

LECTURE 2

INTRODUCTION TO DOUBLE-ENTRY BOOK-KEEPING



LEARNING OUTCOMES

Upon completion of the lecture, the students should be able to:

- Know that the two sides of the accounting equation are represented by the two parts of balance sheet.
- Understand how the double-entry system works in accounts.
- Explain the accounting equation.
- Prepare the simple ledger accounts.
- Balance the accounts and extract a trial balance at the end of the accounting period.

The Accounting Equation

$$\text{ASSETS} = \text{LIABILITIES} + \text{OWNER'S EQUITIES}$$

- **Assets**

Future economic benefits [or service potential] controlled by a business as a result of past transactions or events

- **Liabilities**

Future sacrifices of economic benefits that a business is presently obliged to make to other entities as a result of past transactions or events.

- **Owner's Equities**

Future sacrifices of economic benefits that a business is presently obliged to make to the owners of the business as a result of past transactions or events.

Typical Account Titles

- **Assets**

Cash at bank: Money in hand or in the bank

Accounts receivable or trade debtors: Claims against a client or a customer.

Bill receivable: Claims against the cash of another party, supported by a formal document, a bill of exchange, signed by the other party.

Inventory or stock: Inventory or stock that an entity sells in the normal course of the business.

Office Supplies: Stationery, stamps, paper clips, staples and so forth.

Office furniture: Desks, chairs, filing cabinets, and so forth.

Office equipment: Computers, calculators, and other equipments used in a business.

Building: Building used in a business

Land: Land on which a business building stands.

- **Liabilities**

Accounts payable or trade creditors: Liability to pay cash to another party on open account or amount owing to suppliers

Bill payable: Liability to pay cash to another party, supported by a signed document such as a bill of exchange or a commercial bill.

Salary or wage payable: Liability to pay an employee for work done

- **Owner's Equities**

Capital: The interest of the owner of the business in its assets. [This account title bears the name of the owner]

Drawings: The owner's drawings in terms of cash or goods taken from the business for personal use. [This account title bears the name of the owner]




Rules of Debit and Credit


- **Assets**

[dr.]	Accounts Title	[cr.]
Increase		Decrease
Normal		
Balance		

- **Liabilities**

[dr.]	Accounts Title		[cr.]
Decrease			Increase
			Normal
	Balance		

- **Owner's Equities**

[dr.]	Accounts Title		[cr.]
Decrease			Increase
			Normal
		Balance	

Worked Example

On 1 August 19x5, Susan Jones opens a business that she names Jones's Consulting. She will be the sole owner of the business, so it will be a proprietorship. During the entity's first ten days of operations, the following transactions take place:

- a) To begin operations, Jones deposits \$70 000 of personal funds in a bank account entitled Jones' Consulting.
- b) Jones pays \$50 000 cash for a piece of land for future office site.
- c) Jones purchases \$1 000 in office supplies on credit.
- d) Jones pays cash of \$5 000 for office furniture.
- e) Jones pays \$500 on the account payable she created in transaction [c].
- f) Jones withdraws \$1 000 cash for personal use.

Transaction: Invested \$70 000 into the business

- **Analysis:** The investment in the business increased its cash (asset), and also the owner's equity of the entity. The entries are:

	Cash at Bank	
[a]	70 000	
	Jones, Capital	
	[a]	70 000

Transaction: Paid \$50 000 cash for a piece of land to be used as an office.

- **Analysis:** The purchase increased the entity's land (asset), and reduced cash.

	Cash at Bank	
[a]	70 000	[b] 50 000
	Land	
[b]	50 000	

Transaction: Purchased \$1 000 of office supplies on credit accounts payable.

- **Analysis:** The purchase increased the entity's office furniture (asset), and reduced the liability on accounts payable.

Office Supplies	
[c]	1 000
Accounts Payable	
	[c] 1 000

Transaction: Paid \$5 000 cash for office furniture.

- **Analysis:** The purchase increased the entity's office furniture (asset), and reduced cash.

Cash at Bank	
[a]	70 000
[b]	50 000
[d]	5 000
Office Furniture	
[d]	5 000

Transaction: Paid \$500 on the account payable created in transaction [c].

- **Analysis:** The payment reduced cash, and also the liability accounts payable.

Cash at Bank			
[a]	70 000	[b]	50 000
		[d]	5 000
		[e]	500
Accounts Payable			
[e]	500	[c]	1 000

Transaction: Withdrew \$1 000 for personal living expenses.

- **Analysis:** The drawings decreased cash, and also the owner's equity of the entity.

Cash at Bank	
[a]	70 000
	[b] 50 000
	[d] 5 000
	[e] 500
	[f] 1 000
Jones, Drawings	
[f]	1 000

Balancing The Accounts

	Cash at Bank				Land	
[a]	70 000	[b]	50 000	[b]	50 000	
		[d]	5 000	[B]	50 000	
		[e]	500			
		[f]	1 000		Accounts Payable	
[B]	13 500			[e]	500	[c]
						1 000
						[B]
						500
	Office Supplies					
[c]	1 000				Jones, Capital	
[B]	1 000					[a]
						70 000
				[B]	70 000	
	Office Furniture					
[d]	5 000				Jones, Drawings	
[B]	5 000			[f]	1 000	
				[B]	1 000	

**Jones Consulting
Trial Balance
as at 10 August 19x5**

	Debit	Credit
Account Title	[\$]	[\$]
Cash at Bank	13 500	
Office Supplies	1 000	
Office Furniture	5 000	
Land	50 000	
Accounts Payable		500
Jones, Capital		70 000
Jones, Drawings	1 000	
	70 500	70 500

Trial Balance

- Is a list of all accounts with their balances.
- It provides a check on accuracy by showing whether the total debits equal the total credits.
- It may be extracted at any time upon up-to-date postings

