**Introduction to Accounting**

1. ***What is Accounting?***

Accounting is the production of financial information regarding profit and non-profit making organizations.

1. ***What is the purpose of Accounting?***

To show the performance and the financial position of an enterprise.

This can be used by stakeholder to assess and/or make decisions for the good of the enterprise.

Financial statements are necessary when loans and grants are required.

Financial statements are required when assessing a business for tax purposes.

1. ***Characteristics of Financial Accounting***

Relevant: The information gives must be precise, as required by the user.

Reliable: The information given must be reliable and verified by an auditor or supported by a director.

Comparable: The financial information must be consistent from year to year so that its results can be compared either within a business or between similar businesses.

Understandable: The user must be able to understand the financial information.

1. ***Stakeholders or Users of Financial Information***

**Shareholders and Potential Shareholders**: They are interested in the return on their money invested in the company, the performance of the company and the value of their shares.

**Directors and Managers**: They are interested so that they can make informed decisions to help the business grow.

**Financial Institutions:** They require information to ascertain whether to give a loan or not. They need to know whether the business can repay the loan with interest.

**Trade Creditors:** Their interest is in the liquidity of the business and its ability to repay them on time.

**Employees and Trade Unions:** They are interested in the performance and the financial state of the business so that they know their jobs are secure and if the business may be able to grant a wage rise.

**Competitors:** They will be comparing their performance with that of other similar businesses. If under-achieving, it allows them to make changes.

**The Revenue Commissioners:** They are interested to know that businesses are obeying the legal requirements placed upon them and in finding out how much tax they paid.

**Bookkeeping Terms**

**Double-entry Bookkeeping**

* Recording a transaction on the debit side of one account and on the credit side of another account.

**Books of First Entry**

* General Journal, Sales, Sales Returns, Purchases, Purchases Returns, Cash Book and Petty Cash Book. It is into one of these books that the transaction is first recorded and then entered into the ledgers using double-entry.

**General Journal**

* Used for transactions that requires an explanation. Examples of such items include opening balances at the beginning of the year, purchase or sale of fixed assets on credit, and correction of errors.

**Ledgers**

There are three:

* Debtors’ Ledger- which keeps account of people who owe the business money.
* Creditors’ ledger- which keeps account of the people to whom the business owes money.
* General Ledger - which keeps account of everything in the business other than people, e.g. rent account, sales account, motor vehicles account, etc.

**Trial Balance**

* This is extracted from the ledgers.
* It is an arithmetical calculation to see if the double entry system has been followed.
* All accounts with a debit balance are added together, as are all those with a credit balance.
* Both balances should equal each other and if not then a bookkeeping error has been made.

**The Final Accounts**

* These are extracted from the trial balance.
* These consist of a trading account, profit and loss account and a balance sheet.

**Trading Account**

This is an account showing sales, the cost of sales and the gross profit – the profit from trading.

Gross Profit is only the profit on trading and does not take into account all the expenses of the business.

**Profit and Loss Account**

* Shows all the revenue receipts and revenue expenditure of a business.
* Receipts minus expenditure equal net profit.
* Net profit is the real profit of a business.

**Revenue Receipts**

* Entered in the profit and loss account.
* Gains from day-to-day transactions of a business.
* Examples include discount received, rent received, and investment interest received.

**Revenue Expenditure**

* Entered in the profit and loss account
* Expenses incurred in the day-to-day running of the business, wages advertising, light and heat.

**Carriage**

* The cost of transporting goods into and out of a business.
* Carriage inwards is entered in the trading account.
* Carriage out is entered in the profit and loss account.

**Subscriptions**

* These are fees that members pay to join a club or society, which are income to the club.

**Bad Debt**

* Money owed to a debtor that will not be paid.
* It’s an expense in the profit and loss account.

**Provision for Bad and Doubtful Debts**

* A certain percentage of debtors are expected to be bad.
* It is entered in the profit and loss account.
* It is also subtracted from the debtors in the balance sheet.

**Preliminary Expenses**

* Also called formation expenses.
* Should be written off out of the profits or against the share premium account.

**Balance Sheet**

* This shows the financial position of a firm at a certain date.
* It shows assets and liabilities and capital of a business.

**Assets**

* These are items a business owns.

**Intangible Assets**

* Assets which are invisible but saleable.
* Usually written off (amortised) to the profit and loss account over a number of years, e.g. goodwill, patents.

**Goodwill**

* An intangible asset in the balance sheet.
* It’s money paid for the reputation or the location of a business.
* It should be written out of the accounts over a number of years as it overvalues a balance sheet.

**Patents**

* An intangible asset in the balance sheet.
* Invisible but saleable
* It’s a license that the owner takes out so that no other person can copy his/her invention without permission.

**Fixed /Tangible Assets**

* These are the permanent assets of the business.
* They will last a long time
* They change in value slowly
* Some are depreciated over time, e.g. motor vehicles, equipment.

**Financial Assets**

* Long-term assets into which the business has invested money, e.g. loans given to other businesses or investments.

**Current Assets**

* These are assets that change in value quickly, e.g. closing stock, debtors, cash.

**Trade Debtors**

* Customers of the business who have bought on credit.
* They owe the business money.
* Shown in the current assets in the balance sheet.

**Liabilities**

* These are people bills or financial institutions that a business owes, trade creditors, tax, and loans.

**Trade Creditors**

* These are people or businesses who have sold a business goods on credit
* They are owed money
* Shown in the current liabilities in the balance sheet

**Current Liabilities**

* These are liabilities that are owed within one year, e.g. creditors, bank overdraft, taxation and accruals.

**Long-term liabilities**

* These are liabilities that are owed for longer than a year. E.g. loans, mortgages and debentures.

**Debenture**

* A long term loan.
* Carries a fixed rate of interest.
* Must be repaid in full within a fixed period of time in a lump sum.
* Security is usually given for the loan.

**Capital**

* What the owners have invested in the business plus profit.
* Formula: Assets - Liabilities= Capital.

**Authorised Share Capital**

* The amount of shares the founder members of a company agree to have at the startup of a company.
* It’s written into the Memorandum of Association and Articles of Association.
* Entered in the Financed By section of the balance sheet.

**Issued Capital**

* The amount of shares that have been sold to the public.
* Entered in the Financed By section of the Balance Sheet.

**Ordinary Shares**

* The ordinary shareholders get paid dividends after the preference dividends have been given out.
* They vote in the directions of a company at the AGM.
* Each share has one vote.

**Preference Shareholders**

* A fixed percentage of preference share are given out of the profits as dividends.
* The preference shareholders get paid dividends before the ordinary shareholders.
* The shares usually have no voting rights.

**Shareholders’ Funds**

* Ordinary shares plus reserves.
* The amount is owed to shareholders if the business were to close.

**Dividends**

* Part of the profit of company that is paid out to the shareholders.
* Dividends are proposed by the board of directions and agreed by the shareholders at the AGM. Interim dividends are paid to shareholders during the year.
* Preference shareholders get paid a dividend before the ordinary shareholders.

**Reserves**

* Profit retained within the business and belonging to the ordinary shareholders.
* **Capital Reserves** are non-trading profits that a company earns from selling shares or revaluing a fixed asset. Not earned in the day-to-day running of a company.

Examples include:

Revaluation Reserve

Share Premium Reserve

* Revenue Reserves are profits retained by a company after paying its dividends and taxation. Examples include:

General Reserve

Profit and loss balance.

**Capital Employed**

* The book value of the business.
* Issued capital plus reserves plus long-term liabilities.

**Capital Expenditure**

* Entered in the balance sheet.
* Expenditure incurred in the purchase or the improvement of a fixed asset, e.g. purchased of a building, extension to buildings, fees incurred in the purchase or extension of a building.

**Capital Receipts**

* Entered in the balance sheet.
* These are receipts received from sources other than those from the normal trading of a business, e.g. capital invested in a business, loans from financial institutions and receipts from the sale of fixed assets.