FUNDAMENTALS OF ACCOUNTING COURSEHACK

1. BASIC CONCEPTS OF ACCOUNTING

A. ACCOUNTING

- is the process of identifying, classifying, recording and summarising financial transactions *e.g recording sales in a business*

B. TRANSACTION

- is any business activity that changes assets, liabilities or capital *e.g buying or selling of maize*

C. ASSETS

- This is the possession of the business i.e what the business owns *e.g cash, machinery*

D. LIABILITIES

- This can be defined as what the business owes *e.g Loans, unpaid bills*

E. CAPITAL(EQUITY)

- This is the owners money in the business *e.g owner's investment*

BASIC ACCOUNTING EQUATION

- ➢ Assets = liabilities + capital

NB:

- This must always balance
- accounting in this sense deals with the owner as a separate entity to business

2. DOUBLE ENTRY PRINCIPLE

- ➤ Every transaction has two effects
- ➤ **debit**(Dr*): receives or comes in*
- ➤ **credit** (Cr): *payment or gives away*

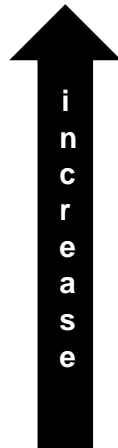## QUICK WAY TO KNOW WHICH IS DEBITED AND CREDITED

Dr

Expenses

Assets

Cr

Liabilities

Equity

Revenue(income)

i n c r e a s e (increase)

Note:

- ➤ *The word D E A L E R as an acronym to remember fast*
- ➤ *Those at the Dr side when they increase Dr also increase or else if they decrease Dr also decreases*
- ➤ *this goes the same to the Cr side when they rise Cr also increases vice versa.*

❖ *Below is an example of a T-account (unbalanced)*:

Dr			Bank			Cr
Feb,2005	**description**	**MWK'000**		**Feb,2005**	**description**	**MWK'000**
2	cash	7000		5	van	4920
24	f. Holmes	1500		29	J. Watson	368
				31	Firelighters	820

❖ *Below is an example of a T-account (balanced)*

Dr		Bank				Cr
Feb,2005	**description**	**MWK'000**	**|**	**Feb,2005**	**description**	**MWK'000**
2	cash	7000	**|**	5	van	4920
24	f. Holmes	1500	**|**	29	J. Watson	368
			|	28	Firelighters	820
			|	28	**balance c/f**	**2392**
		8500	**|**			8500

March, 1	**balance b/ f**	**2392**	**|**

(The bank account has a debit balance)

Note:

- *balance c/f means balance carried forward*
- *Balance b/ f means balance brought forward*

Key:

- *When balance b/ f is at debit side the account has a debit balance*
- *When balance b/ f is at credit side the account has a credit balance*
- *When account has zero balance that means it is a null balance account*

3. BOOKS OF ORIGINAL ENTRY

- this is where transactions are first recorded before going to the ledger

A. CASH BOOKS

- these records all cash transactions

B. SALES DAY BOOK

- records credit sales, that is revenue

C. PURCHASE DAY BOOK

- records credit purchases

D. JOURNAL PROPER

- Non-routine transactions e.g corrections

4. LEDGERS AND TRIAL BALANCE

A. LEDGER

- This is where all accounts are kept

B. TRIAL BALANCE

- this involves listing all credit and debit balance to check accuracy

Note:

- *if Debit equals to credit that means the book balances.*

Example Trial Balance:

ACCOUNT	DEBIT (MWK)	CREDIT (MWK)
Cash	80,000	
Purchases	70,000	
Sales		120,000
Capital		30,000
Totals	150,000	150,000

Steps to prepare trial balance:

1. List all ledger accounts and their final balances.

2. Place each balance in the Debit or Credit column as appropriate.

3. Total each column.

4. Check that Total Debit = Total Credit. If equal, the trial balance balances.

5. FINANCIAL STATEMENT

I. INCOME STATEMENT (PROFIT AND LOSS)

- This statement shows profit or loss over a period *e.g revenue (income), expenses*

II. BALANCE SHEET (STATEMENT OF FINANCIAL POSITION)

- This statement shows what the firm owns and owes *i.e assets=liabilities + capital*

III. CASH FLOW STATEMENT

- This statement tracks (inflows and outflows) movement of cash.

6. ADJUSTIMENTS (END OF YEAR)

A. DEPRECIATION

- value of asset used up e.g machinery loses yearly

B. ACCRUALS

- This means expenses incurred but not yet paid e.g unpaid salaries

C. PREPAYMENT

- This refers to expenses paid in advance for instance Rent paid for next year

D. BAD DEBTS

- This involves money customers won't pay or are unable to pay e.g customer fails to pay K500

7. PRACTICE EXAMPLES (UNDER ACCOUNTING QUICKIE)

1.if a business buy equipment for K100 000 in cash

- asset(equipment) increases, that means is debited(**Dr**) =, +100000
- Asset(cash) decreases, that means is credited (**Cr**)=, -100000

2.if the owner invests MWK200000 in cash

- cash +200000(Debited). **Dr**
- capital +200000(Credited). **Cr**

3.if the business pays rent MWK50000(cash)

- Expense(Rent) +MKW50 000. **Dr**
- Asset(cash) -MKW50,000. **Cr**

REVISION KIT

1.INTRODUCTION

A. ACCOUNTING

- this is the process of identifying, recording, classifying and summarising business transactions e.*g LUANAR farm records fertilizer and maize sales*

B. BOOK KEEPING

- This is the recording part of accounting *e.g cashbook entries*

C. FINANCIAL ACCOUNTING

- focused on reporting the monetary part of transactions mostly to external users
- most recorded for a period of time *e.g annual accounts for ADMARC*

D. MANAGEMENT ACCOUNTING

- this part of accounting records both monetary and nonmonetary parts of transactions
- it is mostly recorded for internal use by managers
- it is recorded in short periods like weeks and days. *for example farm cost analysis*

Users of accounts:

- owners of business, government, managers, creditors ,investors

2.KEY CONCEPTS AND PRINCIPLES

A. BUSINESS ENTITY

- business is seperate from owner ie farm money /= personal money (/= means not equal to)

B. GOING CONCERN

- Business will continue in future e.*g don't value assets as if closing*

C. MONETARY CONCEPT

- record only what can be measured in money e.*g record MKW50000 fertilizer not workers* effort

D. COST CONCEPT

- record assets at original purchase cost *e.g tractor bought at MWK5m, stays recorded as* MWK5m

E. CONSISTENCY

- use same method each year *e.g same depreciation method*

F. ACCRUAL BASIS

- record revenue when earned, expenses when incurred e.g re*cord sales on credit immediately*

NB: *principles are always tested in theory or short notes*

3.ACCOUNTING EQUATION

- Assets = liabilities + capital

A. ASSETS

- what the business possess or owns *e.g cash, buildings, tractor*

B. LIABILITIES

- what the business owes or borrowed *e.g Bank loan, creditors*

C. CAPITAL

- refers to owner's investment into the *business e.g Equity from owner*

NB: *to find capita, if assets= MWK300000 and liabilities= MWK200000,* ***using the formula***:

assets= liabilities + capital

Solution

Capital = Asset - liabilities

=MWK300000 - MWK200000

=<u>MWK100000</u>

4.DOUBLE ENTRY PRINCIPLE

- Every transaction has two sides:

I) Debitor(Dr): what comes in or expense

Ii) Credit(Cr): what goes out or income

✓ Use the **DEALER** Principle

NB:
- ❖ ***real accounts****: Dr what comes in, Cr what goes out*
- ❖ ***Personal accounts****: Dr the receiver, Cr the giver*
- ❖ ***Nominal accounts*** *:Dr expenses/losses, Cr income/gains*

5.BOOKS OF ORIGINAL ENTRY

- ➤ what transactions are first written before posting to ledgers.

I) CASH BOOK
- ➤ Records all cash receipts and payments e*.g. paying wages, receiving sales cash*.

II) SALES DAY BOOK

> Records credit sales *e.g selling maize on credit*

III) PURCHASES DAY BOOK

> Records credit purchases e.*g buying fertilizer on credit*

I) RETURNS INWARD BOOK

> goods you return to supplier *e.g returned damaged fertilizer*

V) JOURNAL PROPER

> Records other non-regular transaction *e.g correction of errors,bad debts*

6.LEDGERS AND TRIAL BALANCE

A) LEDGERS

> Contains all accounts (assets, liabilities, capital, revenue/income, expenses). *Divided into:*

I) general ledger

Ii) sales ledger

Iii) purchases ledger

B) TRIAL BALANCE

> List of all balances from the ledger

Purpose: check accuracy (Debits=Credits) e .g

❖ *Trial balance:*

Account	Debit (MWK)	Credit (MWK)
Cash	80,000	
Purchases	70,000	
Sales		120,000
Capital		30,000

Totals		150,000		150,000

NB: *Totals must be equal*

7.FINAL ACCOUNTS

A.INCOME STATEMENT (*TRADING AND PROFIT/ LOSS ACCOUNT*)

➢ Shows profit or loss for a period

Formula:

❖ Gross profit = sales - cost of good sold (COGS)
❖ Net profit = gross profit - expenses

➢ *Example table*:

ACCOUNT		AMOUNT (MWK)
Sales		500,000
Less (cost of goods sold)		300,000
Gross profit	*(500,000-300,000)*	200,000
Less: expenses		80,000
Net profit	*(200,000-80,000)*	120,000

NB: *The <u>text in read</u> means the workings should be done outside the account table*

B. BALANCE SHEET (*STATEMENT OF FINANCIAL POSITION*)

➢ Shows assets, liabilities and capital at your end.

Assets (MWK)

➢ Cash (50,000)
➢ Inventory (20,000)

- ➢ Building (100,000)

    - ❖ Total (170,000)

Liabilities + capital (MWK)

- ➢ Creditors (30,000)
- ➢ Loan (40,000)
- ➢ Capital (100,000)

    - ❖ Total (170,000)

NB: *must always balance!*

8.ADJUSTMENTS AND END-OF-YEAR ENTRIES

I) DEPRECIATION

- ➢ assets loses value with use *e.g tractor loses mwk200000 value/year*

II) ACCRUALS

- ➢ Expenses owed but unpaid *e.g unpaid wages*

III) PREPAYMENTS

- ➢ paid in advance (expenses) e.*g rent for next period*

IV)BAD DEBTS

- ➢ Customer won't pay e.*g write off MWK10000*

V) PROVISION FOR DOUBTFUL DEBTS

- ➢ estimate of future bad debts e.*g 5% of receivables*

ADD-ONS ON EXAM FORMULAS & RULES

- ❖ ***accounting equation***: *assets=liabilities + capital*
- ❖ ***gross profit***: *gross profit = sales - cost of goods sold (COGS)*
- ❖ ***net profit****= gross profit - expenses*
- ❖ ***Capital at end****= opening capital + profit - drawings*
- ❖ ***Depreciation****= (cost - scrap value) / useful life*
- ❖ ***Trial balance check***: *total debit = Total credit*

NB:

- ➢ *Make sure to understand logic, not memorization.*
- ➢ *Answer three points if asked to describe a concept.*