

BUS103: Subunit 1.3.7.2 “Principles of Accounting Transactions”

Introduction

For all businesses, recording accounting transactions is important in order to keep track of and understand the financial health of the company. An accounting transaction is defined as a part of an accounting system that is a record of money either spent to pay bills, buy inventory, and so forth, or money received from customers, loans, debt collection, and so forth. Transactions are recorded twice, as a debit in one account and a credit to a corresponding account. For example, if Factory XYZ is purchasing \$1,000 in new inventory for the factory, \$1,000 will be deducted from the available cash (credited) and the inventory account will be increased by the \$1,000 purchase of inventory (debited). This process is known as “double entry” and is the accepted practice to account for all financial transactions. Take time to read through the following sections, as they will assist you in your understanding and handling of accounting transactions.

Basic Accounts

For accounting purposes, there are four types of basic accounts: revenue, expenses, assets, and liabilities.

Revenue: This is defined as all income from services given or income from finished products/goods sold.

Expenses: This is defined as any money that has to be paid to keep the business in operation. This could include, but is not limited to rent, utilities, loan payments, and salary expenses.

Assets: This is defined as a piece of property, item, or license that is of any value to the company. This does not have to be a tangible item like a building, vehicle, or land; it can be intangible like copyrights, trademarks, and brand/reputation.

Liabilities: This is defined as any amount of money that the company owes to someone for either goods purchased, services received, or for any loans that were taken out on behalf of the company. Generally, a company may have a lot of liabilities when it first starts, as it may seek out loans for start-up capital before revenue amounts have been generated.

Credits and Debits

As was mentioned earlier, credits and debits are mechanisms used to record accounting transactions. They are opposite processes, whereby one may increase the amount in an account and the other may decrease the amount of an account. It is not as simple to just assume that debits decrease and credits increase because debits and credits are defined based on the account they are affecting.

For example, in asset accounts, a debit increases an asset account, whereas a credit decreases an asset account. To better understand the effects of debits and credits on the four types of accounts, review the following table.

Account Type	Increases Account	Decreases Account
Revenue	Credit	Debit
Expenses	Debit	Credit
Assets	Debit	Credit
Liabilities	Credit	Debit

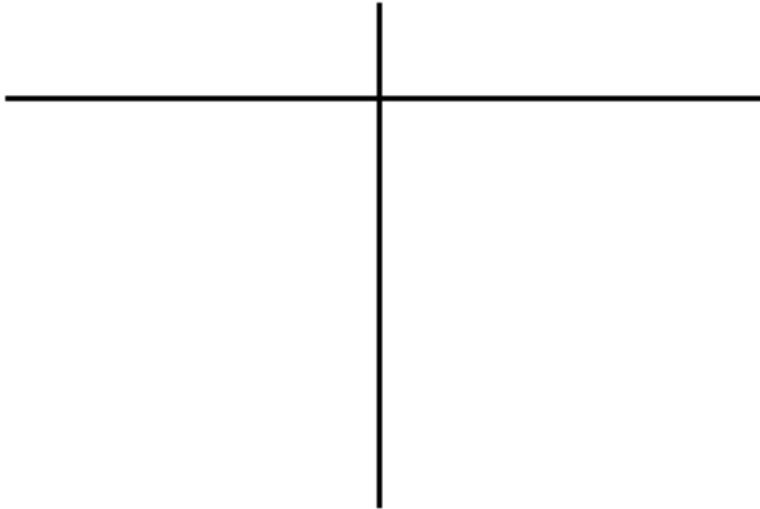
Revenue and liability accounts carry a “credit balance,” meaning that in order to increase these accounts, they must be credited. However, asset and expense accounts carry a “debit balance,” meaning that in order to increase these accounts, they must be debited.

Accounting transactions may affect more than one account type. For example, if a \$10,000 rent payment is paid, then the expense account decreases. Since that expense has been handled, there would be a debit to the expense account. However, the money was taken from the asset account (since available cash is an asset), which would decrease the available cash, resulting in a credit to the asset account. For every accounting transaction, one debit and one credit must be recorded, to signify that one account decreases as another account increases.

Organizing Accounts

It is good practice to identify the types of accounts a company needs in order to accurately establish an accounting system and be able to appropriately record various accounting transactions. Some sample accounts might be these: cash, tangible assets, liabilities, revenue, and expenses.

Each account should have a separate tracking system or a ledger. This is a running list of all transactions that have been posted (or affect) that account. Detailed records should be maintained which include the date of the transaction, amount, transaction description, and a running balance for that particular account. Each account can be tracked using a T-Chart, where credits are recorded on the right and debits are recorded on the left (see the following image).



Documenting Accounting Transactions

It is very important to have a written record of all accounting transactions, which should include any supporting documentation like receipts, bills (also known as receivables), invoices, shipping records, and so forth. For each accounting transaction, be sure to identify the proper accounts that are affected and which accounts should be debited or credited, keeping in mind that one debit and one credit should be recorded for each transaction. Always update the balances of each account after recording the accounting transaction.