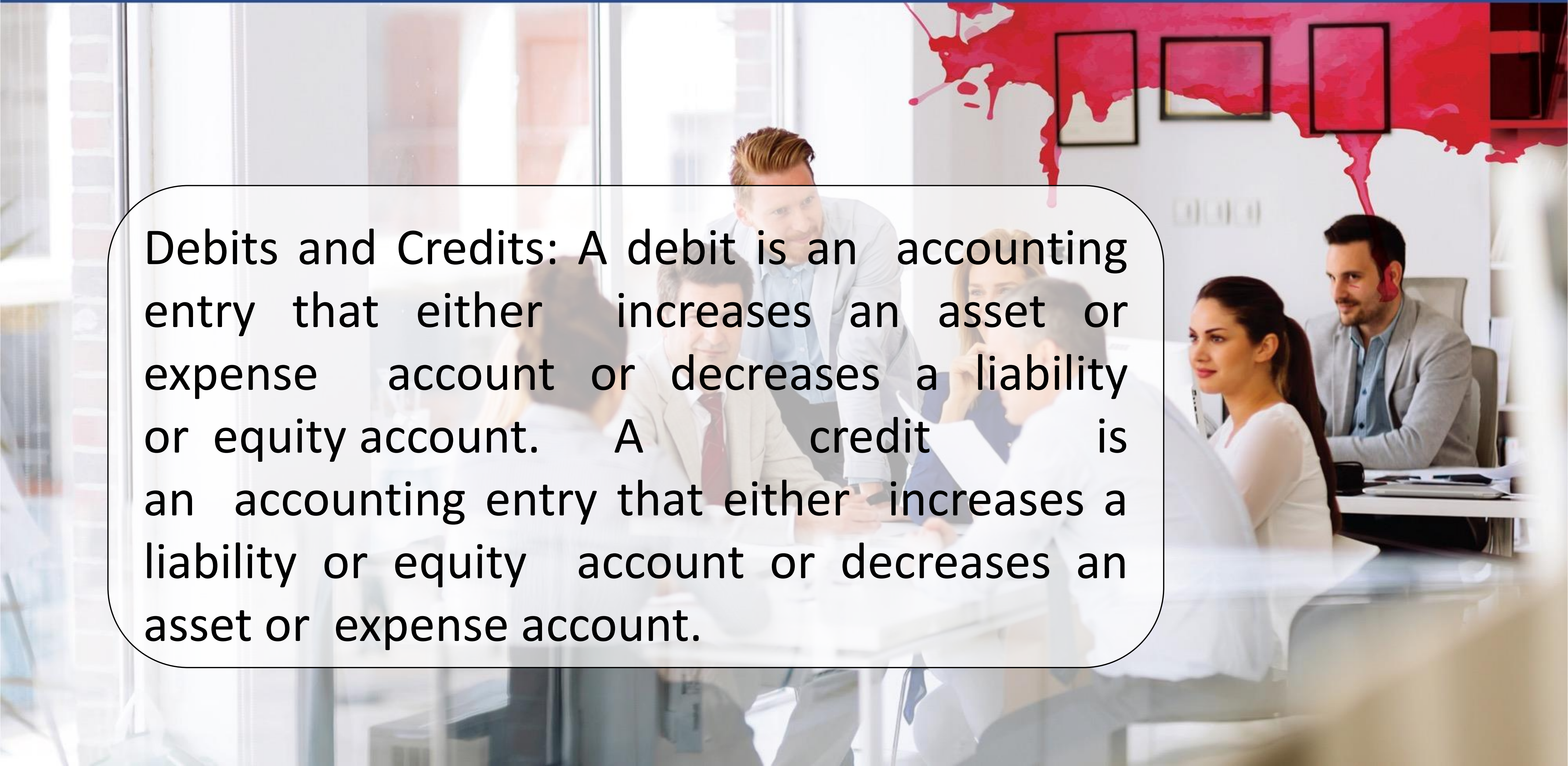
- To report the financial condition of a business at a point in time.
- To report changes in the financial condition of a business over a period of time.
- First, record the economic events affecting a business.
- Second, summarize the impact of these events in a report called financial statements.
- Generally Accepted Accounting Principles (GAAP)

Accounts

What is an Account?

An account is a list of business transactions falling under the same description for a given period of time. A systematic and summarized record of business transactions with respect to person, property, loss, gain, income, expense is known as account. An account is generally prepared for one complete year. The word Account in abbreviation, can be written as A/c. Accounts are prepared and maintained in the ledger. Separate ledger sheet or page is used for each account.

Credit and debit



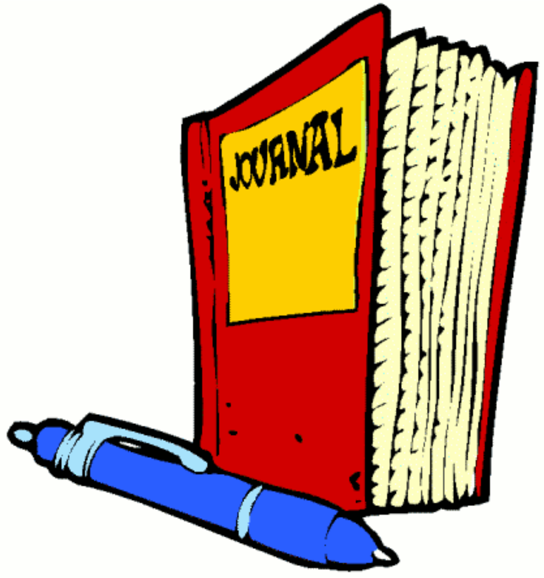
Debits and Credits: A debit is an accounting entry that either increases an asset or expense account or decreases a liability or equity account. A credit is an accounting entry that either increases a liability or equity account or decreases an asset or expense account.

Reconciling an account

- Reconciling an account often means proving or documenting that an account balance is correct. For example, we reconcile the balance in the general ledger account Cash in Checking to the balance shown on the bank statement. The objective is to report the correct amount in the general ledger account Cash in Checking.

Accounting journals

- A journal is a record of financial transactions in order by date.
- The book of original entry.
- Manual systems usually had a variety of journals such as a sales journal, purchases journal, cash receipts journal, cash disbursements journal, and a general journal.



Journal entry

- In manual accounting or bookkeeping systems, business transactions are first recorded in a journal
- A manual journal entry that is recorded in a company's general journal will consist of the following:
  - the appropriate date
  - the amount(s) and account(s) that will be debited
  - the amount(s) and account(s) that will be credited
  - a short description/memo
  - a reference such as a check number

- **Entering invoices or credit notes**
- Invoice entry is the first procedure you perform to initiate a vendor payment. Depending on your business needs, you can enter just a few pieces of required information for an invoice, or enter a wide variety of optional information. This procedure describes the process for entering expense invoices.
- A credit note is used to reverse or correct an invoice. It reverses all of the operations that the invoice performs. A credit note can only be initiated for an invoice, not a payment.
- Occasions when you may need to enter a credit note include reversing a creditor's invoice, making a prompt payment discount or offering a special price reduction.

- Recording payments
- The entry on the table shows how a €1,000 sale may be recorded. The journal entry shows a €1,000 debit to accounts receivable and a €1,000 credit to sales revenue. To record a €1,000 sale — a credit sale — the journal entry needs to show both the €1,000 increase in accounts receivable and the €1,000 increase in sales revenue.
- When the business receives payment from the customer for the €1,000 receivable, the business records a journal entry like that shown.

Recording a Credit Sale		
Account	Debit	Credit
Accounts receivable	1,000	
Sales revenue		1,000

Statement

An account statement is a periodic summary

of account activity with a beginning date and an ending date. The most commonly known are checking

account statements, usually provided monthly,

and brokerage account statements, which are provided monthly or quarterly.

Tip : In the case the records of the accounts are properly maintained then it is quite easy to prepare the statement according

to the required dates.

Statement

- The statement shows the impact that the operations of the business had on its finance for the time interval that the statement is prepared for.

Suppliers’ accounts

If you want to buy from your suppliers on credit and monitor your business relationship with them you need a supplier account for them.
The supplier account usually contains:

- The supplier's name, address and a contact's details.
- The currency in which they conduct their business.
- Your credit limit with them.
- Their bank account details.
- The country in which they are based and the VAT code.

What is a single entry Bookkeeping

The Single entry system is an "informal" accounting/bookkeeping system where the user of this system makes only one aspect (Debit/Credit) to enter a business financial transaction.

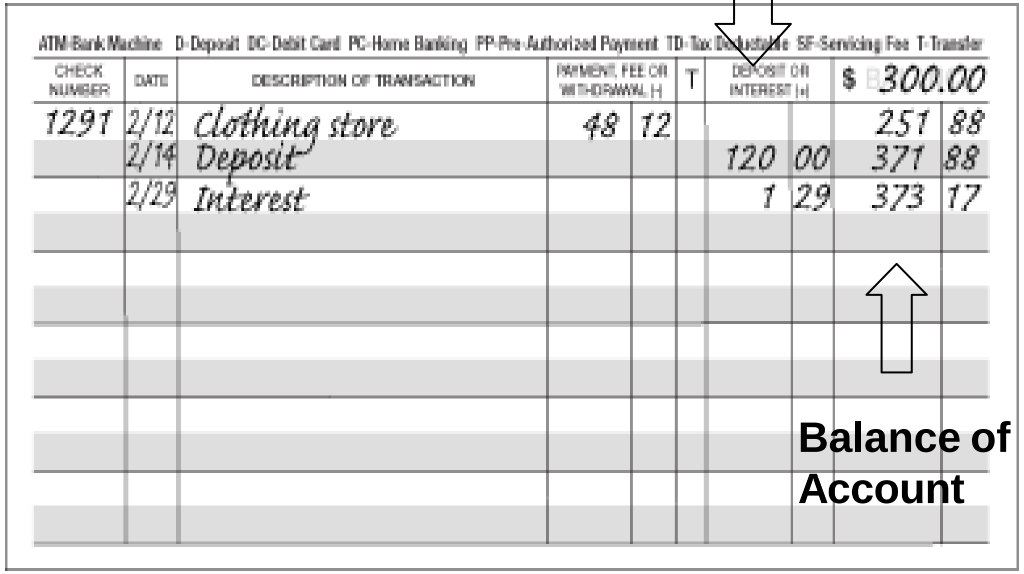
- A single entry system for example may be used to balance a check book where or entry is made for each deposit or cheque written.
- Every Expense entry (ie, payment) is deducted for the balance
- Every Income entry (i.e. deposit is added to the balance)

Example of a single entry

Balancing a Check book by simple Entry System

- Payment (Expense entry)

Deposit and interest (Income Entry)



ATM-Bank Machine D-Deposit DC-Debit Card PC-Home Banking PP-Pre-Authorized Payment TD-Tax Deductable SF-Servicing Fee T-Transfer

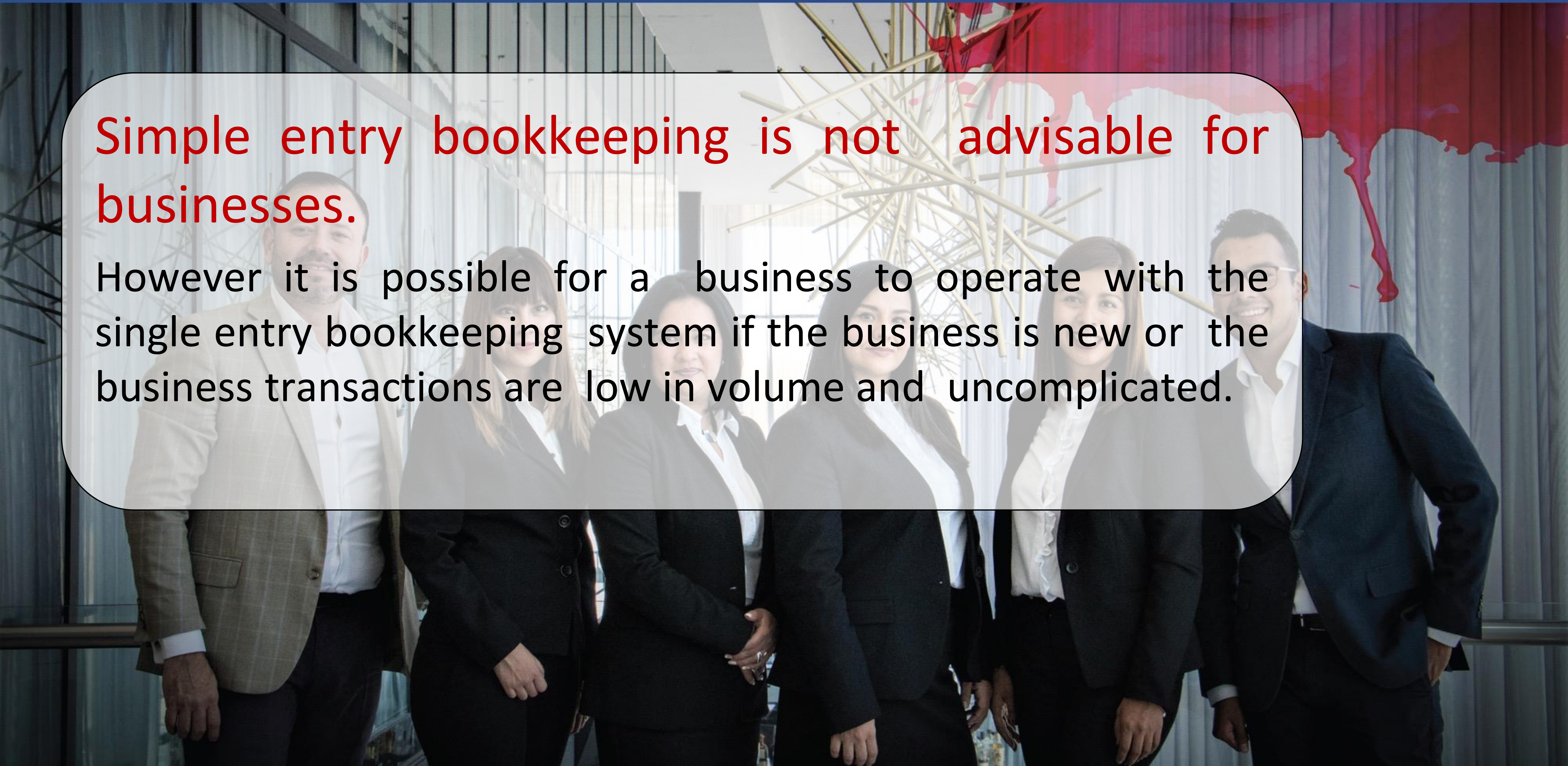
CHECK NUMBER	DATE	DESCRIPTION OF TRANSACTION	PAYMENT, FEE OR WITHDRAWAL (-)	T	DEPOSIT OR INTEREST (+)	$ 300.00
1291	2/12	Clothing store	48 12			251 88
	2/14	Deposit			120 00	371 88
	2/29	Interest			1 29	373 17

Balance of Account

Book columns

- Date - This is the date of the transaction that is written on the invoice or Credit note
- Description - A brief description of the transaction. You can put whatever information you feel necessary, but don't overdo it!
- Reference - You can basically choose whatever reference will help you identify the transaction. Some people use the invoice numbers, or the initials of the type of payment transaction (like DC for Direct Credit).
- Income and Expenses - Simply insert the value of the transaction into the appropriate column... is it money coming in to the business or money going out of the business? You could change the headings to 'Money In' and 'Money Out' if you prefer.
- Bank/Balance - This is a running balance column that changes each time a transaction is entered. Add the income, subtract the expenses.

Single entry bookkeeping for businesses



Simple entry bookkeeping is not advisable for businesses.

However it is possible for a business to operate with the single entry bookkeeping system if the business is new or the business transactions are low in volume and uncomplicated.

Example of a single entry for businesses

Date	Description	Ref	Income	Expenses	Bank Balance	
1-Apr	Balance b/f				200.00	R
4-Apr	Folders and pens	1		15.00	185.00	R
15-Apr	Sale: Ms E Inkson	2	54.00		239.00	R
18-Apr	Sale: Mr R U Redy	3	30.00		269.00	R
19-Apr	Drawings	4		10.00	259.00	R
21-Apr	Envelopes & Stamps	5		20.00	239.00	R
24-Apr	Web host fees	6		40.00	199.00	R
27-Apr	Simply Chairs: Chair	7		127.00	72.00	
29-Apr	Sale: Mr J Mighty	8	30.00		102.00	R
30-Apr	Bank Fee	9		2.50	99.50	R
30-Apr	Sale: Ms T Real	10	54.00		153.50	
	Totals		168.00	214.50	153.50	C/F

BANK RECONCILIATION	
Cash Book Balance	153.50
Add: Unpresented check	127.00
Subtotal	280.50
Less: Deposit not yet showing	54.00
Bank Statement Balance	226.50

Double Entry Bookkeeping

The advisable accounting system for Businesses is Double entry Bookkeeping. Double-entry bookkeeping is a practice that helps minimize errors and increases the chance that your books balance. This method gets its name because you enter all transactions twice.

Double entry Bookkeeping aspects

- Recognition of two aspects. The double-entry book- keeping recognizes that every transaction has two aspects. It is based on the fact that a transaction is an exchange and every exchange involves either two things, or two persons, or a thing and a person
- The double-entry book-keeping system provides the two aspects of the transaction with the names 'debit' and 'credit'. For example, the benefit receiver is given the name 'debit' and the benefit giver is given 'credit'. Thus, for each transaction, one aspect is debited and another aspect is credited.

Double entry Bookkeeping aspects

- The double-entry book-keeping system records two-fold or double effect of every transaction. This implies that the two aspects of a transaction are recorded on two opposite sides of two separate accounts.

Double entry for the same transaction

Double-Entry Bookkeeping: Purchasing an Item with Cash

Account	Debit	Credit
Furniture	$1,500	
Cash		$1,500

Double entry Bookkeeping

Double-Entry Accounting

Balance Sheet Accounts

Asset

Debit	Credit
Increase (+)	Decrease (-)

Liability

Debit	Credit
Decrease (-)	Increase (+)

Owner's Equity

Debit	Credit
Decrease (-)	Increase (+)

Income Statement Accounts

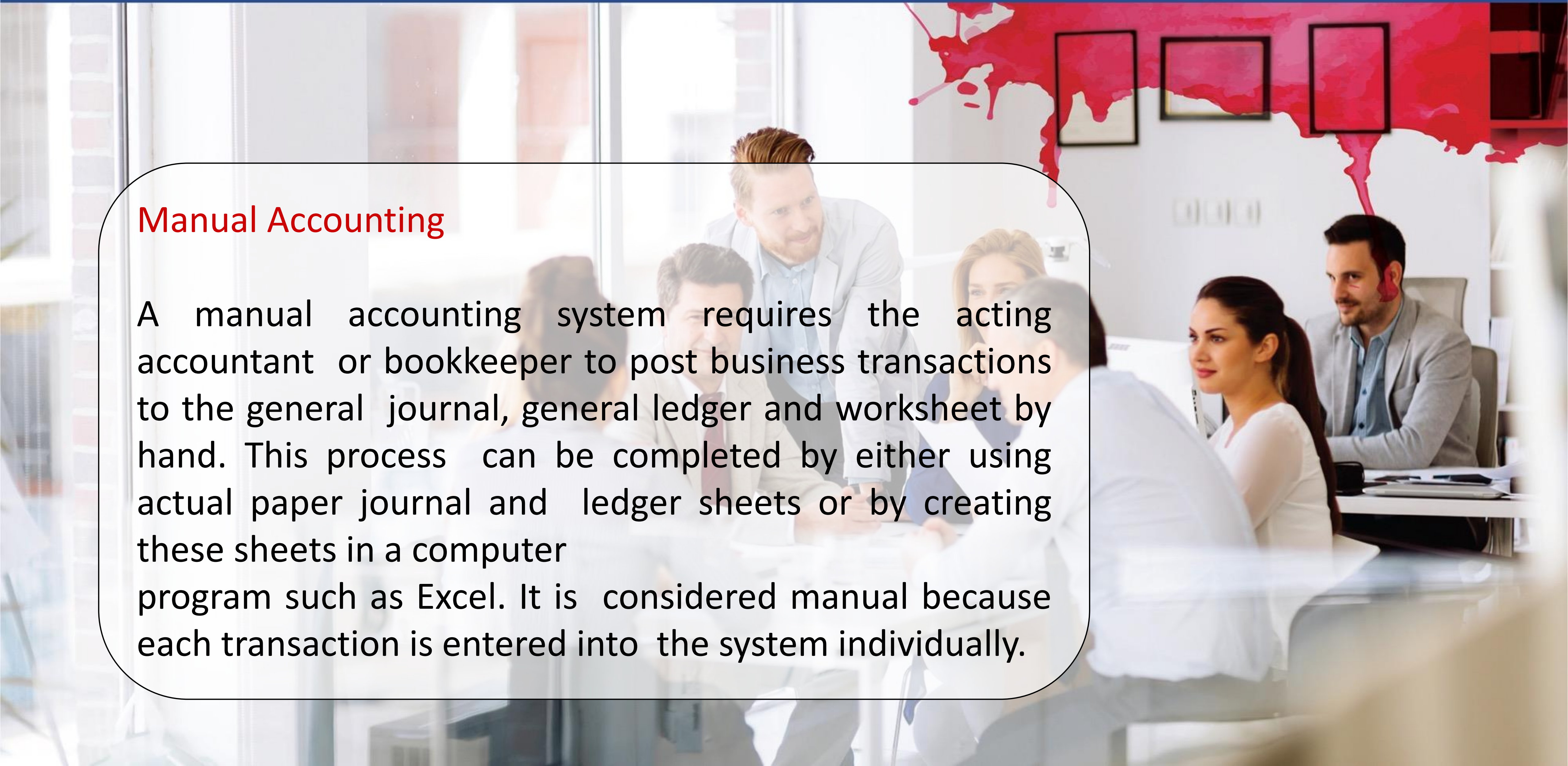
Revenue

Debit	Credit
Decrease (-)	Increase (+)

Expense

Debit	Credit
Increase (+)	Decrease (-)

Manual Vs Computerized Accounting



Manual Accounting

A manual accounting system requires the acting accountant or bookkeeper to post business transactions to the general journal, general ledger and worksheet by hand. This process can be completed by either using actual paper journal and ledger sheets or by creating these sheets in a computer
program such as Excel. It is considered manual because each transaction is entered into the system individually.

Manual Vs Computerized Accounting

Computerized Accounting

- A computerized accounting system allows the user to enter the transaction into the program once, and all accounts are updated as necessary.

For example, if your business buys 1,000 € worth of office supplies with a combination of 500 € cash and 500 € credit, instead of going to each accounting and posting the transaction, with a computerized system you would check office supplies, cash and the selected account payable account and the transactions automatically would post to the accounts.

Manual Vs Computerized Accounting

Advantages of computerized accounting

- Speed and Accuracy: Computerized accounting programs are quicker as far as entering information is concerned.
- End-of-Period Reports: Computerized accounting packages will automatically pull all relevant ledger entries for the period reports.
- Data Manipulation: With a computerized accounting system, information for a particular period of time can be compiled quickly.

Accruals

- Accrual: The meaning of accrual is something that becomes due especially an amount of money that is yet to be paid or received at the end of the accounting period.
  - Realisation: This concept states that revenue from any business transaction should be included in the accounting records only when it is realised.
  - Objective Evidence: every financial entry should be supported by some objective evidence (ie. purchase bills, sale bills, bank statements etc.)

Accruals, example

An accounting firm obtained its office on rent and paid €120,000 on January 1 as annual rent. It does not record the payment as an expense because the building is not yet used. Instead, it records the cash payment as prepaid rent (which is a current asset):

Prepaid rent	DEF	
Bank		DEF

The firm recognizes rent expense over the period. For example, in preparing its quarterly income statement on March 31, the firm expenses out three months' rent i.e. 30,00 (= € 120,000/12 × 3] because 3 months equivalent of time has expired (from 1 January till 31 March).

Rent expense	GHI	
Prepaid rent		GHI

Consistency

Accounting methods once adopted must be applied consistently in future.

Same methods and techniques must be used for similar situations.

A business must refrain from changing its accounting policy unless on reasonable grounds.

Consistency concept is important because of the need for comparability.

Prudence

- Accounting transactions and other events are sometimes uncertain but in order to be relevant we have to report them in time.
- We have to make estimates requiring judgment to counter the uncertainty.
- While making judgment we need to be cautious and prudent.
- Prudence is a key accounting principle which makes sure that assets and income are not overstated and liabilities and expenses are not understated.

Accounting equation

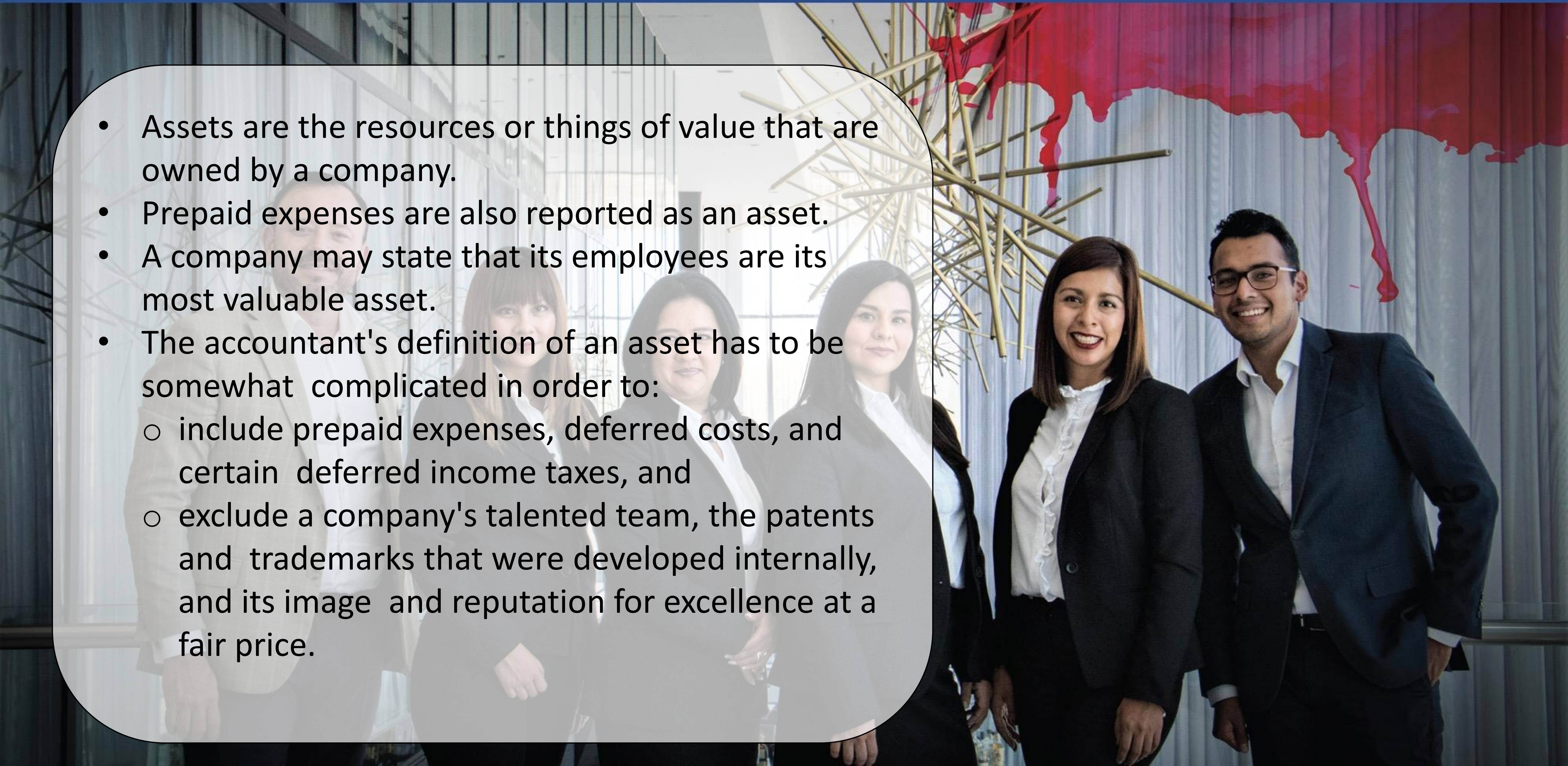
Basic Accounting Concepts, Accounting Equation

Press HERE to watch a video

Accounting equation

- The accounting equation displays that all assets are either financed by borrowing money or paying with the money of the company's shareholders.
- Assets = Liabilities + Shareholder Equity.
- Any purchase or sale by an accounting equity has an equal effect on both sides of the equation, or offsetting effects on the same side of the equation. The accounting equation could also be written as Liabilities = Assets – Shareholder Equity and Shareholder Equity = Assets – Liabilities.

Assets

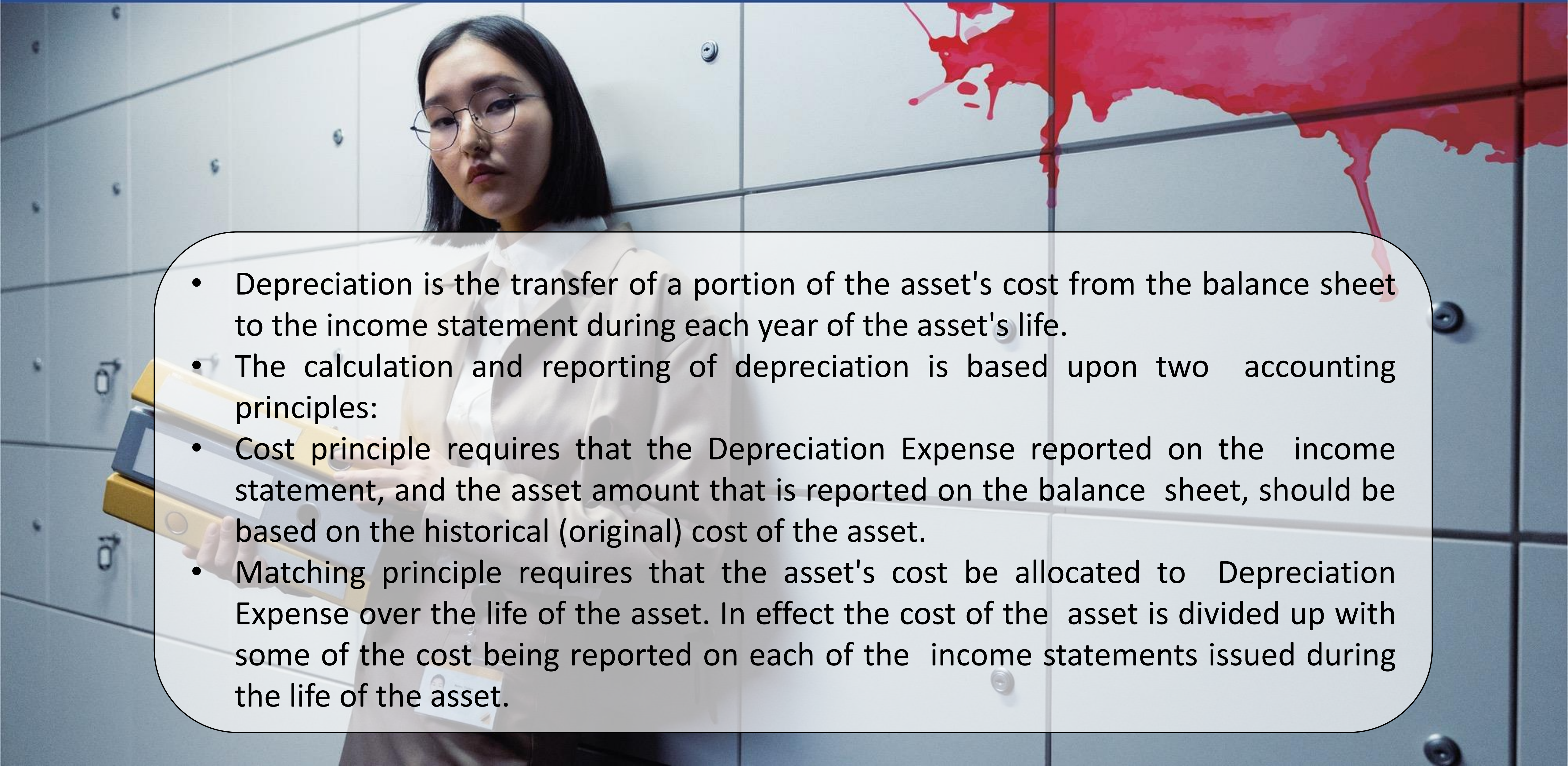


- Assets are the resources or things of value that are owned by a company.
- Prepaid expenses are also reported as an asset.
- A company may state that its employees are its most valuable asset.
- The accountant's definition of an asset has to be somewhat complicated in order to:
  - include prepaid expenses, deferred costs, and certain deferred income taxes, and
  - exclude a company's talented team, the patents and trademarks that were developed internally, and its image and reputation for excellence at a fair price.

Liability

- A liability is an obligation and it is reported on a company's balance sheet.
- A common example of a liability is accounts payable. Accounts payable arise when a company purchases goods or services on credit from a supplier.
- Liabilities are also part of the accounting equation: Assets = Liabilities + Stockholders' Equity.
- Liabilities are often viewed as claims on a company's assets.
- Can also be thought of as a source of a company's assets.

Depreciation



- Depreciation is the transfer of a portion of the asset's cost from the balance sheet to the income statement during each year of the asset's life.
- The calculation and reporting of depreciation is based upon two accounting principles:
- Cost principle requires that the Depreciation Expense reported on the income statement, and the asset amount that is reported on the balance sheet, should be based on the historical (original) cost of the asset.
- Matching principle requires that the asset's cost be allocated to Depreciation Expense over the life of the asset. In effect the cost of the asset is divided up with some of the cost being reported on each of the income statements issued during the life of the asset.

Income statement (profit and loss statement)

- A financial statement that reports a company's financial performance over a specific accounting period.
- Financial performance is assessed by giving a summary of how the business incurs its revenues and expenses through both operating and non-operating activities. It also shows the net profit or loss incurred over a specific accounting period.
- Also known as the profit and loss statement or statement of revenue and expense

Revenue or Income Account

- Revenue or Income Account: represents the company's gross income before expenses are deducted. This account simple shows what the business has earned. The amount is enter here and is added to the balance.

Date	Description	Ref	Income	Expenses	Bank Balance	
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15-Apr	Sale: Ms E Inkson	2	54.00		239.00	R
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BANK RECONCILIATION	
Cash Book Balance	153.50
Add: Unpresented check	127.00
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Balance sheet

- A balance sheet is a financial statement that summarizes a company's assets, liabilities and shareholders' equity at a specific point in time. These three balance sheet segments give investors an idea as to what the company owns and owes, as well as the amount invested by shareholders.
- The balance sheet adheres to the following formula:
- Assets = Liabilities + Shareholders' Equity

Statement of retained earnings

- A financial statement outlining the changes in retained earnings for a specified period.
- The statement is prepared in accordance with generally accepted accounting principles (GAAP). It reconciles the beginning and ending retained earnings for the period, using information such as net income from the other financial statements.

Cash flow statement

- The cash flow statement (CFS) records the amount of cash and cash equivalents entering and leaving a company.
- The CFS allows investors to understand how a company's operations are running, where its money is coming from, and how it is being spent.
- The cash flow statement is distinct from the income statement and balance sheet because it does not include the amount of future incoming and outgoing cash that has been recorded on credit.

Methodological Tool

Manual and Electronic Entries

E-EUPA_LO_3.28_M_001

Methodological Tool

Debit or credit account affect?

E-EUPA_LO_3.29_M_001

Revision Questions

e-eupa Certification for Administration Personnel

Question 1

- Why is Bookkeeping Essential for business?

Question 2

- What are credit and debit notes?

Question 3

- Which are the differences between double and single entry bookkeeping?

Question 4

- What is a balance sheet?

Question 5

- What are the processes and procedures of financial reporting?

Key points

Key Point 1
Bookkeeping
- Introduction to Accounting
- Single entry bookkeeping
- Double entry bookkeeping

Key Point 2
Financial reporting
- Accruals
- Accounting equation
- Depreciation
- Assets
- Liabilities
- Statements

WELL DONE

You have completed Unit 3.8

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