

Double entry for beginners

Mary Ofili examines the concept of double entry, a principle that is the foundation stone of accountancy

Accounts are built on the double entry principle which states that: for every debit entry, there must be a corresponding credit entry. So in posting any transaction into your accounts, you always need to identify which account needs to be debited and which account needs to be credited. This poses a bit of a challenge to people who are new to accounts or people who have not learnt the basics in accounts thoroughly and are now doing a professional accounting qualification.

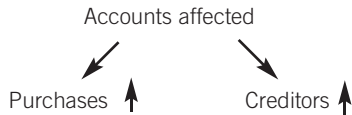
A common acronym used to learn double entry is DEAD/CLIC

<p>DEAD Debit: Expenses Assets Drawings</p>	<p>CLIC Credit: Liabilities Income Capital</p>
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<p>DEAD Debit: Expenses, Assets, Drawings</p> <p>DEBIT TRANSACTIONS If any of these are increasing, you will need to debit the account, and vice versa if it is decreasing</p>	<p>CLIC Credit: Liabilities, Income, Capital</p> <p>CREDIT TRANSACTIONS If any of these are increasing, you will need to credit the account, and vice versa if it is decreasing</p>
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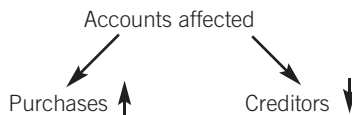
Let's imagine some scenarios

1. I buy products for £150 that I will resell and I have not paid for these products yet (i.e. credit purchase). In such a situation I have incurred an expense and I have also established a creditor because I have not paid. Invariably, my cost is increasing, as I am incurring additional cost and my creditors (liability) are also increasing.



Double entry posting will be:
Dr- Purchases (expense) £150
Cr- Creditors (liabilities) £150

2. I buy products for £150 which I will resell and I have paid for these products immediately (i.e. cash purchase). In such a situation I have incurred an expense and my cash has gone down because I have paid. Invariably, my cost is increasing and my money is decreasing.



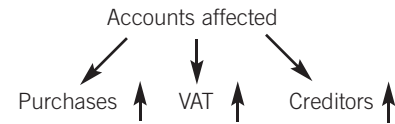
Double entry posting will be:
Dr- Purchases (expense)
Cr- Cash (asset)

Let's introduce VAT to the above scenarios

VAT is tax on commodities and the VAT on sales is a liability to companies and VAT on purchases is an asset because it can be claimed back by VAT registered businesses. This means that a VAT registered business must charge VAT on its sales and this is payable to HMRC and it can reduce this liability by any VAT it may have paid, i.e. VAT on purchases. VAT is currently charged at 20%. (Please note that this statement has been kept to the simple basics).

3. I buy products for £150 net and I have not paid for these products yet (i.e. credit purchase). In such a situation I have incurred an expense and I will have a VAT asset to claim back on this purchase, and I have also established a creditor because I have not paid. Invariably my cost is increasing, my asset is increasing and my creditors (liability) are also increasing.

Net amount	£150.00
VAT amount (20% x £150)	<u>£30.00</u>
Gross amount (total amount owed)	<u>£180.00</u>



Double entry posting will then be:
Dr- Purchases (expense) £150
Dr- VAT (asset) £30
Cr- Creditors (liabilities) £180

In this case, I have simply bought products worth £150, and the company will charge me 20% for VAT, which amounts to £30. I don't have a choice but to pay the full amount of £180 and then I can claim back the VAT which I have paid by completing a VAT return to HMRC if I am VAT registered.

Hence, the VAT on purchases is an asset if the business is VAT registered. For example, if you go to the supermarket to buy stationery for yourself then you have to pay the VAT which you are charged; you don't have a choice. If you are then VAT registered, you can claim that VAT back, but if you are not VAT registered, the full amount will be an expense to you.

So for a business registered under the standard VAT scheme (and a few other VAT schemes), the VAT is never accounted for in the Profit & Loss account, it will always be accounted for in the VAT account which goes into the Balance Sheet. In such cases, VAT is never an expense or an income.

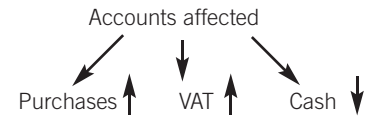
4. If I go and buy products for £150 net and I paid for these products immediately (i.e. cash purchase). In such a situation I have incurred an expense, I will have a VAT asset to claim back on this purchase and my cash has gone down because I have paid the full amount. Invariably, my cost is increasing, my asset is increasing and my money (asset) is decreasing.

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Double entry posting will then be:

Dr- Purchases (expense)	£150
Dr- VAT (asset)	£30
Cr- Cash (asset)	£180

In every business, there is always financial transactions which lead to financial documents which need to be posted into the accounts.

When an expense is incurred, there should always be the question as to what type of expense is incurred and whether this was paid for immediately or not. The relevant expense should be debited and the creditors should be credited if payment hasn't been made or the cash/bank will be credited if payment has been made immediately.

For credit purchases, when payment is later made, the double entry posting will be:

Dr- Creditors
Cr- Cash

In this case, creditors are reducing and cash is also reducing.

Now test yourself; what will be the double entry posting for:

1. If you buy £300 net worth of stationery and payment was made immediately from the bank account?
2. If you buy £110 net worth of purchases and payment was not made immediately?

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• Mary Ofili is a director of The Training Place, the AAT's Training Provider of the Year – Small

Very old accountant: Nebamun was a grain accountant in Egypt some 3,500 years ago, at what is now Karnak Temple

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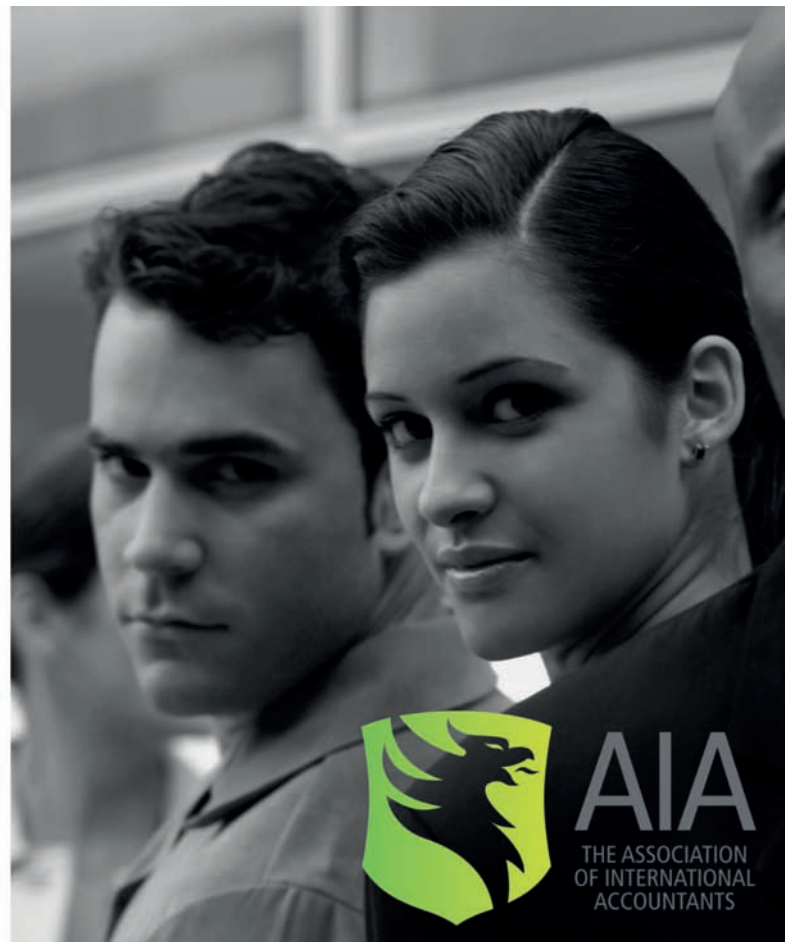
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