**STATEMENT OF PROFIT OR LOSS**

This report is produced at the end of the financial year to establish if the business has made a profit or loss on the goods and services it sells. Here is a very simple example:

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| --- |
| **INCOME** |

Sales account (credit balance) less sales returns account (debit balance)

*Throughout the year, on a daily basis, you record what you sell in the sales account. So when you balance this account, the running total represents total revenue earned from sales during the year, regardless of whether it’s been paid for or not.*

*In the sales returns account, we record the value of everything that has been returned. When preparing the profit or loss, to show a true sales figure we will deduct returns from sales.*

Other income (credit balance)

*Throughout your course, you may come across other types of income too. For example, a rent income account.*

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| **EXPENSES** |

Purchases account (debit balance) less purchase returns account (credit balance)

*The same principle applies for the purchases and purchase returns account. Throughout the year we record the cost of the goods that we’ve purchased and returned, regardless of whether we’ve paid for them or not.*

All other expenses (debit balance)

In these accounts e.g. heat and light, wages, advertising and so on you will accumulate the costs for other revenue expenses. Again, it doesn’t matter if they’ve been paid for or not. The cost has been incurred and will have to be paid for eventually.

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| **TO CALCULATE PROFIT OR LOSS** |

INCOME (credit balances) less EXPENSES (debit balances) = Profit or Loss

**STATEMENT OF FINANCIAL POSITION (BALANCE SHEET)**

This report is produced to illustrate the financial position of the company. It answers questions such as - does the business have anything of value and does the business have any debt?

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| --- |
| **ASSETS** |

Sales Ledger Control Account (debit balance)

*For the purposes of this learning tool, we will just focus on the accounts that people say they find confusing.*

*When we sell something to a customer we record the sale in the sales account (for calculation of profit or loss) and then we record the debt (if it hasn’t yet been paid) in the sales ledger control account. So the balance on this account can only tell us the total amount that our customers are still yet to pay us.*

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| **LIABILITIES** |

Purchase Ledger Control Account (credit balance)

*It’s the same if we purchase goods. We record the purchase in the purchases account (for calculation of profit or loss) and then we record the debt in the purchase ledger control account if we haven’t yet paid for that purchase. So the balance on this account only ever shows us the total amount that we owe to our suppliers.*

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| **ACCOUNTING EQUATION** |

*The accounting equation for the statement of financial position (international term) or balance sheet (British term) is:*

ASSETS (debit balances) less LIABILITIES (credit balances) = CAPITAL (credit balance)

If you try to have some understanding of the bigger picture, and why you are debiting and crediting accounts, then this should help to solve some of the confusion surrounding the account names which all feel similar when you’re first learning double-entry.

The accounts that are transferred to the final accounts as detailed on the previous page, are the main leger accounts, and the balances provide totals to enable us to prepare these reports. However, we also have to keep a record of who owes what! So we use:

Sales ledger (customer accounts)

Purchase ledger (supplier accounts)

These accounts do not form part of the double-entry, they are literally there to remind us who owes what so we can collect debts and pay suppliers.

We use memory techniques to help us apply double entry rules some of which you may be familiar with. We use DEAD CLIC.

|  |  |
| --- | --- |
| Debit the account to increase the value if it’s a:  Expense  Asset or  Drawings account | Credit the account to increase the value if it’s a:  Liability  Income or  Capital account |

Let’s apply the technique:

You sell goods to a customer who has not yet paid:

**What do we need to do?**

|  |  |
| --- | --- |
| Record the sale (profit or loss) | Record the debt (balance sheet) |

**What’s the account type?**

|  |  |
| --- | --- |
| Sales account is recording income | The sales ledger control account is recording a debt owed asset |

**So what’s the double-entry and do we want to increase the value in the account or decrease it?**

|  |  |
| --- | --- |
| Income accounts are credited to increase the value:  DEAD CL**I**C | We need to increase the debt on the SLCA so we debit an asset account.  DE**A**D CLIC |

So the answer is:

CR sales account (increasing income)

DR sales ledger control account (increasing debt owed)

Finally sometimes people struggle identifying what an asset or liability is:

At this level, consider an asset to be anything that can be turned into cash. So you can call in your debts from your customers to obtain cash.

A liability is a debt that your business has to pay.

