

Basic Accounting Concepts

MIS23

1	<p>Every transaction must have a Debit (DR) side and a Credit (CR) side – think of an old fashioned weighing scales in perfect balance – two sides of equal weight, one side equals the other. This concept is called the Double Entry System.</p>		
2	<p>A DR balance is either an Asset or an Expense A CR balance is either a Liability or a Gain/Revenue <i>This may sound like a contradiction but its true!, eg.,</i></p> <ul style="list-style-type: none"> <i>The monthly telephone bill is an Expense and is Debited to the nominal telephone a/c</i> <i>The purchase of a computer, eg, an Asset, is Debited to the Computer Equipment a/c</i> <i>Take out a 5 year loan – the Bank a/c is Debited with the amount received (and lodged) while the Loan a/c is Credited with same - the loan is a Liability!</i> <i>If you owe a supplier €123.00 and you only pay €120.00, then the €3 not paid (a discount in accounting terms) is a Gain. The Bank A/C would be Credited with €120.00, the Discount Received a/c would be Credited with €3 while the Creditors Control a/c would be Debited with €123.0</i> 		
3	<p>An Asset is property or value owned by a company A Liability is money owed to someone, suppliers, bank loans, etc An Expense is charged against profits A Gain adds to Profits</p>		
4	<p>Assets and Liabilities appear in the Balance Sheet Expenses and Gains appear in the Profit & Loss Account</p>		
5	<p>Accounts which receive values are Debited “Dr. the Receiver” Accounts which give values are Credited “Cr. the Giver” Accounts can be represented in a T format with Debits usually on the LEFT of the T and Credits on the RIGHT of the T, eg.,</p> <div style="text-align: center;"> <p>Bank A/C</p> <table border="1" style="margin: auto;"> <tr> <td style="text-align: center; width: 50%;">Debits. (Receipts IN)</td> <td style="text-align: center; width: 50%;">Credits. (Payments OUT)</td> </tr> </table> </div> <p>Money is received from a Cash Sale and lodged to the Bank A/C. The Bank A/C is Debited – it received the Value (Dr. the Receiver) , while The Cash Sales A/C is Credited – it gave the Value (Cr. the Giver)</p>	Debits. (Receipts IN)	Credits. (Payments OUT)
Debits. (Receipts IN)	Credits. (Payments OUT)		
6	<p>The accounts which record all Assets, Liabilities, Expenses & Gains are held in the Nominal Ledger which can also be called the General Ledger. Transactions entered directly into a Nominal Ledger are done by Journals – a Journal must BALANCE, ie., debits must equal credits.</p>		

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	<i>All Double Entry (Debits must equal Credits) takes place in the Nominal Ledger.</i>						
7	<p>The accounts which hold details of all transactions with customers are held in a Sales Ledger.</p> <p>The accounts which hold details of all transactions with suppliers are held in a Purchases Ledger</p> <p>Transaction types common to both Ledgers include:- Invoices, Credit Notes, Receipts (Sales Ledger), Payments (Purchases Ledger), Journal Adjustments Debit and Journal Adjustments Credit</p>						
8	<p>The report which lists all amounts due from Customers or Debtors and also states how long the money is owed, is called the Aged Debtors Listing.</p>						
9	<p>The report which lists all amounts due to Suppliers or Creditors and also states how long the money is owed, is called the Aged Creditors Listing.</p>						
9a	<p><u>Debtors Control A/C in the Nominal Ledger.</u></p> <p>The balance on this a/c represents the total due of all the individual customers or debtors a/cs in the Sales Ledger (SL). Think of the Control A/C as a “mirror image” of the individual Sales Ledger a/cs – any transaction that is posted to a SL a/c is “reflected” in the Control A/C.</p> <p>Take a simple transaction – an invoice for €100 plus 21% VAT, a total of €121, is posted to an individual customer a/c., ie. To the LEFT or DR. side of the customers T a/c In the Nominal Ledger, the following corresponding postings are made.</p> <table><tr><td style="text-align: center;">Sales A/C</td><td style="text-align: center;">Vat Output A/c</td><td style="text-align: center;">Debtors Control A/C</td></tr><tr><td style="border-top: 1px solid black; border-left: 1px solid black; border-right: 1px solid black; width: 100px; height: 50px; display: flex; align-items: center; justify-content: center;">Inv x 100</td><td style="border-top: 1px solid black; border-left: 1px solid black; border-right: 1px solid black; width: 100px; height: 50px; display: flex; align-items: center; justify-content: center;">Inv x 21</td><td style="border-top: 1px solid black; border-left: 1px solid black; border-right: 1px solid black; width: 100px; height: 50px; display: flex; align-items: center; justify-content: center;">Cust x 121</td></tr></table> <p style="text-align: center;">The two credits of 100 + 21 equals the one debit of 121.00</p> <p>When the customer pays in full, the RIGHT hand side of the customer’s T a/c will get the credit of €121. In the Nominal Ledger, the following corresponding postings are made:- the Bank A/C will be Debited with €121 while the Debtors Control A/C will Credited with €121.</p> <p>As can be seen, any transaction in a customers a/c is mirrored in the Control A/C</p> <p>For suppliers a/cs in the Purchases Ledger (also known as the Creditors Ledger), the Nominal Control a/c is called the Creditors Control A/C.</p>	Sales A/C	Vat Output A/c	Debtors Control A/C	Inv x 100	Inv x 21	Cust x 121
Sales A/C	Vat Output A/c	Debtors Control A/C					
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10	<p>The three main reports produced from the Nominal Ledger are:-</p> <p>The Trial Balance – this list each a/c’s balance under either the DEBIT or CREDIT columns: it should balance, if not the reason for the imbalance has to be investigated.</p> <p>The Profit & Loss Report – this states the Gross Profit or Loss made and the Net Profit or Loss made for a particular period.</p> <p>The Balance Sheet states all Assets and Liabilities as at a particular date.</p>																		
11	<p>Format of the Profit & Loss is:-</p> <table><tr><td></td><td>Sales /Gains</td><td>Credit Amount</td></tr><tr><td>Less</td><td>Cost of Sales</td><td>Debit Amount</td></tr><tr><td>Equals</td><td>Gross Profit</td><td>which will be a Credit Balance OR</td></tr><tr><td></td><td>Gross Loss</td><td>which will be a Debit Balance</td></tr></table> <p>Charged against the Gross Profit are the Expenses or Overheads (usually ALL debit amounts). Overheads are grouped by classification, eg.,</p> <p>Personnel Costs (Salaries, Employers PRSI, Staff Expenses, Staff Training, etc)</p> <p>Premises Costs (Rent, Rates, Security, Repairs, Cleaning, Insurance, etc)</p> <p>General Costs (Stationery, Office Supplies, Telephones, Office Equip Maint., etc)</p> <p>Financial Costs (Bank Fees & Charges, Lease Interest, Currency Losses/Gains, etc)</p> <p>Marketing Costs (Advertising, Brochure Printing, Trade Shows, etc)</p> <p>Vehicle Costs (Tax, Insurance, Fuel, Maint & Repair)</p> <p>Depreciation (Office & Computer Equipment, Plant & Machinery, Vehicles, etc)</p> <p><i>etc</i></p> <p>Gross Profit or Loss LESS Total Overheads equals NET Profit or Loss</p>		Sales /Gains	Credit Amount	Less	Cost of Sales	Debit Amount	Equals	Gross Profit	which will be a Credit Balance OR		Gross Loss	which will be a Debit Balance						
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12	<p>The Cost of Sales is traditionally computed as follows:-</p> <table><tr><td></td><td>Opening Stocks</td><td>(a Debit amount)</td></tr><tr><td>+</td><td>(1) Purchases of Goods for Resale</td><td>(a Debit amount)</td></tr><tr><td>+</td><td>(2) Freight or Carriage in getting goods to stores)</td><td>(a Debit amount)</td></tr><tr><td></td><td>Total of (1) + (2) is known as Landed Cost</td><td></td></tr><tr><td>Less</td><td>Closing Stock</td><td>(a Credit amount)</td></tr><tr><td>Equals</td><td>Cost of Goods Sold or Cost of Sales</td><td></td></tr></table> <p>The above approach means that a Stock Valuation Report has to be run on a monthly basis and input into the accounting system.</p> <p>An alternative method gets rid of the above method of calculation by <i>transferring the cost of the item sold</i> from the Balance Sheet Stock A/C to a Cost of Sale A/C held in the Profit & Loss section, ie.,</p> <p>The Stock A/C in the Balance Sheet is Credited and</p> <p>The Cost of Sale A/C in the P & L is Debited with the cost of the item sold.</p> <p>This means that stock purchases are Debited to the Balance Sheet Stock a/c instead of the P&L Purchases A/C.</p>		Opening Stocks	(a Debit amount)	+	(1) Purchases of Goods for Resale	(a Debit amount)	+	(2) Freight or Carriage in getting goods to stores)	(a Debit amount)		Total of (1) + (2) is known as Landed Cost		Less	Closing Stock	(a Credit amount)	Equals	Cost of Goods Sold or Cost of Sales	
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13	<p>Format of the Balance Sheet is typically:-</p> <p>Fixed Assets (Premises, Plant, Vehicles, Office/Computer Equipment.</p> <p style="text-align: center;">+</p> <p>Current Assets (Stocks, Debtors, Cash in Banks, Loans due from staff, etc)</p> <p style="text-align: center;">= Total Assets.</p> <p>Current Liabilities (Creditors, PRSI/PAYE due, VAT Due, Loans Due, Leases Due, etc)</p> <p style="text-align: center;">+</p> <p>Long Term Liabilities (Loans due for more than one year)</p> <p style="text-align: center;">+</p> <p>Funding (Share Capital, Profit/Loss This Year, Retained Profits/Loss b/f)</p> <p style="text-align: center;">= Total Liabilities</p> <p style="text-align: center;">Total Assets MUST EQUAL Total Liabilities</p>										
14	<p>If you start a limited company with an Issued Share Capital of €2, then your Accounts System would have the following 2 Balance Sheet A/cs</p> <div style="display: flex; justify-content: space-around; align-items: flex-start;"> <div style="text-align: center;"> <p>Bank A/C</p> <hr style="width: 100px; margin: 0 auto;"/> <table border="0" style="margin: 5px auto; border-collapse: collapse;"> <tr> <td style="border-right: 1px solid black; padding: 5px;">Share Cap €2</td> <td style="padding: 5px;"></td> </tr> </table> </div> <div style="text-align: center;"> <p>Share Capital Issued</p> <hr style="width: 100px; margin: 0 auto;"/> <table border="0" style="margin: 5px auto; border-collapse: collapse;"> <tr> <td style="border-right: 1px solid black; padding: 5px;"></td> <td style="padding: 5px;">Bank €2</td> </tr> </table> </div> </div> <p>The Bank RECEIVED the value of €2 while the Share Capital GAVE the value!</p> <p>The Bank gave an Overdraft Facility of €50,000. This has no effect on the accounts! You buy €100 (excluding 21% VAT) worth of Stock and pay by cheque. The accounting entries are as follows:-</p> <div style="display: flex; justify-content: space-around; align-items: flex-start;"> <div style="text-align: center;"> <p>Bank A/C</p> <hr style="width: 100px; margin: 0 auto;"/> <table border="0" style="margin: 5px auto; border-collapse: collapse;"> <tr> <td style="border-right: 1px solid black; padding: 5px;">Share Cap €2</td> <td style="padding: 5px;">Stock €121</td> </tr> </table> </div> <div style="text-align: center;"> <p>Stock A/C</p> <hr style="width: 100px; margin: 0 auto;"/> <table border="0" style="margin: 5px auto; border-collapse: collapse;"> <tr> <td style="border-right: 1px solid black; padding: 5px;">Bank €100</td> <td style="padding: 5px;"></td> </tr> </table> </div> <div style="text-align: center;"> <p>Input VAT A/C</p> <hr style="width: 100px; margin: 0 auto;"/> <table border="0" style="margin: 5px auto; border-collapse: collapse;"> <tr> <td style="border-right: 1px solid black; padding: 5px;">Bank €21</td> <td style="padding: 5px;"></td> </tr> </table> </div> </div> <p>The CREDIT on the Bank A/C = the total of the 2 Debits on the Stock & VAT A/cs</p> <p>A very important concept is introduced here - All amounts in a P & L and Balance Sheet are VAT EXCLUSIVE.</p> <p>Vat on Sales is a Liability – it is owed to the government – and is posted to the Credit of a VAT Output A/C</p> <p>Vat on Purchases is an “Asset” and is posted to the Debit of a VAT Input A/C – you can offset it against the Output VAT – the balance is payable to the government. Where Input Vat is greater than Output Vat, then the government has to refund the excess.</p> <p>Input VAT is split between Vat on Purchases for Resale and VAT on Overheads. There is no Vat on Imports from EU Countries and a separate VAT Code is required to account for both EU Imports and EU Exports.</p>	Share Cap €2			Bank €2	Share Cap €2	Stock €121	Bank €100		Bank €21	
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