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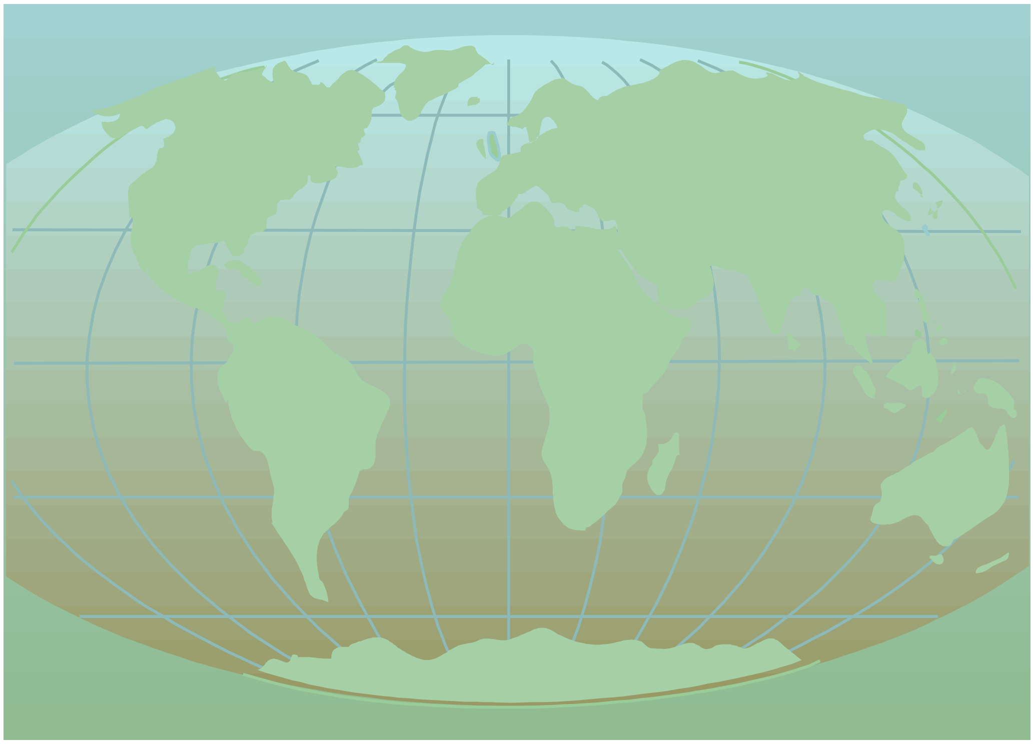

VISION TRAINING SERIES

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|---|---|
| COURSE CODE: | BAPSAG01&02 |
| COURSE TITLE: | PRACTICAL ACCOUNTING FOUNDATION & BUSINESS ACCOUNTING USING PROFESSIONAL ACCOUNTING APPLICATIONS (EXAMPLE PEACHTREE, SAGE PASTEL,LINE 50, ETC) |
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# PREFACE

This Accounting Manual is developed for users/operators of the customised Sage line 50 Accounts Professional, for ease of operations. The manual will be found very useful by the clients of VISION DATA-TECHS (NIG) LTD, who will be required to undergo a short course before using the Sage Line 50 Accounts. The manual caters for both Accountants and non-accountants alike. It does not assume any knowledge of accounting practice.

Please note that the manual is no substitute to the comprehensive manual, which is embedded in the installed program and can be accessed through the help menu.

# 1.0 INTRODUCTION TO FINANCIAL ACCOUNTING

## 1.1 PREAMBLE

The basic accounting principles and fundamentals necessary to take the advantage of Sage Line 50 powerful features are presented in this section without complicated ideas or difficulty of language.

Most businesses are established with the objective of generating a profit through the sales of goods and/or services. To accomplish this objective, you must know how to manage and control the day-to-day operations of the business. These include the company's investments, sales, and expenses; how much money your company owes other companies, and how much money is owed to your company by other companies.

Without this information it would be impossible to make good business decisions. For this information to be as accurate and timely as possible, it is necessary to use an efficient accounting system.

We all use accounting in one-way or the other. Everyone receives money and spends money. The objective of any accounting system is to provide a method for keeping up with a system that is simple to use, yet precise enough to track all resources and expenditures. This is the essence of modern double-entry accounting.

People use money for such things as pay bills, savings, and investments. There are an unlimited number of ways to use or ***apply*** the money we obtain. There are also a great number of ***sources*** of money, such as savings, bank loans, gifts, and sale of property.

For example, assume you go to the supermarket to buy groceries. You spend ₦500 and pay with a cheque, that is, you ***applied*** ₦200 and ₦300 to the purchase of groceries and toiletries respectively, the ***source*** of the money being your bank account.

When you return home you make the following notation:

| | | |
|---|---|---|
| Expenses: | Groceries | ₦200 |
| | Toiletries | ₦300 |
| | | ==== |
| | Total | ₦500 |
| | | ==== |

In your chequebook, you subtract N500 from the previous balance.

The preceding example illustrates an accounting system in which transactions are recorded (noted) properly, but which does not provide complete information about your day-to-day spending activities. While subtracting the N500 cheque permits you to know how much money you have in the bank, the total amount of money spent for groceries or toiletries during the year is not known.

To obtain this information, the entire year's receipts (if you have them) for a category of expense, for example, groceries or toiletries, must be added up. Without this procedure, you do not have information you need to manage your household activities.

## 1.2 DOUBLE ENTRY ACCOUNTING SYSTEM

In the fifteenth century, a monk named Luca Paccioli created an accounting system referred to as double entry. While other systems have been developed, no better method has been found to satisfy the needs of financial accounting.

The basis of double entry accounting is contained in the phrase, “for every debit there is a corresponding credit”. Unfortunately, this simple statement has not always been accompanied by a simple explanation. Many people find it difficult to distinguish the difference between a credit and a debit, or to understand why one always corresponds to the other. In the following paragraphs, double entry accounting is explained in a simple and logical manner to help you understand this fundamental principle of accounting.

In the grocery and toiletry purchase example, you applied ₦200 and ₦300 respectively to the purchase of groceries and toiletries respectively, the source of the ₦500 you paid being the bank account. After recording the purchases in the cheque book and calculating the new bank balance, you could have also recorded the same amounts on notebook sheets labelled “Groceries Account” and “Toiletries Account” respectively, then calculated new balances for groceries and toiletries purchased.

With this method, not only would the correct bank balance be known, but you would also know exactly how much money was spent on groceries and toiletries respectively. You would have accurate and timely information regarding total groceries and toiletries expenditures.

## 1.3 ACCOUNTING BASICS

The following conclusion can be drawn from the above example.

With every financial transaction, a source and application of money always occurs, with the source and application always being in the same amount (equal to one another). Recording transactions into meaningful ***accounts***, provides information that is timely and accurate.

Applications of money are what accountants call ***debits***. Sources of money are ***credits***. To obtain information that is clear, accurate, and timely, these applications (debits) and sources (credits) of money are recorded into different ***accounts***. As many accounts as necessary in order to obtain the desired detail can be created. For example, if you have two accounts at the same bank (such as payroll account and operating account), you would want to keep two separate accounts – one for each.

If very few financial transactions are made from month to month, you would use few accounts. If many financial transactions are made, you might use many accounts.

## 1.4 GROUPS OF ACCOUNTS AND CLASSIFICATIONS

When many accounts are used, it is helpful to group them as a family to provide summary information. For example, a family of accounts called ***Assets*** could be created with members of this family including accounts with names such as Petty Cash, Accounts Receivable, and Inventory. Another family of accounts could be ***liabilities*** with the members being accounts with names such as Accounts Payable and Bank loans.

Keeping a close watch on these two families makes it easy to determine the ***net value*** of your property. This value is usually referred to as ***net worth***, and is obtained by subtracting total liabilities from total assets. Obviously, if total assets exceed total liabilities, you are in a good financial position. If the opposite in the case, you should be concerned that adequate resources may not be available to meet your obligations. To help prevent this from happening, it is necessary to collect and manage information from two other accounts: ***Expenses*** and ***Revenues***.

People sometimes have difficulty understanding the difference between an ***Asse***t or ***Investment*** and an ***Expense***. The difference is primarily based on the reason funds were applied to purchase an item. For example, if you buy a rare and valuable stamp for ₦20,000, it is considered an ***investment*** since the stamp can be sold for cash at a later date. On the other hand, purchasing a 25K stamp to mail a letter to friend is classified as an expense because no one would be interested in purchasing the stamp once it is cancelled by the post office. In other words, investments are purchased with the intent to maintain or increase their value, while expense items are bought to satisfy an immediate need and typically lose most or all of their value once used.

Within the ***Expense*** account family, you will have such accounts as Groceries, Toiletries, Rent, Utilities, Clothing, Telephone Bill, Auto Repairs, Fuel & Gas, and Entertainment.

Just as with assets and expenses, an understanding of the differences between liabilities and revenue is important. Usually, these two account families are considered sources of money. However, liability sources must be paid back.

For example, money borrowed to buy Christmas gifts is a liability because it must be repaid. In contrast, money received as a Christmas bonus from your employer is revenue (income) --- it does not need to be paid back. ***Revenue*** account family members would include such items as Salary or Wages Received, Bonuses, Interest from Savings, and Royalties.

The difference between Assets and Liabilities is defined as ***Capital*** or ***Equity***. An understanding of how the Revenue and Expense account families affect Equity/Capital is critical to successful financial management. If expenses exceed revenue, the difference must come from borrowing – liability sources that must be paid back. Additionally, when liability sources are used to make up revenue shortfalls, net worth (Equity/Capital) is diminished by the amount of borrowings. If expenses equal revenues, net worth remains the same. And, if revenues and expenses are managed well, the excess (profit) funds (revenue minus expenses) increase net worth.

In this discussion, the following account families have been identified: **ASSETS**, **LIABILITIES**, **EQUITY/CAPITAL**, **INCOME/REVENUE** and **EXPENSES**.

The total list of account family members is called the ***Chart of Accounts***. As can be seen by the following illustration, you need to determine the level of details.

## <u>DEMONSTRATION OF DOUBLE ENTRY ACCOUNTS USING PROPER ACCOUNTS HEADINGS</u>

The following transactions illustrate the concept that for every application of funds there is always a source of funds.

1. Receive payroll cheque for the amount of ₦2,000.

| | | |
|---|---|---|
| Application: | Asset-Deposit to Bank | ₦2,000 |
| Source: | Income-Salary | ₦2,000 |

2. Pay Electricity bill of ₦500 with a cheque.

| | | |
|---|---|---|
| Application: | Expense-Electricity | ₦500 |
| Source: | Asset-Bank Account | ₦500 |

Some transactions may have two or more applications and/ or sources, but the total of the applications always equals the total of the sources.

3. Purchase an automobile for ₦50,000 with ₦15,000 cash down payment and a bank loan of ₦35,000.

| | | |
|---|---|---|
| Application: | Asset-Car | ₦50,000 |
| Source: | Asset-Cash | ₦15,000 |
| Source: | Liability-Bank loan | ₦35,000 |

Remember, money applied always has a source. This is true for personal and business transactions. The only difference between accounting for yourself and that of large corporations is the number of transactions and the detail desired.

## THE ACCOUNTING SYSTEM

Once the objectives in establishing an accounting system are understood, a definition of your chart of accounts with the amount of detail desired can start.

Obviously, the most complete and detailed information as possible is desirable. However, assembling this data usually requires some effort. For example, to track your accounting information using a manual system, the following reports would be the minimum required to provide accurate and timely information:

### CHRONOLOGICAL LISTING OF TRANSACTIONS

This report is known as a ***journal*** because all monetary transactions are recorded in it, just as you would record daily activities in a personal journal. All sources and applications of funds are recorded in journals.

Some companies like to have a journal for each type of transaction. For example, a company might have separate journals for purchases, sales, receivables, accounts payable, and general transactions that differ from the transactions recorded in the other journal types.

The objective of journals is to group transactions by origin. Grouping transactions permits the summarising of events affecting the finances of a business.

**CLASSIFIED LISTING OF TRANSACTIONS BY ACCOUNT**

Besides journal reports, reports that summarise financial transactions according to the accounts defined in the Chart of Accounts are useful.

Once all the transactions for a period (usually monthly or yearly) have been recorded, it is necessary to create a reports summarised accounts that reflect the current financial status or condition of the business. The reports that reflect this information are known as ***financial statements***.

## 1.5 FINANCIAL STATEMENTS

Being able to summarise financial information permits the logical review of accounting data. By using logical summarisation methods, a mass of information can be reviewed in a consistently structured, chronological order and be used to better operate a business. While there are many accounting summary reports, for instance, daily activity reports that summarise all transactions for the daily operations of a business, the two most common general reports used to make financial decisions are the Balance Sheet and the Income Statement.

**BALANCE SHEET**

The Balance Sheet is a summary view of account balances and represents the totals for all levels of accounts, that is the summary totals for the members of a family if accounts. The following demonstrates this concept.

The Balance Sheet always presents the financial status of a business or person as of the ending date of the period for which it is created. Therefore, the summary totals on a Balance Sheet could totally change from one day to the next. For example, an asset account family make-up changes dramatically. Current assets decrease by the reduction of cash and fixed assets increase by the value of the equipment. The Balance Sheet becomes meaningful when used with past Balance Sheets for comparison purposes. The net changes from period to period can be easily visualised — a benefit of logical, consistently structured financial summary reports.

**INCOME STATEMENT**

The Income Statement presents a totally different picture of the business from that presented by the Balance Sheet. The Income Statement summarises revenue and expense accounts for a given period of time. Profit or Loss is the difference between the revenue during a period of time and the cost associated with that revenue.

If revenue for a period is greater than expenses, then equity increases. If expenses exceed revenue, then equity decreases. The Income Statement is also called a Profit or Loss Statement and represents the addition to equity/capital or the reduction of equity/capital.

The following example illustrates a Balance Sheet and Income Statement that compare summarised financial information for two years. This form of presentation is known as a comparative financial statement. Notice that although the two Balance Sheets have different amounts in many accounts, Assets still equal Liabilities plus Capital. Also, the summary information related to the net profit shown in the Balance Sheet matches the amount shown on the Income Statement. Although the information presented on the two statements is different, they always tie to each other through the profit and loss amount.

## BALANCE SHEET
## AS OF DECEMBER 31

| | 1997 | 1998 |
|---|---|---|
| ASSETS | | |
| Current Assets | 1,000.00 | 1,250.00 |
| Fixed Assets | 3,000.00 | 3,500.00 |
| Other Assets | 500.00 | 400.00 |
| TOTAL ASSETS | 4,500.00 | 5,150.00 |
| | ======= | ======= |
| LIABILITIES | | |
| Accounts Payable | 700.00 | 1,300.00 |
| Loans | 1,000.00 | 800.00 |
| Total Liabilities | 1,700.00 | 2,100.00 |
| EQUITY | | |
| Initial Capital | 2,500.00 | 2,500.00 |
| Profit/(Loss) | 300.00 | 550.00 |
| Total Equity | 2,800.00 | 3,050.00 |
| | ------------ | ------------ |
| TOTAL LIABILITIES AND EQUITY | 4,500.00 | 5,150.00 |
| | ======= | ======= |

## INCOME STATEMENT
## FOR THE YEAR ENDED DECEMBER 31

| | 1997 | 1998 |
|---|---|---|
| SALES | 3,500.00 | 5,600.00 |
| Less: COST OF GOODS SOLD | 2,000.00 | 3,000.00 |
| GROSS MARGIN | 1,500.00 | 2,600.00 |
| Less: GENERAL EXPENSES | 1,000.00 | 1,600.00 |
| NET PROFIT FROM OPERATIONS | 500.00 | 1,000.00 |
| Less: TAXES | 200.00 | 450.00 |
| NET PROFIT AFTER TAXES | 300.00 | 550.00 |

**<u>EIGHT IMPORTANT ELEMENTS OF GOOD FINANCIAL CONTROL</u>**

So, now you have learned eight important elements of good financial control. These are:

- The principle reason to install a COMPLETE accounting system is the need for fast, accurate information that helps make decisions.
- For five centuries the best method of accounting has been the double entry method that states for every debit there is a corresponding credit, that is, for every application of money there is a source of money.
- To obtain required financial information there are two types of reports: item-by-item in chronological order called Daily Entries and classified by accounts.
- The listing of all the accounts is called a Chart of Accounts.
- The difference between total Assets and total Liabilities equals Equity/Capital. Or, stated another way, total Assets equal total Liabilities plus total Equity/Capital.
- The information contained in Assets, Liabilities, and Equity/Capital are summarised in a financial statement called Balance Sheet.
- The difference between income and expenses in the same period is called a profit or loss. Profit increases equity and a loss decreases equity.
- The Income Statement or Profit and Loss Statement shows the profit or loss of a company for a specified period of time (usually monthly and Year-to-Date).