

BOOKKEEPING

Introduction to bookkeeping

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Bookkeeping

Bookkeeping is the method of recording and summarizing business transactions. It is important in the operations of any business, from a corner grocery to a giant automobile company.

A company's books (bookkeeping records), show what it owns, its income and expenses, and the money it owes.

Bookkeeping

Bookkeeping gives a company such vital information as whether the firm is making or losing money, it also shows which of the company's departments and products are doing well or poorly.

Bookkeeping

It shows whether the company needs to borrow money or has extra cash to invest, and it helps companies and individuals make out their tax returns.

A good bookkeeping system provides the facts on which the management of a company bases many decisions.

Bookkeeping

A person interested in a business career should know something about bookkeeping. He/she can grasp the basic facts of success or failure in business only by understanding bookkeeping terms and reports. Many people use bookkeeping methods to keep personal records.

Bookkeeping

Bookkeeping is closely related to accounting. In general, bookkeeping involves recording and summarizing business transactions. Accounting includes interpreting the facts supplied by bookkeeping, and working out methods for making bookkeeping records. Many persons who work in the accounting departments of companies perform both bookkeeping and accounting tasks.

Uses of bookkeeping

In Business. Every company uses bookkeeping. A large firm usually has an accounting department that is responsible for this work. In many big companies, the various departments do their own bookkeeping, and the accounting department then compiles a complete report. Accounting departments may have computers, accounting software, and electronic equipment that does a large part of their work.

Uses of bookkeeping

Small companies may have only one or two bookkeepers who do part of their work by hand. All companies, large or small, use the same bookkeeping principles, but each company has its own requirements and the bookkeeping system must meet these needs. For example, a company that manufactures steel may need records of hundreds of bank accounts, but a drugstore may need only one.

Uses of bookkeeping

In the Professions. Doctors, dentists, lawyers, and other professional men and women must be sure that their patients or clients, are charged accurately for every service. They also have to be certain that bills are sent out promptly and that payments are recorded. Expense records must also be kept.

When professional people form a clinic or a partnership, they often employ one or more full – time bookkeepers. Otherwise they must keep their own records or employ an assistant who keeps records.

Uses of bookkeeping

In Social Organizations. Such as school clubs, bookkeeping records permit the treasurer or secretary to make a complete report of the club's finances. Club records usually include a cash book that shows how much money the organization has received from the dues paid by members. It also shows how much money the club has spent. The records may include a complete record of the members' names and their dues, and a record of how much cash the club has on hand.

Basic bookkeeping terms

In order to understand bookkeeping, a person must be familiar with several basic bookkeeping terms.

Assets are things of value or of use in business and industrial operations. A company's assets may include: cash, merchandise, equipment, land, buildings, supplies, insurance policies paid in advance and accounts receivable from customers. Accounts receivable include amounts owed to a company by customers for credit purchases.

Basic bookkeeping terms

Liabilities are accounts payable by the company. Accounts payable include debts owed by the company to its various suppliers. A company's liabilities might include its debts to other firms for merchandise and services; wages due to employees; property, income and other taxes; payments due to a bank on loans and mortgages; etc.

Basic bookkeeping terms

Proprietorship (Equity) is an owner's investment in his company. It equals the total assets minus the total liabilities. Suppose Mr. Clark owns a trucking company. He has a truck worth \$ 40,000, loading equipment worth \$ 20,000 and a bank account of \$ 10,000. His total assets are \$ 70,000.

He owes garage and gasoline bills totaling \$ 5,000 and must pay his assistant wages of \$ 300 at the end of the week. His total liabilities are \$ 5,300. Mr. Clark's proprietorship is $\$ (70,000 - 5,300) = \$ 64,700$.

Basic bookkeeping terms

Expenses are decreases in proprietorship (Equity) resulting from business operations. If Mr. Clark pays \$ 120 for tyre repairs, he decreases his proprietorship.

Basic bookkeeping terms

Income is increases in proprietorship (Equity) resulting from business operations. If Mr. Clark receives \$ 500 for a trucking job, he increases his proprietorship.

Double entry bookkeeping

Double entry bookkeeping provides a company with a complete record of each of its transactions. This system is based on an important equation that comes from the relation between assets, liabilities and proprietorship (Equity). Here is the equation:

$$\text{ASSETS} - \text{LIABILITIES} = \text{PROPRIETORSHIP (EQUITY)}$$

Double entry bookkeeping

Both sides of this equation must always balance. So, in terms of this equation, only six kinds of business transactions can take place:

1. an increase in an asset that is offset, or balanced, by a decrease in another asset;
2. an increase in an asset that is offset by an increase in a liability;
3. an increase in an asset that is offset by an increase in proprietorship;

Double entry bookkeeping

4. a decrease in an asset that is offset by a decrease in a liability;
5. a decrease in an asset that is offset by a decrease in proprietorship;
6. an increase in a liability that is offset by a decrease in proprietorship.

Double entry bookkeeping

In each of these transactions, a change in one part of the basic equation balances a change in another. Every transaction has a twofold effect. If a transaction is to be recorded completely, both effects must be entered in the bookkeeping record.

Double entry bookkeeping requires two entries for every transaction. This explains the system's name. It offers protection against errors, because each transaction has two equal bookkeeping effects, both of which are recorded.

The account

ACCOUNT PAGES. The basic record in double entry bookkeeping is the account. An account may be prepared in various ways. But it usually appears on a page or sheet divided down in the middle to form two equal parts. The title of the account, or the name of what is to be recorded, appears at the top of the page. Bookkeepers enter increases on one side and decreases on the other one. The difference between the total increases and total decreases is called the balance; it shows the amount in the account at any time.

The account

There are five basic types of accounts: assets, liabilities, proprietorship, income and expenses. In practice, many separate accounts may be grouped under each of these types. For example, a firm may have a separate asset account for each customer that owes money to it. It would also have a liability account for each company to which it owes money. These accounts form groups that may be considered together.

Debits and credits

Whenever a company makes a transaction, the transaction affects at least two accounts. Each transaction must be analysed to determine which accounts are affected, and whether they should be increased or decreased. Some accounts are increased by entries on the left-hand side, and some are increased by entries on the right-hand side. The terms “debit” and “credit” indicate the two different sides of an account.

Debits and credits

AT ONE TIME,
DEBIT MEANT “HE OWES” AND CREDIT
MEANT “HE TRUSTS”.

In modern bookkeeping, “debit” means the left-hand side of an account and “credit” means the right-hand side.

Debits and credits

Suppose a bookkeeper wants to show increases and decreases in a certain account. The rule for doing this comes from the basic equation “Assets – Liabilities = Proprietorship (Equity)”. Restated, this equation is “Assets = Liabilities + Proprietorship (Equity)”, or “A = L + P (E)”.

Debits and credits

Asset accounts are increased on the left or debit side, and decreased on the right or credit side. Liability and Proprietorship accounts are increased on the right or credit side, and decreased on the left or debit side.

These rules are based on custom and have been adopted by general agreement. Just as all automobile drivers drive on the right-hand side of the streets of the United States, so all bookkeepers show increases in asset accounts on the left and decreases on the right.

Debits and credits

In the six basic kinds of business transactions, Income and expenses represent changes in proprietorship (equity). so income and expense accounts are connected with proprietorship (equity) accounts: in other words, income accounts increase proprietorship and expense accounts decrease proprietorship.

Expense accounts are increased on the left or debit side and decreased on the right or credit side. Income accounts are increased on the right or credit side and decreased on the left or debit side.

Debits and credits

All these rules may be expressed in a general rule for debit and credit: asset and expense accounts are debited for increases and credited for decreases. Liability, proprietorship and income accounts are credited for increases and debited for decreases. This rule tells a bookkeeper which side of an account he enters an increase or a decrease.

The Journal

Before the bookkeeper records a transaction, he must analyse it in terms of its effects on assets, liabilities, proprietorship, income and expenses. For example:

- Which accounts does the transaction affect?
- Does the transaction increase or decrease these accounts?

When the bookkeeper has answered these questions, he makes the first record of the transaction in a book called “the Journal”.

The Journal

This book contains entries for transactions that affect all kinds of accounts. The process of making these entries is called “journalizing”.

A journal entry records a transaction by listing both the account to be debited and the account to be credited. To avoid confusion, the name of the account to be credited is indented slightly to the right, and the two amounts – debit and credit – appear in different columns. Debits appear in the column on the left and Credits appear in the column on the right.

The Journal

A date and an explanation complete the entry.
Here are two journal entries:

June 2 nd 2003	CASH	120.00	
	SALE of MERCHANDISE		120.00
	Sold merchandise for cash		
June 3 rd 2003	RENT EXPENSE	225.00	
	CASH		225.00
	Paid rent for month ended May 31st		

The Journal

The first of these entries instructs the bookkeeper to debit the cash account by \$ 120,00 and to credit the sales account by \$ 120,00.

The second entry tells him to debit the rent account by \$ 225,00 and to credit the cash account by \$ 225,00.

The bookkeeping cycle

POSTING TO ACCOUNTS.

Bookkeeping may follow a regular monthly or quarterly cycle; it may also follow a cycle lasting for a calendar year or for a fiscal year. Every day the various departments of a company prepare or receive many kinds of business documents. These may include checks, sales and purchase invoices (bills), and reports of the receipt of merchandise. The departments forward these documents to the bookkeeping department for journalizing.

The bookkeeping cycle

After a bookkeeper enters a transaction in the journal, he posts it to the appropriate accounts. Posting means transferring entries from the journal to the account pages in a book called “**the Ledger**”. At the end of the bookkeeping cycle, the bookkeeper totals and balances each account in the ledger. That is, he adds up the amounts on each side of the account and determines the difference. If the total debits exceed the total credits, the account has a debit balance. If the total credits exceed the total debits, the account has a credit balance.

The trial balance

When the bookkeeper journalizes transactions, he records a debit equal in amount to each credit, or a credit equal in amount to each debit. So debits and credits should always balance one another. At the end of the bookkeeping cycle, the bookkeeper prepares a trial balance when all transactions have been journalized and posted to accounts.

A trial balance consists of a list of all the accounts in the ledger with their balances.

The trial balance

The accounts are in balance if the total of debits from the accounts equals the total of credits. This balance proves that equal debits and credits have been posted to the accounts. If the accounts do not balance, an error has occurred and must be found.

However, some kinds of errors may exist even when the accounts are in balance. For example, “compensating errors” are errors that balance one another.

The trial balance

An error in principle occurs when an entry has been placed in an incorrect account. This may have no influence on the equality of debits and credits. The trial balance also provides a convenient list of accounts and amounts from which financial statements can be prepared for the accounting period.

Financial Statements

The bookkeeper rearranges and classifies the information from the trial balance in the form of financial statements. The chief financial statements include the income statement and the balance sheet.

The income statement reports the operations of the company by showing all its income, expenses and net profit (or net loss).

The balance sheet shows the financial condition of the company by listing all its assets, liabilities and its equity.

Closing the Ledger

After the financial statements have been prepared, the bookkeeper closes the ledger.

First: he sets up a “profit and loss account”. Then, by preparing appropriate closing journal entries, he transfers the balances of all income accounts and of all expense accounts to this new account. Then, also by journal entry, he transfers the balance of the profit and loss account, representing the firm’s profit (or loss) for the accounting period, to the equity accounts [profit (loss) for the year, retained earnings or reserves – as the case may be].

Closing the Ledger

When these entries have been posted, the income and expense accounts are in balance, as is the profit and loss account.

The profit or loss for the accounting period must be added to or subtracted from the chosen equity account. This shows the company's gains or losses.

Closing the Ledger

Before the ledger is closed, the bookkeeper may make “*adjusting entries*” that bring the accounts up to date in such items as depreciation and accrued interest.

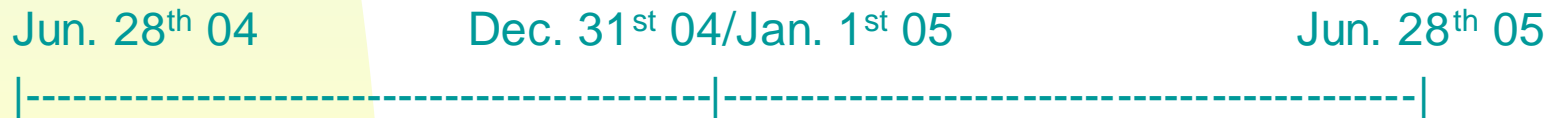
Depreciation usually refers to the normal decline in the use value of buildings, machinery, and other equipment. For example, machinery wears out and becomes less valuable.

Accrued interest is interest that has been earned, but has not yet been received by the company.

Accruals and Payables

DEFERRED EXPENSES and DEFERRED REVENUES

Imagine that our company pays \$ 5,000.00 in advance for insurance policies providing for insurance coverage for a whole year; precisely as of June 28th 2004 until June 28th 2005, as described below:



Accruals and Payables

What we have to pay attention to, is the stretch of time in which our policies cover the year 2005; i.e. as of January 01st 2005 until June 28th 2005, as follows:



Accruals and Payables

The formula to calculate the deferred expense is:

$$(5,000.00 \times 179) / 365 = 2,452.05$$

The foregoing also works with regard to deferred revenues. In fact, if we put it in reverse and consider that now we are the insurance company that earned insurance policies in advance, at the end of the year our company will obtain a deferred revenue by using the same formula.

Accruals and Payables

ACCRUED REVENUES and ACCRUED LIABILITIES

Imagine that our company has accrued 5% annual interest on a \$ 3,000.00 loan to one of our employees; imagine that interest starts accruing as of September 1st 2004 until September 1st 2005, and that our company shall be paid accrued interest on September 1st 2005, as shown below:

Sept. 1st 04

Dec. 31st 04/Jan. 1st 05

Sept. 1st 05



Accruals and Payables

What we have to pay attention to, is the stretch of time covered by interest accrual during the year 2004; i.e. as of September 1st 2004 until December 31st 2004, as follows:



Accruals and Payables

The formula to calculate the accrued revenue is:

$$(3,000.00 \times 5 \times 122) / 36,500 = 50.14$$

The foregoing also works with regard to accrued liabilities. Imagine that our company must be charged with a payable interest on borrowed money due to a bank loan. If we consider the above mentioned deadlines, at the end of the year, after having used the same formula, we will obtain an accrued liability.

Additional records

Bookkeeping systems usually include records in addition to the journal, ledger, and financial statements. For example, books of original entry include any records in which transactions are entered before being journalized and posted to a ledger.

Additional records

Books of original entry also include cash-disbursement books, purchases books and sales books. Specialized-purchases books include invoice registers and voucher registers.

INVOICES are usually lists of merchandise that has been shipped or received.

VOUCHERS are business documents of various kinds, including invoices, receiving reports and purchase orders.

The General Ledger

The ledger is a book of accounts. **The General Ledger** contains the asset, liability, equity, income and expense accounts. **It is self-balancing.** That is after all entries for the accounting period have been posted, the debits should equal the credits. A **Subsidiary Ledger** is a book of accounts, all of the same kind, with a total that agrees with a controlling account in the general ledger.

The General Ledger

For example, most companies have too many customers to include an account for each in the general ledger. So the general ledger has one master account – the controlling account – for all customers, to which total sales and total collections from customers are posted.

The General Ledger

The subsidiary ledger contains individual accounts for each customer. The details of sales and collections are posted to this subsidiary ledger. The sum of the balances of the subsidiary ledger should equal the balance of the controlling account. The general and subsidiary ledgers are often called books of final entry.

Careers in bookkeeping

There are many career opportunities in bookkeeping because most companies use a bookkeeping system. In smaller firms, with less bookkeeping, a person may also be assistant office manager, cashier, or clerk. Larger companies have staffs of bookkeepers ranging from two or three persons to hundreds. In the largest ones, a bookkeeper may have a specialized job, such as preparing payrolls or posting to accounts.

Careers in bookkeeping

The bookkeeper is a key man in his company's information system. If he understands his work, he may know more about the company's financial condition and its operations than anyone else. A successful bookkeeper enjoys careful, detailed work, takes pride in doing his job accurately and punctually, and can explain his records clearly and concisely.

Careers in bookkeeping

A beginning bookkeeper learns even more on the job. Each firm has its own specialized bookkeeping requirements. A good bookkeeper works closely with a company's management, and usually has excellent opportunities to advance to such positions as office manager, chief accountant, assistant treasurer, or treasurer. Some persons become public bookkeepers and head their own firms.

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THANK YOU

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