

BACKGROUND

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:

ASSETS - LIABILITIES = 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

Credits(-)
decrease
decrease
decrease
increase
increase
increase
increase
decrease
decrease
increase
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:

ASSETS - LIABILITIES - 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:

PROFIT = INCOME - EXPENSE

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

ASSETS - LIABILITIES -(CAPITAL + PROFIT) = 0

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

ASSETS - LIABILITIES -CAPITAL - 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:

ASSETS - LIABILITIES - CAPITAL - (INCOME - EXPENSE) = 0 Removing the parenthesis we see that:

ASSETS - LIABILITIES - CAPITAL - INCOME + EXPENSE = 0

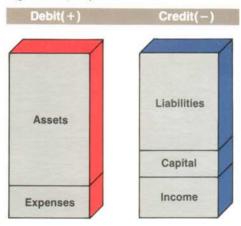
An increase in income appears as a credit (negative value) in the General Journal offset by a debit (positive value) to assets. An increase in expense appears as a debit (positive value), offset by a credit (negative value) to assets.

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

- $\ \square$ 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



BACKGROUND

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)

Debit(+) Journal Credit(-) 2010-Accounts Payable Debits to the Accounts Payable account are automatically prompted for if you enter a Vendor Number (e.g., V5). To use this feature, you should regularly credit Accounts Payable as soon as an invoice is received from the vendor; this crediting is done through the General 1020-Cash on Deposit Journal before you enter the Checks Written transaction. Entered automatically by the Checks You may override the Accounts system to the account specified in Payable prompt by pressing the Written Control Information (command 32, RETURN key and entering any Maintenance Menu). other account number (such as an expense account number if you don't care to keep track of Accounts Pavable). Instead of entering a vendor 1110-Accounts Receivable number at CHECK TO, you may enter Do not use a negative sign for any name. You may also enter the Cash Received credit (income) word VOID to indicate a void check. entries. The entries will be interpreted as negative values. Credits to Accounts Receivable are automatically prompted for if you enter a Customer Number (e.g., C4). Debits to Accounts Receivable are automatically entered whenever an 1020-Cash on Deposit invoice to that customer is recorded Entered automatically by the in the Invoices Written journal. Cash system to the account specified in You may override the Accounts Received Control Information (command 32, Receivable prompt by pressing the Maintenance Menu). **RETURN** key and entering any other credit account number (such as an income account number if you don't care to keep track of Accounts Receivable). Instead of a customer number, you may enter any name. 4011-Sales 2030—Sales Tax Payable Entries into these accounts are 1110-Accounts Receivable automatically prompted for if you Entered automatically by the specify the account numbers in system, to the account specified in Invoice Prompts (command 35, Invoices Control Information (command 32, Maintenance Menu). The invoicee Written Maintenance Menu) unless CASH is may be a customer number, any entered at CUSTOMER NO. name, or the word CASH (to indicate a cash sale). ANY ACCOUNT ANY ACCOUNT General Journal



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