

# THE BOOKKEEPER

Simplified Guide





## Debits and Credits

The Bookkeeper uses the *double-entry method* of accounting. Double-entry simply means that each transaction has equal and offsetting entries—a “debit” and a “credit.” In standard accounting practice, *debits are always positive* and *credits are always negative*. The sum of debits and credits should always be zero—the books of any company should always be in balance.

The Bookkeeper accounting system is designed to avoid out of balance situations by always requiring equality between debits and credits. Three of the four journals (Checks Written, Cash Received, and Invoices Written) are balanced automatically. Offsetting entries are made according to the account numbers you enter under Control Information (command 32 from the Maintenance Menu).

Only in the General Journal and General Ledger will you encounter debits and credits. But since debit and credit terminology may seem contrary to intuition, it's important to grasp the basics of these two terms and how they work within the accounting structure.

Figure 1 illustrates debits and credits as they apply to the types of accounts in the General Ledger and General Journal.

Figure 1. Debits and Credits

Debit (+)	Account	Credit (-)
increase	Assets	decrease
decrease	Liabilities	increase
decrease	Capital	increase
decrease	Income	increase
increase	Expense	decrease

Figure 2 amplifies these concepts and relates them directly to the standard accounting configuration built into The Bookkeeper.

Figures 1 and 2 illustrate the paradoxical nature of debits and credits. Increasing income is recorded as a credit (-). Increasing expense is recorded as a debit (+).

These two figures provide the basic information that's needed to understand debit and credit entries to the General Journal. But for more insight, let's follow the basic accounting equations through to see how these paradoxes arise.

The simplest of the accounting equations is this:

$$\text{ASSETS} - \text{LIABILITIES} = \text{CAPITAL}$$

Capital is also known as “owner's equity”. Put into words, this equation says, “What you own is equal to the assets you control minus the money you owe.”

Figure 2. General Ledger Account Types

Debits (+)	Type of Account	Credits (-)
increase	Current Assets (1000 to 1499)	decrease
increase	Fixed Assets (1500 to 1799)	decrease
increase	Other Assets (1800 to 1999)	decrease
decrease	Current Liabilities (2000 to 2599)	increase
decrease	Long Term Liabilities (2600 to 2999)	increase
decrease	Capital (3000 to 3999)	increase
decrease	Income (4000 to 4999)	increase
increase	Cost Of Sales (5000 to 5999)	decrease
increase	Expenses (6000 to 7999)	decrease
decrease	Other Income (8000 to 8499)	increase
increase	Other Expenses (8500 to 8999)	decrease

In the General Ledger, debits and credits must sum to zero—the books must balance. Using basic algebra to manipulate the above equation, we derive the General Ledger equation:

$$\text{ASSETS} - \text{LIABILITIES} - \text{CAPITAL} = 0$$

If capital increases, it will generally be offset by an increase in assets. This explains why increased capital appears as a *credit* (negative value) and increased assets appear as a *debit* (positive value) in the General Ledger.

Now let's see how income and expense fit into this picture. As a business operates, it takes in money (income) and spends it (expenses). At the end of a given period, this money flow will hopefully yield a profit. This concept can be expressed with this equation:

$$\text{PROFIT} = \text{INCOME} - \text{EXPENSE}$$

At end-of-month and end-of-year, this profit will be added to capital, giving this equation:

$$\text{ASSETS} - \text{LIABILITIES} - (\text{CAPITAL} + \text{PROFIT}) = 0$$

Removing the parenthesis, we get a new version of the General Ledger equation:

$$\text{ASSETS} - \text{LIABILITIES} - \text{CAPITAL} - \text{PROFIT} = 0$$

Profit (an increase in capital) is generally offset by an increase in assets. The increase in assets is recorded as a *debit* (positive value). The profit is recorded as a *credit* (negative value). The General Ledger balance is maintained.

To take it a step further, remember that **PROFIT equals INCOME minus EXPENSE**. Thus we can substitute **INCOME minus EXPENSE** into this last equation to derive the following:

$$\text{ASSETS} - \text{LIABILITIES} - \text{CAPITAL} - (\text{INCOME} - \text{EXPENSE}) = 0$$

Removing the parenthesis we see that:

$$\text{ASSETS} - \text{LIABILITIES} - \text{CAPITAL} - \text{INCOME} + \text{EXPENSE} = 0$$

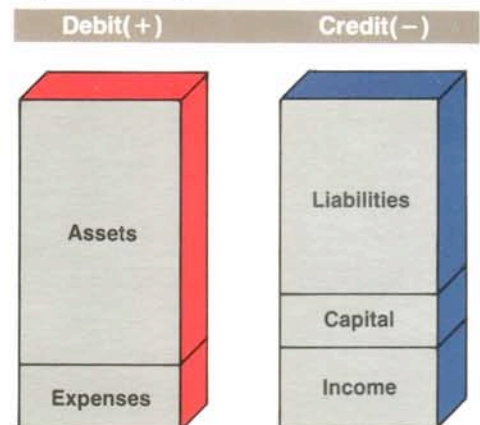
An increase in income appears as a *credit* (negative value) in the General Journal offset by a *debit* (positive value) to assets. An increase in expense appears as a *debit* (positive value), offset by a *credit* (negative value) to assets.

To sum up, here are the four seeming paradoxes of the double-entry system of accounting:

- Increasing CAPITAL is a credit (-)
- Increasing PROFIT is a credit (-)
- Increasing INCOME is a credit (-)
- Increasing EXPENSE is a debit (+)

Figure 3 graphically depicts the way these elements fit into the General Ledger equation.

Figure 3. Equality of Debits and Credits





## Journal Recording To General Ledger Accounts

You need to use the double-entry method of debits and credits only when entering transactions to the General Journal. The other three journals (Checks Written, Cash Received, and Invoices Written) use a simplified entry method which has these features:

- Only one side of the transaction needs to be entered. The other side is entered automatically to the accounts specified in the CONTROL INFORMATION MENU (command 32 from the MAINTENANCE MENU).
- Minus signs are not used for credit entries—the system recognizes the debit and credit side of transactions entered to these journals.

Figure 4 illustrates how data entry works with the CONTROL INFORMATION contained on the Sample Data Base Diskette. The explanations in this figure describe variations that you may wish to use when maintaining your own books with The Bookkeeper.

Figure 4. Data Entry Journal Organization (Sample Data Base Diskette)

