Lesson 4.

System of accounting accounts and double entry record

Ph.D in Economic sciences,

Associate Professor

Ulan Moldokmatov

AGENDA

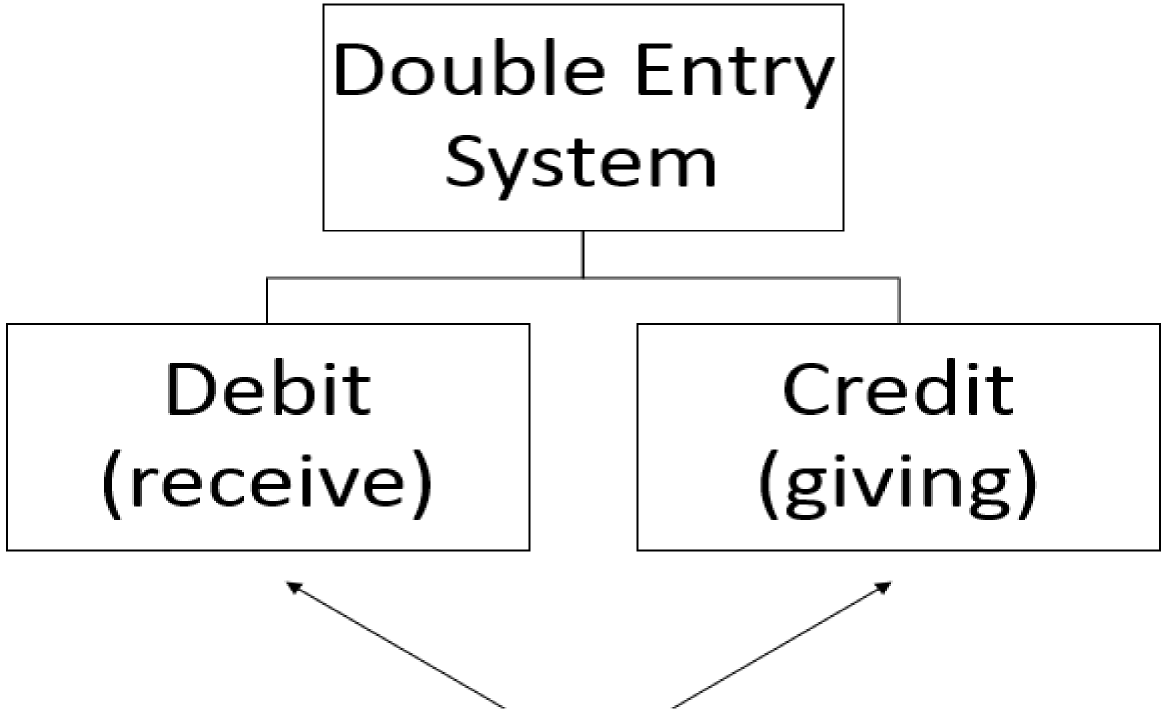
I. The concept of double entry, identification and analysis of business operations

II. Accounts of synthetic and analytical accounting

III. Turnover statements on the accounts of synthetic and analytical accounting

I. Understanding DOUBLE ENTRY SYSTEM

The double entry system is a system that records every business transaction into two separate ledger accounts with the same amount, one account is debited while the other account is credited with the same amount, ensuring that the accounting equation (Assets = Liabilities + Equity) remains balanced.



Same value all the time

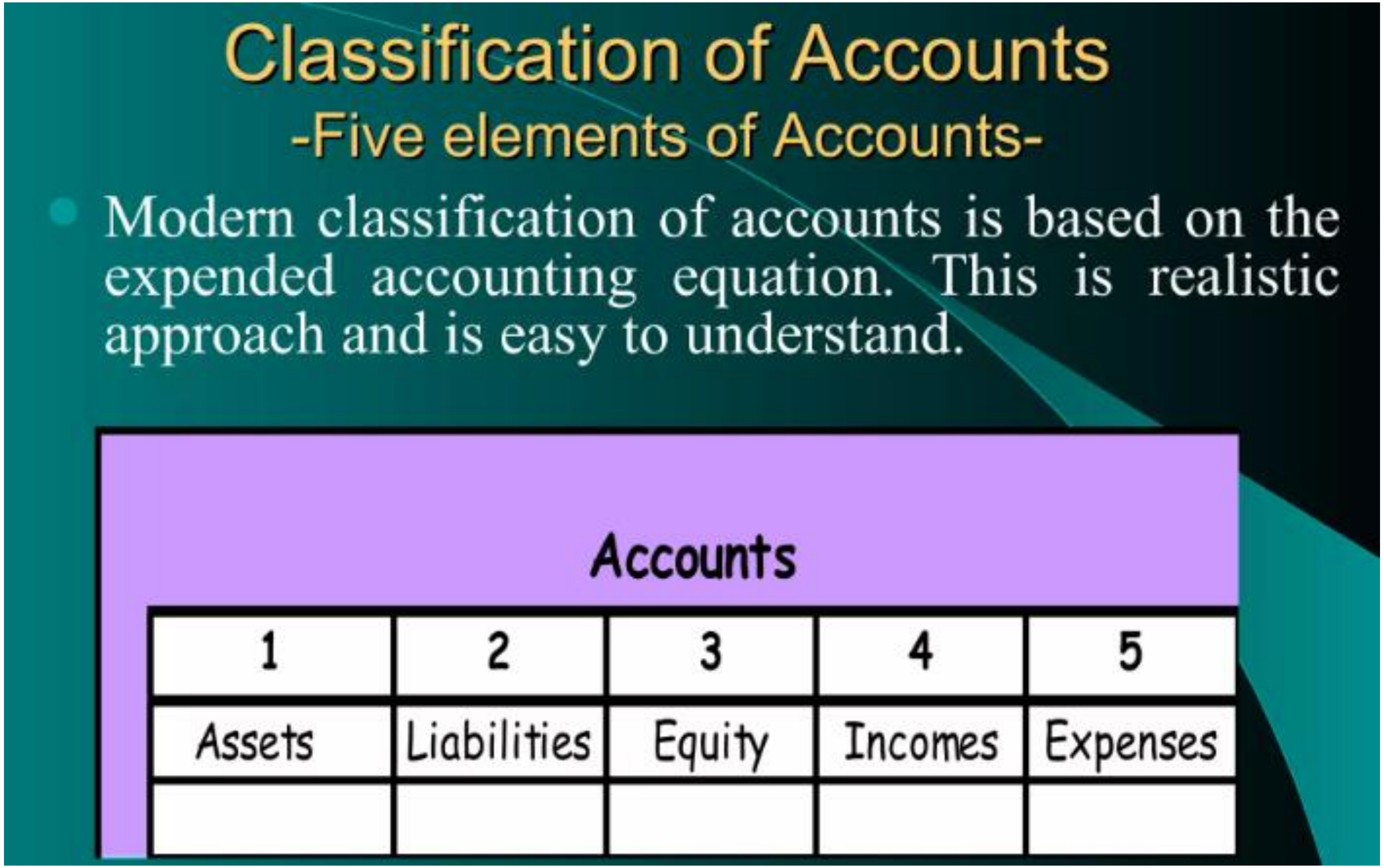
Double Entry System

- Modern Accounting System is based on double entry system which is based on the fundamental accounting equation
- Assets=Liabilities + Equity
- The double-entry accounting system ensures that the accounting equation always remains in balance.
- Debits must be equal Credits.

The original entry into the books of the business that records the debit and credit aspects of the source documents that evidence a financial event is called **transaction**. Purchasing goods, paying bills, receiving cash, selling goods, recording depreciation, making payments, adjusting prepayments etc are the examples of business events which are need to be recorded in term of transaction. Every transaction must include at least on account debited and at least one account credited. Debits and Credits are system of notation used in bookkeeping to determine how to record any financial transaction.

Accounts and their classification

- Account is the individual record of an asset, a liability, a revenue, an expense or capital, in a summarized manner. (Sales, Purchases, Cash, Bank, Income, Exp etc). It means if I need to see the detail of purchase or sale I will see the account of purchase or sale. Account included the detailed record of five element of accounting.

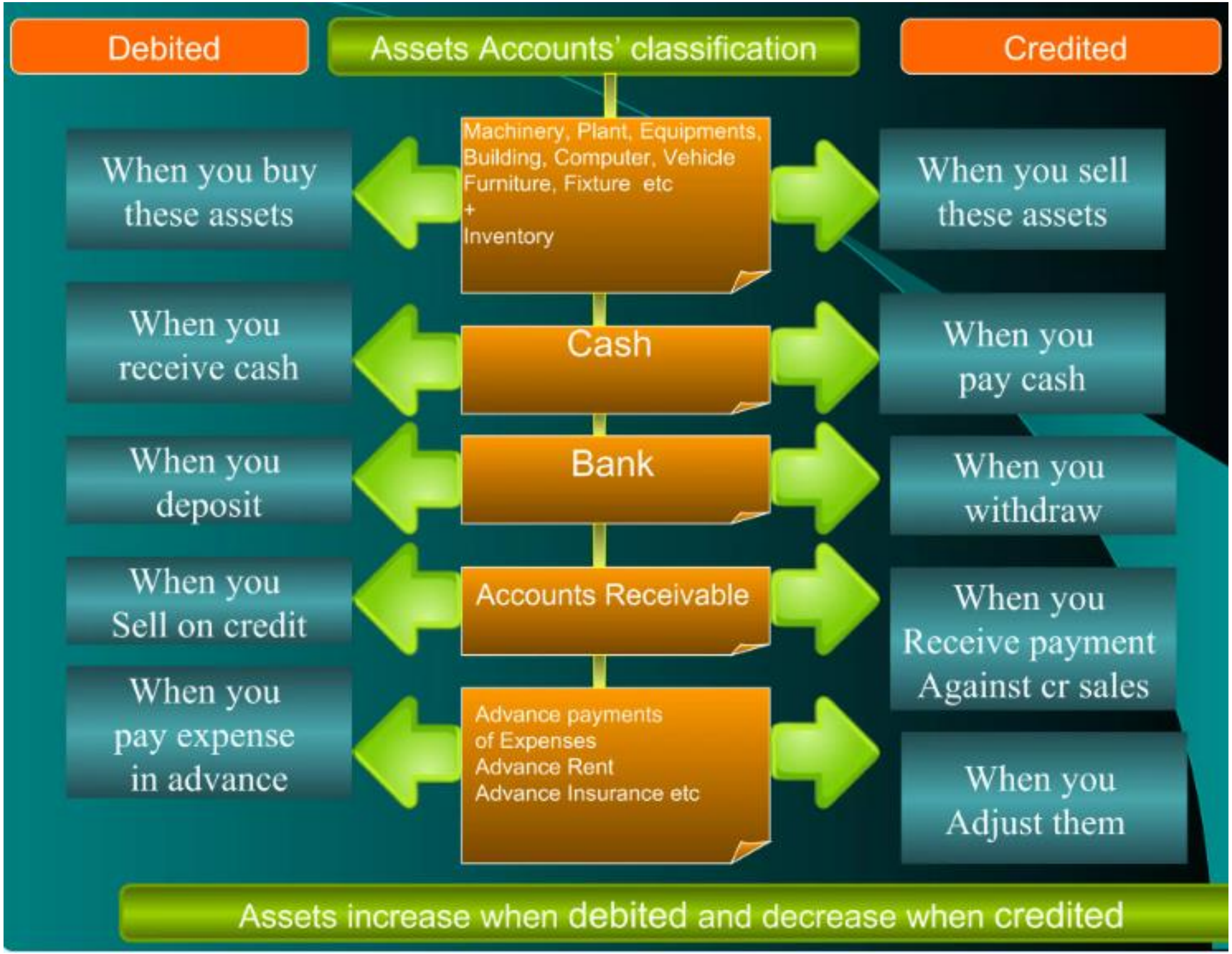


An asset is a resource with economic value that an individual, a company, or a country owns or controls with the expectation that it will provide a future benefit.

Rules of Debit and Credit

Five elements of accounts with their respective normal balance

	ASSETS	LIABILITIES	CAPITAL	REVENUE	EXPENSES
NORMAL BALANCE	DEBIT	CREDIT	CREDIT	CREDIT	DEBIT
WHEN INCREASE	DEBIT	CREDIT	CREDIT	CREDIT	DEBIT
WHEN DECREASE	CREDIT	DEBIT	DEBIT	DEBIT	CREDIT

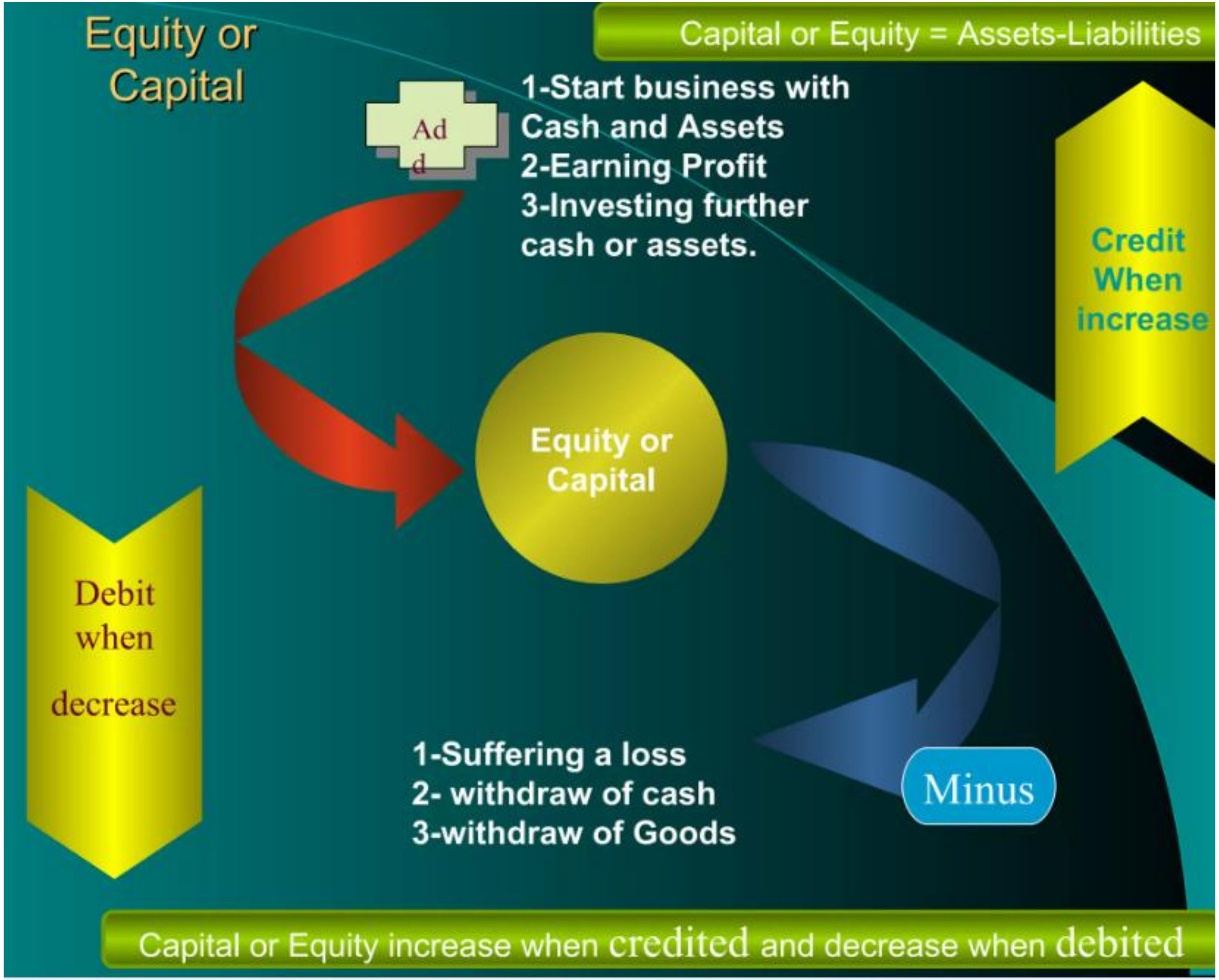

Debited
Assets Accounts' classification
Credited
When you buy these assets
Machinery, Plant, Equipments, Building, Computer, Vehicle Furniture, Fixture etc + Inventory
When you sell these assets
When you receive cash
Cash
When you pay cash
When you deposit
Bank
When you withdraw
When you Sell on credit
Accounts Receivable
When you Receive payment Against cr sales
When you pay expense in advance
Advance payments of Expenses Advance Rent Advance Insurance etc
When you Adjust them
Assets increase when debited and decrease when credited

- Liabilities: Liabilities are obligations or debts that an enterprise has to pay at some time in the future. They represent creditors' claims on the firm's assets. Followings are types of liabilities
- **Purchases on credit**. When you buy goods or assets on credit and promise to pay the due amount at some future. We use Accounts payable account for these.
- **Expense due but not paid.** If expenses like rent , wages etc are due on end of the month/year but not paid are called outstanding expenses or accrued expenses.
- **Unearned revenue.** Suppose Ali is manufacturer of butter, one of his customer pays him Rs. 50,000 in advance. Unless Ali delivers the butter to his customer, the amount will be not be treated as Sales or Revenue, but it would be treated as Liability. When Ali delivers the butter, unearned revenue will be converted into REVENUE.


Liabilities.
Debited
Credited
When you pay for
Goods/ assets
Bought on
Credit
When unpaid
expenses
Are paid
Purchase on credit
Accounts Payable
Rent Payable
Wages payable
etc
When you buy
Goods/ assets on
Credit
When expenses
Not paid on time
When goods
Deliver for the
Amount received
Or
Cash returned
Advances from customers
When advance
Received from
Customers
Liabilities increase when credited and decrease when debited

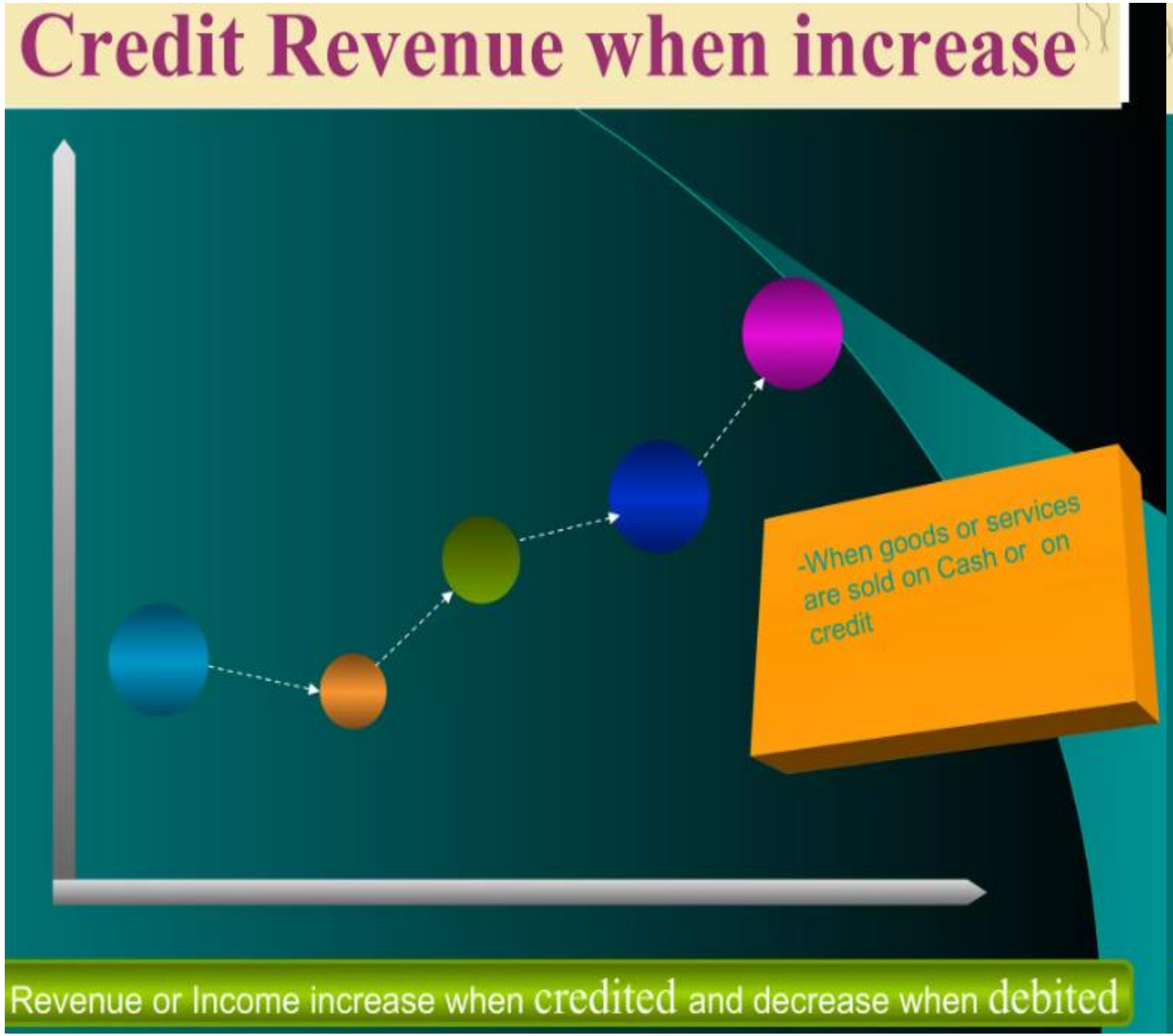
Capital or Equity

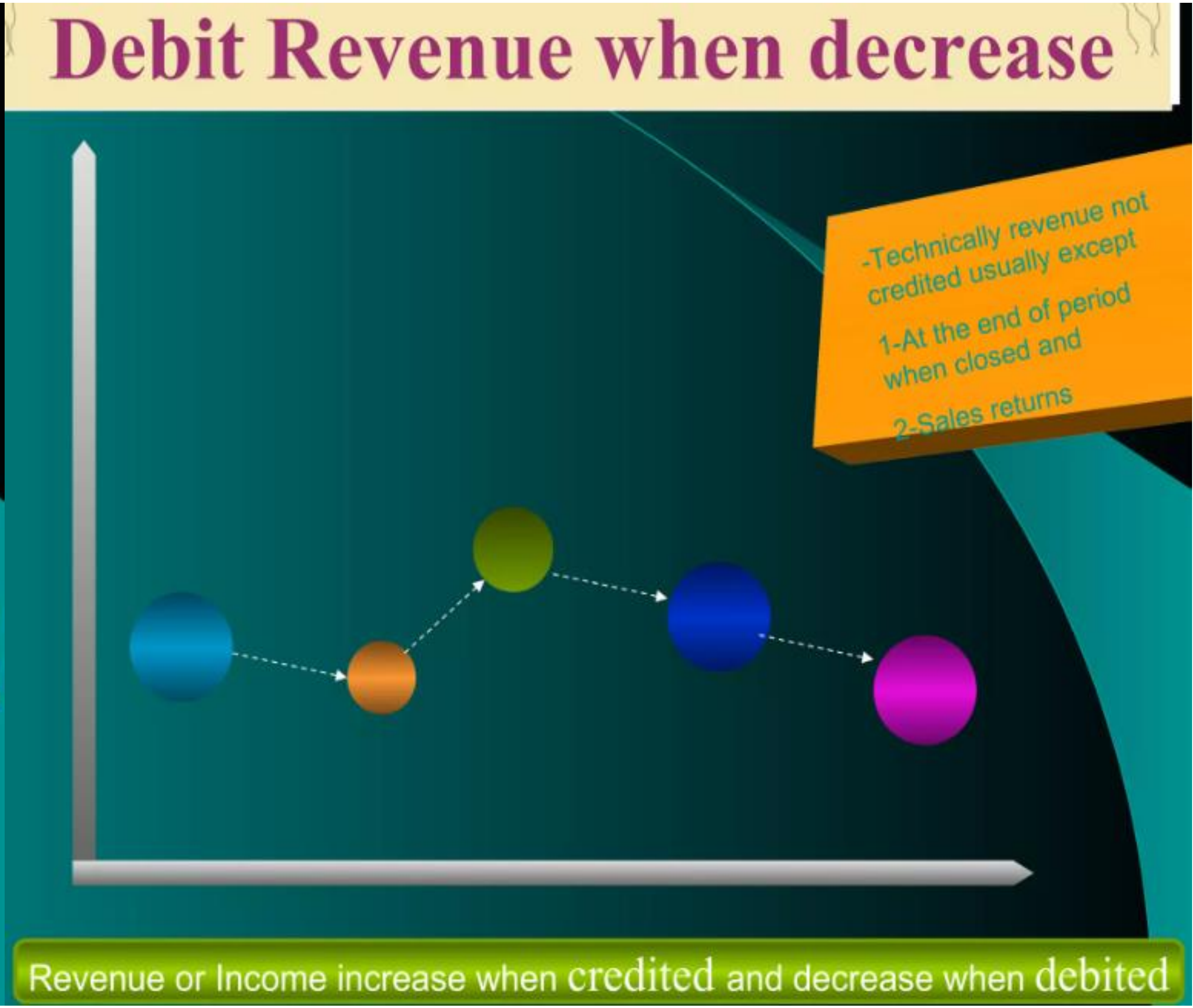
- Equity or Capital represents the owner's claim to the assets. When a new business starts, capital includes the amount invested by owner in term of cash or assets. For the next subsequent years, profits are added in it and losses and withdrawals or drawings are subtracted from it. So owner's capital increased by earning profit or investing further assets and decreased by suffering loss or taking cash or goods for personal use and selling assets of the business.


Equity or Capital
Capital or Equity = Assets-Liabilities
Ad
d
1-Start business with Cash and Assets
2-Earning Profit
3-Investing further cash or assets.
Credit When increase
Equity or Capital
Debit when decrease
1-Suffering a loss
2- withdraw of cash
3-withdraw of Goods
Minus
Capital or Equity increase when credited and decrease when debited

Revenue, also known as turnover, is the total amount of money that a business has taken in over a defined period, such as a year, from the sale of its products or services.

Revenue minus Expenses equals profit (or net income). It is a fundamental equation used in accounting and financial analysis to determine the financial performance of a business or entity. When revenue exceeds expenses, it results in a positive value, indicating a profit. Conversely, if expenses exceed revenue, the result is a negative value, indicating a loss. Profit is an important measure of the financial health and success of a business.



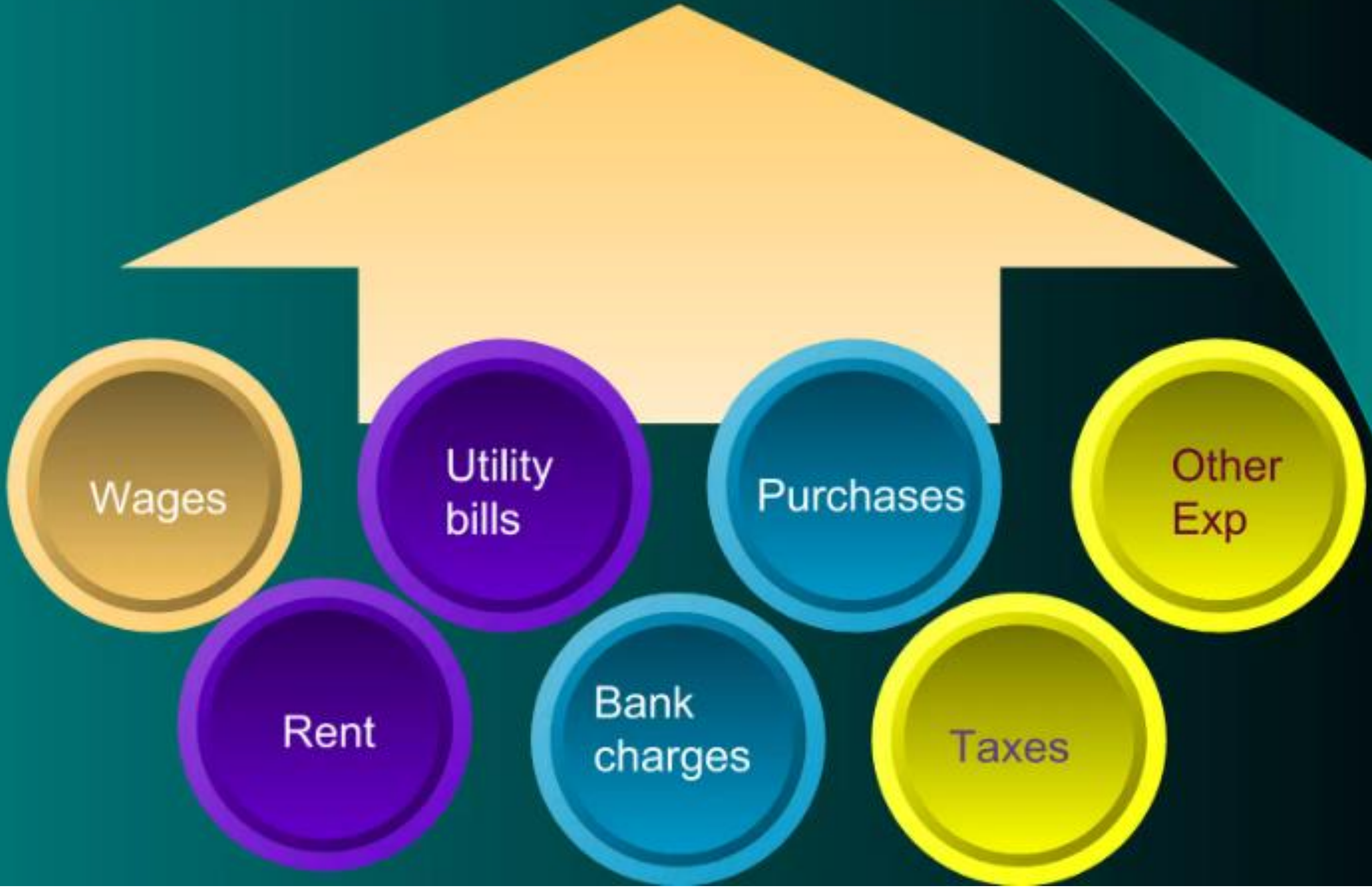


Expenses

- An expense in accounting is the money spent or cost incurred in an entity's efforts to generate revenue.
- Goods or services purchased directly for the running of the business that have completely spent their economic value at the time of the preparation of the financial statements. e.g. Wages expense, Bank charges, Electricity expense.
- Expenses are debited when incurred regardless of being paid or payable

Expenses

When incurred/ increased are debited



Normally expenses are not decreased

- Generally expenses are not decreased so never credited. When accounting period completes and revenues (sales) and expenses accounts are closed and are needed to transfer the balances to Trading and P&L.
- Expenses are credited to Trading and P&L account
- Purchase returns are also credited .

Example.

On 1st of January 20XX. Almaz started as Ltd Co. by investing 200 000 soms.

GENERAL JOURNAL

DATE		Description	Account Number	Debit	Credit
20XX					
Jan	10	Cash		200 000	
		To Capital (Almaz) Almaz invested cash in business			200 000

Accounting Equation in balance

- We originate Journal Entry as below
- Building dr 80,000
- To Cash cr 80,000
- Cash decreased and Asset (Building increased by the same amount) Total Asset are equal to Rs. 120,000 cash and Rs. 80,000 Building. (120,000+80,000) = 200,000.

Cash Building = Liabilities + Equity / Capital

200,000 = 0000 + 200,000

Cash increase by debiting and Building increased by debiting also

II. Synthetic Accounts

- **Definition**: Synthetic accounts, also known as summary or control accounts, aggregate data from multiple transactions and provide an overview of financial activities.
- **Purpose**: They give a summarized view of the company's financial position and performance. These accounts are useful for preparing financial statements, such as the balance sheet and income statement.
- **Examples**: Common synthetic accounts include Accounts Receivable, Accounts Payable, Inventory, Sales, and Purchases.
- **Characteristics**:
  - **Aggregated Data**: Combine data from multiple transactions.
  - **Summary-Level Information**: Provide an overall picture rather than detailed insights.
  - **Simplifies Reporting**: Helps in preparing summarized financial reports.

Analytical Accounts

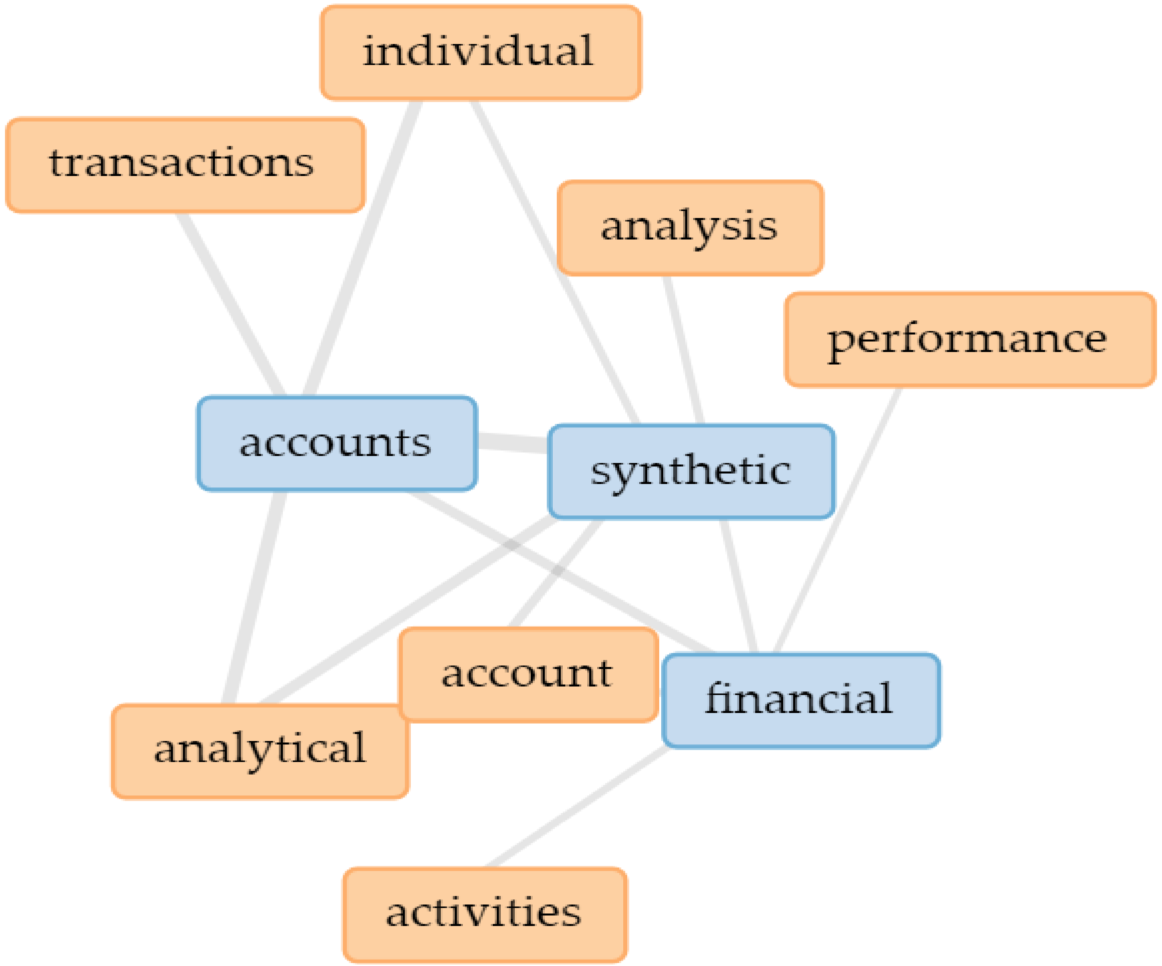
- **Definition**: Analytical accounts, also known as detailed or subsidiary accounts, provide detailed information about individual transactions.
- **Purpose**: They offer specific details on each transaction, allowing for in-depth analysis and tracking of financial activities.
- **Examples**: Detailed records of transactions with each customer or supplier, individual inventory items, and specific expense categories.
- **Characteristics**:
  - **Detailed Data**: Include information about each transaction.
  - **Transaction-Level Information**: Offer insights into specific financial activities.
  - **Supports Control and Reconciliation**: Helps in reconciling synthetic accounts and controlling individual account activities.

Relationship Between Synthetic and Analytical Accounts

- **Hierarchy**: Analytical accounts feed into synthetic accounts. The data from detailed transactions in analytical accounts are summarized in synthetic accounts.
- **Control and Reconciliation**: Synthetic accounts act as control accounts that need to be reconciled with the total balances of their respective analytical accounts to ensure accuracy.
- **Example**:
  - **Accounts Receivable (Synthetic Account)**: Summarizes the total amount owed by all customers.
  - **Customer Sub-Accounts (Analytical Accounts)**: Track individual balances and transactions for each customer.

Practical Example:

- **Transaction Level**:
  - Customer A purchases goods worth $500 on credit.
  - Customer B purchases goods worth $300 on credit.
- These transactions are recorded in the analytical accounts:
  - Customer A Account: Debit $500
  - Customer B Account: Debit $300
- **Summary Level**:
  - The synthetic account, Accounts Receivable, summarizes these transactions:
  - Accounts Receivable: Debit $800 (total of all individual customer accounts)
- In summary, synthetic accounts provide a high-level summary of financial data, while analytical accounts offer detailed information on individual transactions. Both types of accounts are essential for comprehensive financial management and reporting.



Thanks for your attention !