



Introduction to Accounts

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Welcome to the Introduction to Accounts Guide

All businesses are legally bound to keep accounts. Accounts help you to keep track of all your day-to-day transactions and to report on the state of your business.

In the past, all accounts were kept manually in books - hence the term 'bookkeeping'. The standard method for keeping the books is called 'double-entry bookkeeping'.

Use this guide to explore and understand the fundamentals of double-entry bookkeeping and learn about the key accounting concepts.

Don't worry about learning and remembering all the principles in the guide - you won't need to keep books manually! We simply want to introduce you to the fundamentals that often happen behind the scenes in Sage 50 Accounts and that are taken care of automatically for you.

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How To Use This Guide

The following symbols appear throughout the guide:



Where you see the pencil icon, the sections that follow refer to manual procedures or reference information.



Where the computer icon appears, this indicates that the information to follow relates to your Sage 50 Accounts software.

Use the glossary in *Terms Introduced in this Guide* on page 30 to learn more about any terms you are unsure about.

Why Do I Need to Keep Accounts?

Every business needs to maintain accurate records to track how much money it has, where that money came from and how it is spent. An accounting system maintains these records.

Your accounting records are essential because they can answer important questions such as:

- Am I making or losing money from my business?
- How much is my business worth?
- How much is owed to me, and how much do I owe?
- How can I change the way I operate to make more profit?

In addition, there are certain legal requirements that mean you must keep records for inspection purposes.

For example, if you are VAT-registered, then according to HM Revenue & Customs guidelines, your accounting records must be complete and up-to-date. You don't need to keep them in any particular way, but they must be easy for HM Revenue & Customs to inspect and the figures in your VAT Return must be easy to find. You must keep these records for a minimum of six years.

Limited companies must send a set of company accounts to Companies House, the official Government register of UK companies, every year, as legislated in the Companies Act 1985.

They are also liable to pay corporation tax, and are legally required to keep sufficient records of their income and outgoings in order to make a complete and correct Company Tax Return. Again, these records must be kept for at least six years.

Accounting and Business

Accounting is the system a business uses to measure its financial performance by recording and classifying all the transactions such as income, expenditure, assets and liabilities in an accepted standardised format. Recording transactions helps to provide the information needed to evaluate a company's past performance, present condition and future prospects.

Examples of the types of transactions or events that you might record are:

- You make a sale. Evidence of the sale might be a sales slip or till receipt.
- You make a purchase. There might be a purchase invoice and a cheque stub to show this.
- You pay your employees. Your cheque book, or perhaps your bank statement, might support this.

In any business, there are many of these documents and you will need some kind of logical system to record them. Traditionally, they are first recorded in chronological order in a book. If you are new to computerised accounting, this may be how you currently keep a record of your business's transactions, for example by listing each item in a cash book.

Eventually, a business can accumulate a great number of transactions in its cash book or other records. So how can you best use this information to answer questions about your business?

Once you have recorded and classified transactions, you or your accountant can use the information to produce reports and charts to answer questions such as:

- What were my total sales this month?
- What were my total expenses and what were the types and amounts of each expense?

- How much cash is on hand?
- How much does the business owe?
- How much is the business owed?

So, you can see that the next task after recording and classifying transactions is using the data to create meaningful reports to show the performance of the business.

Every business has its own method of maintaining its accounting books. However, the underlying principles of bookkeeping and accounting remain the same.

Let's look at some of the basic principles of accounting. When you have a firm understanding of these fundamentals, you can deal with many kinds of accounting problem.

Key Accounting Concepts

There are two fundamental accounting concepts that were developed centuries ago, but which remain central to the accounting process. These are:

- The Accounting Equation
- Double-Entry Bookkeeping

The following sections look at each of these concepts in more detail.

The Accounting Equation



The accounting equation keeps all the business accounts in balance. It represents the fundamental business reality: what the business owns = what the business owes.

In order to start a business, the owner usually has to put some money down to finance the business operations. For example, you decide to start a company called the Classic Wine Company and invest £5,000 of your own money to get the business started. Since you, the owner, provide this money, it is called owner's equity. This money is an asset for the company.

At this stage, the business's assets are equal to the owner's equity. If you were to close the business down at this point, you would receive all of its assets.

Because a company usually has liabilities - that is, amounts owed by the business, as well as assets, this equation might not be an accurate representation of the business's status. If the business has liabilities, these also need to be taken into consideration.

Let's say that you decide to accept a loan of £10,000 from the bank to help with the costs of starting up your business. When you accept the loan, the business's assets increase by £10,000. In addition, this loan is also a liability for the company.

Now, the accounting equation looks like this:

$$\begin{array}{ccccc} \text{ASSETS} & = & \text{LIABILITIES} & + & \text{OWNER'S EQUITY} \\ (\pounds 15,000) & & (\pounds 10,000) & & (\pounds 5,000) \end{array}$$

Now the company's assets consist of the money you invested and the loan you took from the bank. The liabilities appear before your owner's equity in the equation because your creditors have first claim on the company's assets. This is a more accurate representation of a normal business's accounts.

If the business were to close down now, any assets left over after paying off the company's liabilities would belong to you.

For more details about assets and liabilities, see *Understanding Balance Sheet Accounts* on page 25 or *Terms Introduced in this Guide* on page 30.

Let's look now at how you would record items such as the money you invest and your bank loan in your business's accounts. The next section introduces you to the concept of double-entry bookkeeping and illustrates how to record different types of transactions using this system.



Introducing Double-Entry Bookkeeping

In a manual bookkeeping system, transactions are all recorded in a book called a ledger. Each page of this book represents an individual named account, such as the Bank account.

An account is a record of all transactions of a particular type, for example bank, sales or stock transactions.

In Sage 50 Accounts, these accounts are called nominal accounts or Nominal Records, and they are stored in the Nominal option, which you can access from the Company navigation group. There is a separate Nominal Record for each account. The software uses these records to keep track of the transactions you enter.

The Double-Entry System

Bank A/C	
Debit	Credit
?	?

The basic principle of double-entry bookkeeping is simple. Every time a transaction takes place - whether it's a sale, purchase or other type of transaction - it consists of two sides. There is the entry on the account that 'gives' the money and the corresponding entry on the account that 'receives' it.

Say your business takes a loan from the bank for £10,000.

Remember the Accounting Equation introduced earlier:

Assets = Liabilities + Owner's Equity.

You have borrowed the £10,000 from the bank and owe this amount back to the bank, so the loan is a liability to your company. In addition, now that your company has the £10,000, the money is an asset to the business.

To record the loan transaction in your accounts, you need to record both of these effects, that is, the increased asset and the liability. To show this, you would put £10,000 in an account called, for example, Bank Loan, and £10,000 in another account called Bank Current Account. The Bank Loan account is the liability and the Bank Current Account shows the asset.

This transaction needs two entries in your accounts. The first shows the destination of the money received and the second entry shows where the money comes from.

In a double-entry accounting system, every transaction affects at least two of your accounts, so you make at least two entries - hence the name. One entry is called a debit entry and the other is called a credit entry.

Remember, Sage 50 Accounts makes this process easy and takes care of the double-entry automatically for you.

Manual Double-Entry and T Accounts

Manual nominal accounts are structured in a T format. The T divides the page into three areas, used for the account name and the debit and credit columns. In bookkeeping, we write debit as Dr and enter it into the left-hand column of the account, and write credit Cr in the right-hand column:

Dr Sales Account Cr					
Date	Details	Amount	Date	Details	Amount

Dr Bank Account Cr					
Date	Details	Amount	Date	Details	Amount

T accounts take their name from the lines that divide the page into its three sections: the space for the account name and the debit and credit columns. Together, the lines resemble the letter 'T'.

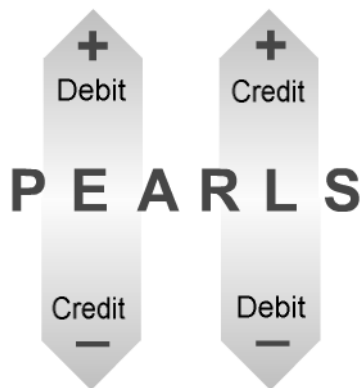
This is what you need to remember:

- Every transaction affects two or more accounts.
- We must decide which accounts are involved.
- The total of the debits must equal the total of the credits.

The secret of double-entry is knowing which accounts to debit and which to credit. Sage 50 Accounts takes care of the double-entry for you, but you will find it helpful if you understand the theory behind the transaction postings the software makes. How do we know which nominal account to debit and which to credit?

Remembering Debits and Credits using PEARLS

There is a principle you can use when practising double-entry bookkeeping that might help you to deal with nominal accounts accurately. This is known as PEARLS because of the order in which it places the nominal account categories: **P**urchases, **E**xpenses, **A**ssets, **R**evenue, **L**iabilities, **S**ource of Funds.



- To increase P E A accounts, post a DEBIT entry.
- To decrease P E A accounts, post a CREDIT entry.
- To increase R L S accounts, post a CREDIT entry.
- To decrease R L S accounts, post a DEBIT entry.

Use PEARLS to help you make perfect debit and credit decisions.

First, you'll need to choose the correct PEARLS category for each nominal account you need to affect. For example:

P (Purchases)	Raw material purchases, purchases of items for resale
E (Expenses)	Wages, stationery, petrol, rent
A (Assets)	Debtors, equipment, property, vehicles
R (Revenue)	Sales
L (Liabilities)	Loans, mortgages, creditors, VAT
S (Source of Funds)	Capital, owner's equity, retained earnings from the previous trading year

Let's look at some examples of applying PEARLS.

REMEMBER: Purchases, Expenses, Assets, Revenue, Liabilities, Source of Funds

Double-Entry Examples

You decide to start a new business called the Classic Wine Company. For each of the steps below, decide which accounts you'll need to affect, then look at which PEARLS category they fall into to help you to decide whether you need to debit or credit each nominal account.

- On 1st December, you put £5,000 of your own money into the new company.

You'll need to show the investment in your Bank and Owner's Equity nominal accounts. Using PEARLS, you can see that the Bank account is an **Asset** account and the Owner's Equity account is a **Source of Funds** account.

You need to increase the Bank account balance by £5,000. To increase a P E A account, you debit it, so you'll need to record a **debit** for £5,000 to the Bank account.

You also need to increase the Owner's Equity account by £5,000. To increase a R L S account, you credit it, so you'll need to record the balancing **credit** entry for £5,000 to the Owner's Equity account:

Dr			Bank Account			Cr		
Date	Details	Amount	Date	Details	Amount			
01 Dec	Capital Invested	5,000						

Dr			Owner's Equity Account			Cr		
Date	Details	Amount	Date	Details	Amount			
			01 Dec	Capital Invested	5,000			

- On 3rd December, your bank gives you a loan of £10,000.

You need to show the increase in your Bank account balance, and the Bank is an **Asset** account. To increase a P E A account, you need to debit it, so record a **debit** for £10,000 to the Bank.

You also need to show the increased amount in the Loans Taken account. This is a **Liability** account. To increase a R L S account, you need to credit it, so you should record a **credit** for £10,000 to the Loans Taken account:

Dr			Bank Account			Cr		
Date	Details	Amount	Date	Details	Amount			
01 Dec	Capital Invested	5,000						
03 Dec	Bank Loan	10,000						

Dr			Loans Taken			Cr		
Date	Details	Amount	Date	Details	Amount			
			03 Dec	Bank Loan	10,000			

REMEMBER: Purchases, Expenses, Assets, Revenue, Liabilities, Source of Funds

3. On 8th December, you find suitable premises and pay rent of £500 by cheque.

Because you're paying money out of your bank account, you need to decrease the balance of this **Asset** account. To decrease a P E A account, you need to credit it, so this time you should record a **credit** to the Bank.

You'll need to show that you've increased the Rent account. Rent is an **Expense** account (overhead), and to increase a P E A account you need to debit it, so you should record the balancing **debit** for £500 to the Rent account:

Bank Account					
Dr			Cr		
Date	Details	Amount	Date	Details	Amount
01 Dec	Capital Invested	5,000	08 Dec	Rent Payment	500
03 Dec	Bank Loan	10,000			

Rent					
Dr			Cr		
Date	Details	Amount	Date	Details	Amount
08 Dec	Rent Payment	500			

REMEMBER: Purchases, Expenses, Assets, Revenue, Liabilities, Source of Funds

4. On 9th December, you buy some bottling equipment for £3,000 and some wine supplies for £800 and pay for both by cheque.

The bottling equipment you buy becomes an asset to your business that you will continue to use for some time. Your Equipment Account is therefore an **Asset** account and as you are increasing its balance, you need to record a **debit** entry for £3,000 to it. The balancing entry reduces your Bank account (another **Asset** account), so you should record the £3,000 **credit** entry to that account.

Your wine supplies are a **Purchase** of materials and you need to show that its balance is increasing. PEARLS states that to increase a P E A account, you should debit it, so you'll need to record the £800 **debit** to your Wine Supplies account. You'll be reducing the Bank account balance again, so record a **credit** for £800 to the Bank:

Bank Account					
Dr			Cr		
Date	Details	Amount	Date	Details	Amount
01 Dec	Capital Invested	5,000	08 Dec	Rent Payment	500
03 Dec	Bank Loan	10,000	09 Dec	Bottling Equipment	3,000
			09 Dec	Supplies	800

Equipment					
Dr			Cr		
Date	Details	Amount	Date	Details	Amount
09 Dec	Bottling Equipment	3,000			

Wine Supplies					
Dr			Cr		
Date	Details	Amount	Date	Details	Amount
09 Dec	Supplies	800			

See if you can complete the next two examples yourself. In each case, remember that there needs to be a debit and a credit and use PEARLS to decide what type of account each one is and what type of entry you should make to it. In the simplest terms, a debit is the application of money, and a credit is the source of money.

Use the T-accounts on the following page to show where you'd place the debit and credit entries.

REMEMBER: Purchases, Expenses, Assets, Revenue, Liabilities, Source of Funds



Remember: When you complete these examples, use PEARLS to help you decide which account to debit and which to credit.

- On 15th December, you make your first sale and receive a cheque for £2,000.

These are the two accounts involved:

Bank Account					
Dr			Cr		
Date	Details	Amount	Date	Details	Amount
01 Dec	Capital Invested	5,000	08 Dec	Rent Payment	500
03 Dec	Bank Loan	10,000	09 Dec	Bottling Equipment	3,000
			09 Dec	Supplies	800

Wine Sales					
Dr			Cr		
Date	Details	Amount	Date	Details	Amount

- On 18th December, you hire a part-time assistant for the day and pay £50 by cheque. You'll need to post entries to these two accounts:

Bank Account					
Dr			Cr		
Date	Details	Amount	Date	Details	Amount
01 Dec	Capital Invested	5,000	08 Dec	Rent Payment	500
03 Dec	Bank Loan	10,000	09 Dec	Bottling Equipment	3,000
			09 Dec	Supplies	800

Wages					
Dr			Cr		
Date	Details	Amount	Date	Details	Amount

Answers

- In the first example, you're putting money from the sale into your Bank account and thus increasing its balance. As the Bank is an **Asset** account and you're increasing its balance, you need to **debit** it with the £2,000 from your sale.
The corresponding entry is to your Sales account. Using PEARLS, you can see that this is a **Revenue** account. As you're increasing the balance of a R L S account, you need to record a **credit** for £2,000 to Sales.
- The second example requires you to reduce the balance of your bank account as you're paying money out. It's an **Asset** account, so you need to record a **credit** for £50 to the Bank. You also need to show the entry on your Wages account. Wages is an **Expense** account and you're increasing its balance, so you'll need to record the £50 **debit** entry to this account.

Summary

At the close of business on 18th December, there are balances on the following accounts:

■ Bank	12,650 Dr	This is the overall balance obtained by totalling all of the debit and credit entries on the account.
■ Capital Invested	5,000 Cr	
■ Loans Taken	10,000 Cr	
■ Rent	500 Dr	
■ Equipment	3,000 Dr	
■ Wine Supplies	800 Dr	
■ Wine Sales	2,000 Cr	
■ Wages	50 Dr	

To see the overall effects on your accounts, turn to *The Trial Balance Report* on page 21, where you can see all of the accounts placed together in the Trial Balance.

Well done. Now you've experienced the accounting principles that take place behind the scenes in Sage 50 Accounts.

Remember, Sage 50 Accounts deals with all of the double-entry bookkeeping for you automatically.



Types of Accounting & VAT Schemes in Sage 50 Accounts

There are two main methods of keeping accounting records. The first is the cash-based method. The second is the accrual method, also called invoice accounting.

Cash-Based Accounting

Most of us use the cash method of accounting to keep track of our own personal finances. This method recognises that income is earned, when you actually receive money and does not take expenses into account until you pay cash out.

For example, your personal bank or cheque account record is based on the cash method. You record expenses in it when you pay a cheque out, and record income when you receive money into the account.

In business, cash accounting applies if you deal only with cash sales, where your customers pay you immediately for any goods you sell or services you provide. For example, if you run a shop where your customers pay for all items as they purchase them and you put the money directly into your till, you operate on a cash-based system.

You can account for VAT on a cash basis. The VAT authorities - HM Revenue & Customs in the UK, or the Revenue Commissioners in the Republic of Ireland, operate a Cash Accounting scheme designed to help small businesses manage their cash flow by allowing them to calculate VAT on the payments they make and receive, rather than on the invoices they issue or, in the Republic of Ireland, on the payments they receive from customers and the invoices they receive from suppliers. Sage 50 Accounts allows you to account for VAT using the VAT Cash Accounting Scheme - for information about setting up your software to use this method, see your Sage 50 Accounts help.

For more information about VAT, see *Introducing VAT (Value Added Tax)* on page 14.

Invoice Accounting

The accrual method of accounting applies when your customers don't pay you immediately, but receive an invoice from you which they must then pay within a certain time. These are known as credit sales, and the length of time within which you require your customers to pay you is called your 'credit terms'.

Using this method of accounting, you need to recognise income when it is earned, not when you receive the money. Similarly, if you buy goods from your suppliers on a credit basis, you also need to recognise expenses when you incur them rather than when you actually make a payment.

For example, if you make a sale to a customer and raise an invoice dated 19th November, but don't receive payment for the sale until 12th December, you need to record the sale on 19th November, not 12th December. The income from the sale therefore shows on November's accounts, not December's.

You can account for VAT on an accrual basis. This is referred to as the Standard VAT Scheme. By default, Sage 50 Accounts is set up to use this method of accounting for VAT.

For more information about VAT, see *Introducing VAT (Value Added Tax)* on page 14.

Introducing VAT (Value Added Tax)

VAT is a Government tax imposed on certain goods or services supplied by VAT registered businesses. Legally, most businesses must register for VAT. To find out whether you need to register for VAT, see section *When Do I Need to Register for VAT?* on page 14.

When you make purchases you pay VAT on them, and when you make sales you charge VAT on them.

At the end of a period, you must pay the amount of VAT collected on sales - that is, output tax, less the amount of VAT charged on purchases - input tax, to the VAT authorities. If the amount of input tax is greater than the amount of output tax, you can claim a refund of the difference from the VAT authorities.

You pay what you owe or claim what you are owed by submitting VAT Returns periodically, usually every three months. In order to complete your VAT Returns, you must ensure that you account for VAT where it applies. For more information about accounting for VAT, see *Accounting for VAT* on page 15.

When Do I Need to Register for VAT?

The supply of any goods and services which are subject to VAT at any rate is known as taxable supplies. If the value of your taxable supplies - that is, your total sales or turnover, not just your profit, exceeds the VAT registration limit specified by the VAT authorities, you must register for VAT. Currently, this limit is £64,000 in the UK or, for users in the Republic of Ireland, €70,000 in respect of the supply of goods or €35,000 in respect of the supply of services. This means that, for example, if your business is based in the UK and your turnover for the past twelve months or less exceeds £64,000, or you expect it to exceed this threshold within the next 30 days, you must register for VAT.

When you register for VAT, you receive a VAT registration number which you must quote on all VAT invoices and other business documents.

For information about how to register, contact your local tax office. Alternatively, if you are based in the United Kingdom, you can visit www.hmrc.gov.uk, or www.revenue.ie if you are resident in the Republic of Ireland.

Which is the Right Accounting Scheme for Me?

If you are a small business, the Cash Accounting Scheme is designed to make accounting for and paying VAT easier. If your taxable turnover is between £350,000 and £600,000 a year, or €1,000,000 in the Republic of Ireland, you can arrange to account for VAT on the basis of cash received and paid, rather than the invoice date or time of supply.

If you want to use the Cash Accounting Scheme, you don't need to apply. You can start using this scheme when you begin using Sage 50 Accounts. For information on how to set up Sage 50 Accounts to use the Cash Accounting Scheme, see your online help.

Note: If you want to use the Cash Accounting Scheme, you must meet certain conditions as set out by the VAT authorities. For information, contact your local tax office or visit www.hmrc.gov.uk or www.revenue.ie if you are resident in the Republic of Ireland.



Accounting for VAT

When you buy and sell goods or services, the net price of an item is increased by the VAT amount to give the gross price. The VAT amount is generally a percentage of the net amount, for example 17.5%. This percentage is called the VAT rate.

There is more than one VAT rate - the rate used depends on the goods or service provided. The standard rate charged on the majority of goods and services is 17.5%, but some items, such as fuel, are subject to a reduced rate of 5%. Other goods and services, such as books and children's clothing, are zero-rated. Certain goods and services are exempt from VAT, and you cannot charge VAT on these sales. Exempt supplies include postal services, sale of land or property and certain types of education and health care.

If you are VAT-registered, you must keep careful records of the VAT you pay and collect. This means you must file documents such as invoices and credit notes for a minimum period of six years. This allows VAT inspectors to check the figures you have used to fill in your VAT Return when they carry out their periodic visits.

The Need for a VAT Account

If you are VAT-registered, as well as keeping documents such as invoices and credit notes, you must also maintain a record of the totals of your VAT for each tax period. To do this, you need a VAT account.

You may choose to keep two VAT accounts - one for VAT on sales and the other for VAT on purchases.

So far in this guide we have looked at selling and purchasing goods without taking any account of VAT. If you are registered for VAT then you must account for it, on both sales and purchases. You do this using your VAT accounts.

Recording VAT on Sales

Let’s look back at the wine sale you made earlier. The value of the sale and the cheque you received was £2,000. In the manual double-entry example, you recorded this as a debit for £2,000 to your Bank nominal account and a credit for £2,000 to the Sales account.

The wine you sold is subject to VAT at the standard rate of 17.5%. This means that the £2,000 sale you made actually consists of £1702.13 net sales price plus £297.87 VAT.

To account for this VAT element of the sale, the correct double-entry would actually be:

- £2,000 **debit** to the Bank nominal account;
- £1702.13 **credit** to the Sales nominal account; and
- £297.87 **credit** to the VAT on Sales nominal account.

Although this transaction creates three entries in your nominal accounts, the total of the credits balances the debit entry to your Bank account.

The balance on your VAT on Sales account increases by £297.87. This is a liability account, and now shows that you owe this money to the VAT authorities. Your Sales account shows £1702.13, the net amount of the sale. Your Bank balance still increases by £2,000, as this is the amount you actually received and this money remains in your business’s accounts and may be used to pay other expenses, until you come to pay VAT to the tax authorities at the end of the period.

Alternatively, instead of recording the sale directly into your Bank account, you might raise an invoice to a regular customer which breaks down the net value of the sale and the VAT element. In this case, the debit entry affects the Debtors Control nominal account instead of the Bank nominal account.

To summarise, the debit side of the double-entry increases the **A**sset account, whether this is your Debtors Control or your Bank account. The credit entries increase the **R**evenue and **L**iability accounts, in this case Sales and VAT on Sales.

Record the transaction for Wine Sales, including VAT:

Double-entry postings:

Account	Value
Bank	2000.00Dr
Sales	1702.13Cr
VAT on Sales	297.87Cr

Values added

Sales VAT	
Debit	Credit
	VAT on sales £297.87

Sales	
Debit	Credit
	Wine sales £1702.13

Bank	
Debit	Credit
Wine sales £2000	

INFO

Behind the scenes, Sage Accounts automatically posts the three entries to the Bank, Sales and VAT on Sales accounts.

Recording VAT on Purchases

Let's look back at one of the purchases you made earlier. When you bought wine supplies, you paid £800 by cheque. When you recorded the double-entry, you entered a debit of £800 to your Wine Supplies account and a credit of £800 to your Bank account to reduce its balance.

The supplies you bought are subject to VAT at 17.5%, so the £800 value actually consists of £680.85 net and £119.15 VAT.

To take into account the VAT element of the purchase, the double-entry should be:

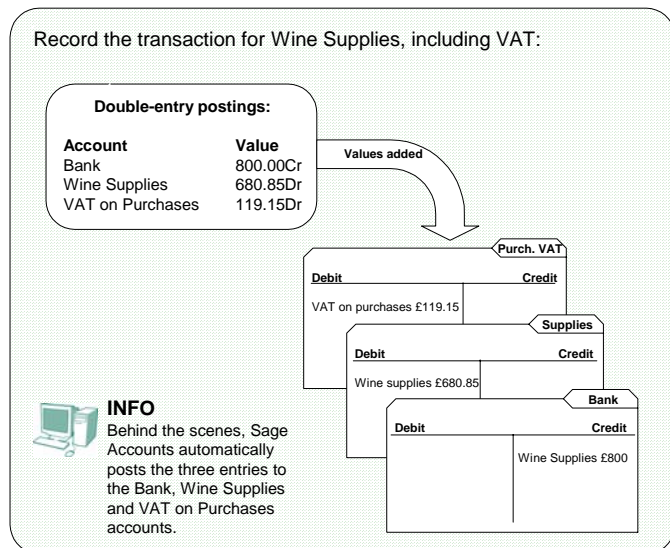
- £680.85 **debit** to the Wine Supplies account;
- £119.15 **debit** to the VAT on Purchases account; and
- £800 **credit** to the Bank account.

Although this transaction creates three entries, the total of the debits balances the credit entry to your Bank account.

The balance of your VAT on Purchases account increases by £119.15. This account now shows the VAT on this purchase as an asset that you can claim back from the tax authorities. Remember, though, that the VAT on both your sales and purchases is taken into account at the end of the VAT period so it is likely that overall you need to pay what you owe to the authorities. Your Wine Supplies account shows £680.85, the net value of the sale. Your Bank account still decreases by the full £800, as this is the amount you actually paid for your purchases.

Alternatively, instead of recording the purchase directly from your Bank account, you might receive an invoice from a regular supplier which breaks down the net value of the purchase and the VAT element. In this case, the credit entry affects the Creditors Control account instead of the Bank account.

To summarise, the debit sides of the double-entry increase the **Purchases** account and the **VAT on Purchases** account, which is an **Asset**. The credit entry decreases an **Asset** account, whether this is your Bank or the Creditors Control account.





Advantages of Sage 50 Accounts

Some of the advantages of using Sage 50 Accounts are:

- You don't have to worry about where to record debits and credits or making sure your entries are balanced. Sage 50 Accounts deals with the double-entry process automatically and with total accuracy.
- Sage 50 Accounts calculates VAT automatically and records the correct entry in the relevant VAT control account. At the end of a VAT period, you can produce your VAT Return at the touch of a button.
- The software maintains a complete list of all the transactions you enter, known as the audit trail, for you.
- You can produce reports and financial statements quickly and easily.
- Sage 50 Accounts lets you retrieve up-to-date accounting information quickly, such as the current status of a customer's account or your sales figures to date.
- You can keep your accounts information confidential by setting up your own password to access the software. You can also set up user names and access rights for individual users.

Sage 50 Accounts comprises several modules. Many of these represent the main accounting books or ledgers. For example:



Customers

The Customers module represents your sales ledger. This is where you record details of the customers you sell goods or services to.



Suppliers

This module represents your purchases ledger and is where you enter details of the suppliers you buy your materials and stock from.



Company

The Company module contains the Nominal Ledger option, which represents the main or general ledger used in accounting. This contains all of your accounts, including commonly-used accounts such as sales, purchases, assets, liabilities and VAT accounts.



Bank

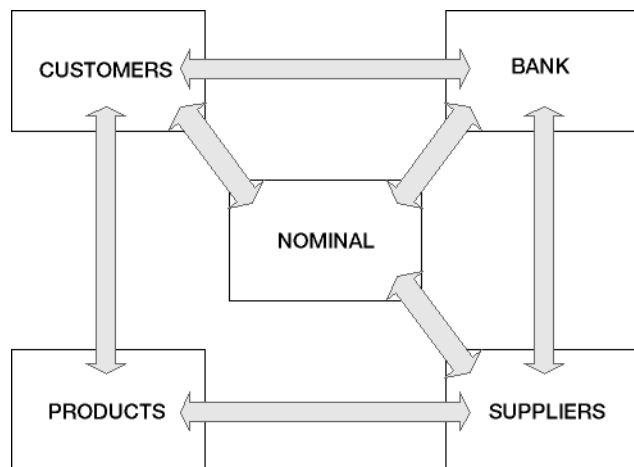
The Bank module represents your cash book and enables you to process payments from and receipts into the bank account. You can also keep a track of petty cash and reconcile your bank account with your bank statement.



Products

The Products module enables you to set up records for your stock items, so that you can see what you have in stock and totals for what you have sold.

In Sage 50 Accounts, these options are fully integrated. The following diagram shows how the main ledgers are integrated within Sage 50 Accounts:



This means that the modules share common data: for example, if you enter a sales transaction as an invoice via Customers, Sage 50 Accounts automatically posts the details to the Nominal Ledger as well as to the Customer account, meaning that you don't need to re-enter any information. When you record the customer's payment of the invoice in the Bank, Sage 50 Accounts reduces the balance on the Customer account and updates the Debtors account in the Nominal Ledger.

How Does Sage 50 Accounts Deal With Double-Entry?

Sage 50 Accounts uses the traditional double-entry system to record a debit and a credit entry for every transaction you enter. It records these entries for you automatically according to the type of transaction you enter, so that you don't need to worry about affecting the correct accounts or balancing the entries yourself.

Sage 50 Accounts also takes care of the VAT element of your taxable transactions by recording the VAT amount in a separate account specifically for VAT.

For example, if you enter a sales invoice onto the system to record the sale of goods to a customer, Sage 50 Accounts automatically makes the following postings:

- A debit to the Debtors' Control account for the gross amount of the invoice to show the increased asset to your business.
- A credit to the Sales account for the net amount of the sale to show the increase in revenue.
- A credit to the Sales VAT Control account for the VAT element of the invoice to show your company's increased VAT liability.

The only exception to this automatic double-entry process occurs in the case of journal entries.

Journal Entries

The journal is used for recording non-regular transactions. These might include:

- Entering opening figures of a new business.
- Depreciation of fixed assets.
- Error corrections in your accounts.
- Purchase and sale of fixed assets.
- Writing off bad debts.

You can also use journal entries to make transfers between any of your nominal account types: Asset, Liability, Income or Expense.

Beware however, when using journal entries, you must adhere to strict double-entry bookkeeping principles; for every debit total, there must be a corresponding balancing credit. This does not mean that for every single debit item you must post a single credit item.

For example, you can post several debits but one balancing credit, and vice versa. As long as the net difference between your postings is zero - that is, the total value of credits equals the total value of debits, you can post the journal entry.

For information about how to post journal entries, see your Sage 50 Accounts help.



Essential Management Reports

You've seen that you need to record your business transactions such as sales, expenses, assets and liabilities and you've learned more about these types of day-to-day entries.

In order to measure the success of your business, you now need to analyse the information in your audit trail and present it in a meaningful way. Producing reports or statements from your accounts data enables you to answer questions such as:

- Has my business made a profit over this period?
- What is my business worth?

There are two essential statements, often referred to as 'management reports' because they help you to manage your business, that answer these questions. These are the Profit and Loss and the Balance Sheet reports. In addition, the Trial Balance is a useful summary of the information stored in your audit trail.

The following sections look at these reports in more detail, and show you how to produce them from your accounts. Remember, though, that Sage 50 Accounts generates these reports automatically for you; for more information about producing your management reports in Sage 50 Accounts, see *How Does Sage 50 Accounts Deal With Management Reports?* on page 27.

The Trial Balance Report

The Trial Balance report lists the balances on all of the nominal accounts, listing debit balances in a column on the right and credit balances in a separate column on the left-hand side. The total of the debit column should equal the total of the credit column; in other words, the Trial Balance balances.

Why Create a Trial Balance?

If each transaction is entered in two accounts, one as a debit and the other as a credit, the sum of all debits is equal to the sum of all credits.

If your accounts are accurate, the sum of all debits must equal the sum of all credits and so your Trial Balance balances. It is therefore, a useful check to make sure that your double-entries are correct and your accounts are in order.

As well as being a check on the bookkeeping, the Trial Balance is a valuable source of information used to help in the preparation of the management reports.

Producing a Trial Balance

When you create the Trial Balance manually, you need to start by totalling the debits and credits on each of your accounts to produce an overall balance for each one. Once you have these overall account balances, you need to transfer them into the Trial Balance structure.

Let's look at producing the Trial Balance for your wine company. We'll use the gross balances from the Double-Entry Examples section for simplicity.

The Bank has a few entries, so you need to calculate a final balance for this account. When you total the debits and credits for the Capital Invested, Bank Loan, Rent Payment, Bottling Equipment, Supplies, Wine Sales and Wages entries, the overall balance is £12,650 Dr.

Each of the other accounts you used in the Double-Entry Examples contains only one entry, so totalling these accounts is easy. The overall balances for your accounts are as follows:

- Bank £12,650 Dr
- Owner's Equity £5,000 Cr
- Loans Taken £10,000 Cr
- Rent £500 Dr
- Equipment £3,000 Dr
- Wine Supplies £800 Dr
- Wine Sales £2,000 Cr
- Wages £50 Dr

Now, you need to transfer each of these balances into the Trial Balance structure. This essentially lists all the accounts and shows all debit balances in one column and all credits in another:

Bank Account					
Dr					Cr
Date	Details	Amount	Date	Details	Amount
	Balance	12,650			
Owner's Equity Account					
Dr					Cr
Date	Details	Amount	Date	Details	Amount
				Capital Invested	5,000
Loans Taken					
Dr					Cr
Date	Details	Amount	Date	Details	Amount
				Bank Loan	10,000
Rent Account					
Dr					Cr
Date	Details	Amount	Date	Details	Amount
	Rent Payment	500			
Equipment					
Dr					Cr
Date	Details	Amount	Date	Details	Amount
	Bottling Equipment	3,000			
Wine Supplies					
Dr					Cr
Date	Details	Amount	Date	Details	Amount
	Supplies	800			
Wine Sales					
Dr					Cr
Date	Details	Amount	Date	Details	Amount
	Sales	2,000			
Wages					
Dr					Cr
Date	Details	Amount	Date	Details	Amount
	Wages	50			

Trial Balance		
	Dr	Cr
Bank	12,650	
Capital		5,000
Loan		10,000
Rent	500	
Equipment	3,000	
Purchases	800	
Sales		2,000
Wages	50	
	17,000	17,000

If the sum of all the debits does not equal the sum of all the credits, then there is a mistake somewhere in the accounts or the Trial Balance. This can occur if:

- The figures in individual accounts have been totalled incorrectly.
- The figures in individual accounts have been entered incorrectly.
- The figures have been transferred to the Trial Balance incorrectly.
- The figures have been totalled incorrectly in the Trial Balance.

Sage 50 Accounts produces the Trial Balance instantaneously for you. Because Sage 50 Accounts records double entries automatically on the correct accounts, generating the Trial Balance is not necessary to check the accuracy of accounts as it is in a manual bookkeeping system; however, it allows you to check the balances on your nominal accounts and make sure you have recorded transactions on the correct records. For details about how to produce a Trial Balance in Sage 50 Accounts, see your Sage 50 Accounts help.

The Profit and Loss Report

The Profit and Loss report shows your company's profit or loss for a specified accounting period, such as a month or a year.

Why Produce a Profit and Loss Report?

The Profit and Loss report answers the question How profitable is my business? You should produce this report at least monthly - if you do not create one until after the end of your financial year and then find that overall, the business has made a loss, then it is too late to do anything about it. If you produce the report regularly, you are in a good position to take steps to put your business back on track.

Understanding Profit and Loss Accounts

The Profit and Loss report is made up of the balances of each of your income and expenditure nominal accounts, grouped into categories. It shows sub-totals for sales, purchases, direct expenses and overheads, together with the amount of gross profit and the net profit or loss made.

If you are recording VAT, the report shows the values for each category exclusive of any VAT amounts. This is because you owe any VAT you take on sales to the tax authorities and they owe back to you any VAT you pay on purchases, expenses and overheads. In other words, the overall VAT value for a specified period is not your income or expenditure, but a liability or asset to your company that appears as such on your Balance Sheet.

Let's look at the account types that make up your Profit and Loss report: sales, purchases, direct expenses and overheads.

Sales

Your business might make two different types of sale: cash sales, where the customer pays for goods or services immediately, or credit

sales, in which you provide an invoice for your customer, which they must pay within a certain number of days - your credit terms.

If you deal only with cash sales, then your sales value for a particular period is the amount of cash that your business receives in that period. However, if you deal with credit sales, you must include the value of the goods sold or services provided but not yet paid for in your total sales figure for that period. This is because even though you might not have received payment, you have still made a sale.

Purchases

Your purchases are a form of expense. They include purchases of stock for resale, or perhaps of raw materials for production if you are a manufacturing business.

Direct Expenses

Direct expenses are those that are directly associated with the production of goods for sale or that directly contribute in some way to the generation of income for your business. For example, labour costs, sub-contractors, commissions, advertising and samples are all classed as direct expenses.

On the Profit and Loss report, the value of direct expenses and purchases is subtracted from your total sales for the period to produce a gross profit figure.

Overheads

Overheads relate to all the other expenses of running your business and remain fairly constant over time. Examples of overheads include:

- Rent and rates.
- Heating, lighting and water.
- Telephone, stationery and postage.
- Advertising and promotions.

The Profit and Loss report deducts any overheads from your gross profit to show the net profit for the period. This is an important figure because it provides for future investment and shows whether the net worth of your business will increase. If there is no net profit, you have not made any money over the specified period and need to take steps to improve your business's performance.

Producing a Profit and Loss Report

Sage 50 Accounts uses your nominal accounts and Chart of Accounts structure to produce the Profit and Loss report for you.

The Chart of Accounts organises your nominal accounts into various groups called categories. For more information about the Chart of Accounts, see your Sage 50 Accounts help.

The categories you need to use to construct a Profit and Loss report are those that contain the account types we looked at in the previous section: sales, purchases, direct expenses and overheads. To calculate your profit, these categories are used as follows:

SALES
 less PURCHASES
 less DIRECT EXPENSES
 = **GROSS PROFIT**
 less OVERHEADS
 = **NET PROFIT**

The figures you need to construct the Profit and Loss account are available in the Trial Balance:

Trial Balance		
	Dr	Cr
Bank	12,650	
Capital		5,000
Loan		10,000
Rent	500	
Equipment	3,000	
Purchases	800	
Sales		2,000
Wages	50	
	17,000	17,000

Profit and Loss Account The Classic Wine Company	
Sales	2,000
less purchases	800
less direct expenses	50
= GROSS PROFIT	1,150
less overheads	500
= NET PROFIT	650

Your Gross Profit, sometimes known as the operating profit, is the profit your company has made before you take into account the expenses of running your business.

The Net Profit shown on the report is your profit after all expenses and costs have been taken into account; that is, the actual profit you have made from running your business this period.

The Balance Sheet Report

The Balance Sheet provides a snapshot of your business at a specific point in time. You will usually need to produce your Balance Sheet at the close of business on a certain day, such as the last day of each month.

Why Produce a Balance Sheet Report?

Your company's Balance Sheet represents the position of your business at the time that you produce the report, as your assets and liabilities vary day-to-day.

The report shows the difference between what you owe and what you own - this difference shows you what your company is actually worth.

Understanding Balance Sheet Accounts

The Balance Sheet shows what your company owns - your assets, and what it owes - your liabilities. It also displays your company's capital - this is the difference between the assets and liabilities and is also known as the net assets or net worth of the business.

Let's look at each of the account types that make up your Balance Sheet: assets, liabilities and capital.

Assets

An asset is something of value that is owned by the business. These can be further classified as fixed assets and current assets.

■ Fixed Assets

Fixed assets are those that are used in the running and operating of the business and that the business will normally retain for at least a year. They include land and buildings, plant and equipment, fixtures and fittings and vehicles.

These assets usually have a certain useful life and so their value reduces, or depreciates. The Balance Sheet displays the value of fixed assets as their purchase price less any depreciation to date.

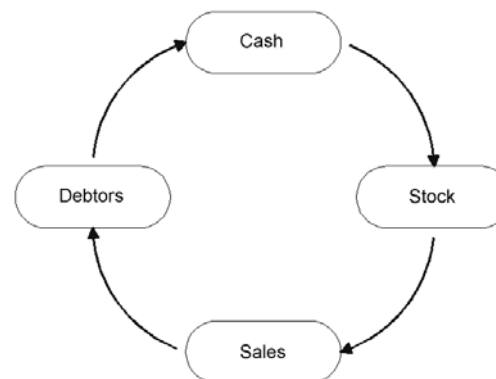
Another type of fixed asset is goodwill. This is any advantage that enables a company to earn better profits than its competitors, such as a well-regarded brand name or good customer relations. This is called an intangible asset because it has only a hypothetical value. Other examples of intangible assets are patents and trademarks.

■ Current Assets

Current assets are those that the business uses on a day-to-day basis and that can quickly be converted into cash. They are also known as liquid assets, as they can be quickly liquidated into cash.

Examples of current assets include cash in hand, money in the bank, debtors, stock and work in progress.

Current assets usually move in a cycle. For example, your company invests cash in stock, then sells the stock to customers who become your debtors. When the customers pay for the products with cash, this enables the cycle to start again:



From this you can see how important it is to keep control over your debtors - until your customers pay you, the cycle cannot continue and you may not be able to invest in further stock. Remember: until you receive the payment, you have not actually made any profit.

Liabilities

Liabilities are those amounts that you owe to third parties including banks, suppliers, tax authorities and employees.

A liability is a legal obligation to pay a debt. The debt can be paid with money, goods or services, but it is usually paid in cash.

■ Current Liabilities

Current liabilities are those that are due for payment within a relatively short period of time. They include your creditors, overdrafts and hire purchase or lease payments due within the next twelve months.

■ Long Term Liabilities

Long-term liabilities are obligations that will not become due for a comparatively long period of time, usually not within the next twelve months. They include mortgages, other loans and hire purchase or lease agreements that do not have to be paid within one year. Only the amounts payable after twelve months are long-term liabilities; amounts payable within a one-year range are current liabilities. For example, a mortgage is a long-term debt and payment is spread over a number of years. However, the instalments due within the next year are classed as current liabilities.

Capital

Capital is money invested in the business by its owners. It may come from the owners putting in money of their own, or it may be raised by selling shares in a company. Capital is also created when a company makes a profit and retains all or some of it in the business.

Capital, also called net worth, is essentially what is yours. Using the Accounting Equation that we discussed earlier, it is the value of the

business as represented by subtracting its liabilities from its assets, and shows what would be left over if you paid off everyone that the business owes money to. If there are no business liabilities, the net worth is equal to the total amount of the assets of the business.

Producing a Balance Sheet Report

As with the Profit and Loss report, Sage 50 Accounts bases the layout of your Balance Sheet report on your chart of accounts structure.

The categories used to construct your Balance Sheet report are those that contain the account types we looked at in the previous section: assets, liabilities and capital. To calculate your business's net worth, these categories are used according to the Accounting Equation, as follows:

$$\text{ASSETS} = \text{LIABILITIES} + \text{SOURCE OF FUNDS}$$

The values you need to produce your Balance Sheet report are also available in the Trial Balance:

Trial Balance		
	Dr	Cr
Bank	12,650	
Capital		5,000
Loan		10,000
Rent	500	
Equipment	3,000	
Purchases	800	
Sales		2,000
Wages	50	
	17,000	17,000

Balance Sheet The Classic Wine Company	
Fixed Assets (Equipment)	3,000
Current Assets (Bank, Debtors)	12,650
less Current Liabilities (Creditors, VAT)	0
Net Current Assets	12,650
Total Assets	15,650
less Long Term Liabilities (Loan)	10,000
Net Assets	5,650
Financed by	
Capital	5,000
Reserves	650
	5,650

The Assets less Liabilities figure, also called Net Assets, which appears on the Balance Sheet should equal the value of Capital and

Reserves, also known as Financed By, at the bottom of the report. This is your business net worth and represents what your business is worth at this point in time.

Linking the Profit and Loss and Balance Sheet Reports

Generally, you will prepare the Profit and Loss and Balance Sheet reports together because in a way they are twin reports. The Profit and Loss report shows what happened within your business over a certain period of time, and the Balance Sheet shows the resulting condition of the business at the end of that period.

If you look at copies of the Profit and Loss and Balance Sheet reports you produce from Sage 50 Accounts for the same period, you can see that the Net Profit that appears at the bottom of the Profit and Loss report is the same as the Reserves value that appears in the Financed by section of the Balance Sheet. This is the link that ties the Profit and Loss to the Balance Sheet and shows the effects of that period's trading on the overall position of the business.



How Does Sage 50 Accounts Deal With Management Reports?

Some of the advantages of using Sage 50 Accounts to produce your management reports are:

- You can produce your Trial Balance, Profit and Loss and Balance Sheet reports at the touch of a button, using the information stored in your Nominal Ledger.
- Sage 50 Accounts allows you to print your reports straight away, or simply view them on screen.

- You can produce each report as a PDF document, save it to file for later viewing, or you can send each report as an e-mail attachment.

In Sage 50 Accounts, you can produce all of these reports from within Company > Financials:

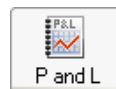
Trial



Use the Trial option to produce your Trial Balance report. This report shows the current debit or credit balance for all nominal accounts that show a value - that is, unused nominal accounts are not listed.

The report also shows the total value of all your debit entries and credit entries. Because Sage 50 Accounts controls the double-entry postings for you, these values will balance.

P and L



Use the P and L option to create your Profit and Loss report. You can calculate a Profit and Loss for the current month, or for any range of consecutive months within your current financial year.

The report shows the balances of each of your income and expenditure accounts grouped into categories and sub-totalled to show Sales, Purchases, Direct Expenses and Overheads. Your Gross Profit and Net Profit figures are also shown.

Balance



Use the Balance option to produce your Balance Sheet report. The Balance Sheet details what your business owns - your assets, and what it owes - your liabilities. The difference between the assets and liabilities - that is, your net assets or net worth, also appears on the report.

The Balance Sheet report is cumulative, and shows both the current year's figures and any values brought forward from the previous financial year.

Next Steps...

Thank you for taking the time to read the Introduction to Accounts Guide.

We hope the guide has given you a background understanding of the main processes used by Sage 50 Accounts. For further help and assistance when using the software, open Sage 50 Accounts' integrated Help system by pressing F1 at any time.

You can also use the Practice Company feature and demonstration data included in Sage 50 Accounts to practise any new procedures - this is a set of fictitious company accounts, which you can access by selecting File > Open and choosing Demo Data.

We hope you enjoy using Sage 50 Accounts.

Your Questions Answered

Why is my bank account a debit entry, when I have money in the account and on my statement it's a credit entry?

A bank account is an asset account. Therefore, if you put £100 into your company bank account a debit entry of £100 is made in the account. The bank keeps its own business accounts. Your statement is in effect a copy of the parts of the bank's accounts that refer to you. Your £100 is owned by you and is therefore a liability to the bank, as they owe you this money back. Therefore, the £100 is a credit entry in the bank's account.

Why do we keep a record of what we are owed in the Nominal Ledger and also in the Sales Ledger?

In the Nominal Ledger we know how much we are owed as a total. However, in the Sales Ledger we can keep a record for each customer. This tells us how much each customer owes us and what transactions have been made with that customer. You can also use the Sales Ledger details to keep track of how long customers' debts have been outstanding.

What is the difference between current liabilities and long-term liabilities?

Current liabilities are those liabilities which fall due for payment within twelve months, for example money owed to suppliers and VAT liability. Long-term liabilities are liabilities that fall due in more than twelve months, such as your mortgage and loans taken over a period of a number of years.

I've heard of liquid assets - what are they?

Liquid assets are those assets which can be turned into cash relatively quickly. Examples are cash, money in the bank and monies owed to you by your customers.

What is Output VAT?

As the name suggests, output VAT is the VAT charged on sales, the output of a business.

What is Input VAT?

As above, it is VAT on items that come into a business, expenses and items that have been purchased.

How do I know if my business is performing well?

Accountants use many means to establish whether a business is performing well. As a general rule, if you are making healthy profits and the value of your business is rising then it could be said that your business is performing well. For further confirmation, speak to someone who is qualified to advise you.

Terms Introduced in this Guide

Account	A record of all transactions of a particular type, for example stock, or relating to a particular customer, supplier and so on.
Assets	Generally, assets are items that a business owns. These can be current assets such as cash, or fixed assets such as equipment, vehicles and property.
Liabilities	These are amounts that a business owes to a third party, such as bank loans or mortgages.
Journal (Also Daybook; Cash Book)	A book in which transactions are recorded as they occur. It provides a chronological record of all business activities. One ledger you may be familiar with is the cash book, in which you record all of your receipts and expenditure. Alternatively, you might use daybooks to record different types of transactions separately, for example listing income from your customers in the Sales Daybook.
Ledger	A collection of accounts of a similar type, containing the totals from all the journals. Traditionally, a ledger was a large book with separate pages for each account. In computerised systems such as Sage 50 Accounts, each ledger consists of a group of computer records. The main ledgers are nominal - the Nominal Ledger option in Sage 50 Accounts, accessed from the Company module, sales - the Customers module, and purchases - the Suppliers module.
Owner's Equity	The total of all capital -paid-in and donated, plus retained earnings. For a sole trader or partnership, this would be the amount remaining after the value of all liabilities is subtracted from the value of all assets.
Debits	An entry that increases an expense or asset account, or decreases an income, liability or net worth account. The debit is one side of the double-entry bookkeeping process.
Credits	An entry which increases an income, liability or net worth account, and decreases an expense or asset account. The credit is one side of the double-entry bookkeeping process.
Postings	The recording of an entry in the company's accounting records, for example the listing of a transaction in the cash book.
Capital	The money that the proprietors have contributed to the business to enable it to function. Share capital is the amount provided by way of shares. It also includes any profits that have been left in the business.
Retained Earnings	Profits of the business that have not been paid to the owners or shareholders, but that have been retained in the business for reinvestment.

Overhead	Business expenses, such as rent, utilities and insurance that are not directly connected to the goods or services you produce.
Net Amount	The amount of a transaction before VAT is added. Also the amount that remains after all deductions have been made, for example in the case of wages.
Gross Amount	The total amount of a transaction including any VAT. Also the total amount before anything is deducted, for example in the case of wages.
Control Account	An account that shows the total of transactions entered in an individual ledger. Control Accounts are built into Sage 50 Accounts to allow automatic double-entry to take place. For example, the Debtors Control Account shows a summary of all the transactions posted to the Sales Ledger.
Depreciation	A decrease in the original value of an item because of wear and tear, deterioration and becoming out of date over the course of its expected life span. The depreciation of your fixed assets is an expense to your company that can be offset against the profits you make, and the value of the asset on the company Balance Sheet is also reduced by the same amount.
Write Off	To cancel a debt, for example if you believe that an outstanding invoice to a customer will remain unpaid. Also to reduce the value of a fixed asset such as a vehicle to zero, for example at the end of its useful life.
Balance Sheet	A report that shows the total of what your business owns - your assets, and what it owes - your liabilities. It also displays your company's capital - this is the difference between the assets and liabilities and is also known as the net assets or net worth of the business. The Balance Sheet provides a snapshot of your business at a point in time and you will usually produce it at the end of a period, for example at the end of a month.
Profit and Loss	The Profit and Loss report shows you whether or not your company is trading profitably. It is made up of the balances of each of your income and expenditure accounts, grouped into categories such as Sales, Purchases, Direct Expenses and Overheads.
Gross Profit	The profit before subtracting the expenses of doing business, that is, the overheads. It is equal to the net value of sales minus the cost of goods or services sold and before payment of taxes and operating expenses.
Net Profit	The profit after subtracting all expenses and costs, that is, after subtracting overheads. This shows the actual profit you have made from running your business during this period.

Notes

Notes

Notes