FINANCIAL MANAGEMENT FOR
GEORGIA LOCAL UNITS
OF ADMINISTRATION

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INTRODUCTION

As illustrated in Chapter 2, each financial transaction increases or decreases a Local Unit of Administration's (LUA) accounts. The primary purpose of this chapter is to explain the relationship of increases or decreases and the accounting terms "debits" and "credits."

DEBITS AND CREDITS

Accounting classifies increases or decreases in an LUA's accounts as <u>debits</u> or <u>credits</u>. Sometimes, the abbreviations for these terms in the accounting records are "DR" for debit and "CR" for credit. Before the use of computers for governmental accounting purposes, a general ledger account was pictured as looking like a "T." The left side of the "T" account was the debit side and the right side was the credit side. Exhibits I-3-1 illustrates a "T" account.

Debits are recorded on the left side of an account and credits on the right side.

Exhibit I-3-1
ILLUSTRATION OF A "T" ACCOUNT

ACCOUNT NAME AND NUMBER

(DEBIT)	(CREDIT)
DR	CR

With the use of various levels of technology in governmental accounting, the "T" account no longer is visible in computer systems. However, an awareness of the concept of the "T" account is useful in understanding double entry accounting.

CHANGES IN ACCOUNT BALANCES

Recording transactions in accounting systems are simply changes in account balances. Changes in account balances, (i.e., a debit or credit) either will increase or decrease an account balance depending upon where that account appears in the accounting equation. Using Exhibit I-3-2 below, each transaction may be analyzed individually to determine which accounts are increased and decreased, resulting in either debits or credits. When relating debits and credits to the LUA's financial position, debits do not increase equity, nor do credits decrease equity. The change in equity relates to the type of account affected.

Exhibit I-3-2
CHANGES IN ACCOUNT BALANCES

ACCOUNT	NORMAL ACCOUNT BALANCE	DEBIT	CREDIT
Assets	Debit	Increase	Decrease
Liabilities	Credit	Decrease	Increase
Fund Equity	Credit	Decrease	Increase
Revenues	Credit	Decrease	Increase
Expenditures/Expenses	Debit	Increase	Decrease

The following expanded accounting equation (see Chapter 2) illustrates when debits and credits appear as increases or decreases (for purposes of illustration, the term expenditures is used, however, the term expenses could have been substituted):

ASSETS		= LIABILITIES		+ FUND BALANCE		+ REVENUES		- EXPENDITURES	
Debit	Credit	Debit	Credit	Debit	Credit	Debit	Credit	Debit	Credit
Inc.	Dec.	Dec.	Inc.	Dec.	Inc.	Dec.	Inc.	Inc.	Dec.

Since the accounting equation always must be in balance, every transaction always must consist of the total debit amounts equal to the total credit amounts. Double entry accounting requires that for every entry (or entries) made to the debit side of an account(s), an entry (or entries) for the same total amount is made to the credit side of another account(s). The following examples illustrate the use of debits and credits.

1. A LUA begins the year with assets of $600, no liabilities and therefore a fund balance of $600.

ASSETS		= LIABILITIES		+ FUND BALANCE		+ REVENUES		- EXPENDITURES	
Debit	Credit	Debit	Credit	Debit	Credit	Debit	Credit	Debit	Credit
Inc.	Dec.	Dec.	Inc.	Dec.	Inc.	Dec.	Inc.	Inc.	Dec.
$600	=			+			+	$600	-

Note that the accounting equation balances and the debits equal the credits.

2. The LUA receives approval for an unrestricted state grant totaling $6,000. This transaction increases assets (i.e., a debit) and increases revenues (i.e., a credit) by the same amount.

ASSETS		= LIABILITIES		+ FUND BALANCE		+ REVENUES		- EXPENDITURES	
Debit	Credit	Debit	Credit	Debit	Credit	Debit	Credit	Debit	Credit
Inc.	Dec.	Dec.	Inc.	Dec.	Inc.	Dec.	Inc.	Inc.	Dec.
$600	=			+	$600	+			-
6,000							6,000		
6,600	=			+	600	+	6,000		-

Note that the revenue increased so the revenue account was credited and the asset account increased or debited. The total debits still equal the total credits (i.e., $6,600).

3. The LUA receives invoices for expenditures totaling $7,000. This transaction increases expenditures (i.e., a debit) and increases liabilities (i.e., a credit).

ASSETS	=	LIABILITIES	+	FUND BALANCE	+	REVENUES	-	EXPENDITURES
Debit Credit		Debit Credit		Debit Credit		Debit Credit		Debit Credit
Inc. Dec.		Dec. Inc.		Dec. Inc.		Dec. Inc.		Inc. Dec.
$600	=		+	$600	+		-	
6,000								6,000
6,600	=		+	600	+			6,000 -
		$7,000						- $7,000

Note that expenditures increased so they were debited and liabilities increased so they were credited.

4. The LUA borrows $4,500 from the bank to cover future operating expenditures. This transaction increases assets (i.e., a debit) and increases liabilities (i.e., a credit).

ASSETS	=	LIABILITIES	+	FUND BALANCE	+	REVENUES	-	EXPENDITURES
Debit Credit		Debit Credit		Debit Credit		Debit Credit		Debit Credit
Inc. Dec.		Dec. Inc.		Dec. Inc.		Dec. Inc.		Inc. Dec.
$600	=		+	$600	+		-	
6,000								6,000
6,600	=		+	600	+			6,000 -
		$7,000						- $7,000
4,500	=	4,500						
11,100	=	11,500 +		600	+			6,000 - 7,000

The accounting equation still balances (i.e., $11,100 = $11,500 + $600 + $6,000 - $7,000). Also, note that the recording of each transaction results in debit amounts equal to credit amounts (i.e., $18,100).

SUMMARY

1. Debits are entries to the left side of any general ledger account in a manually maintained accounting system.

2. Credits are entries to the right side of any general ledger account in a manually maintained accounting system.

3. Assets, expenditures and expenses normally have debit balances.

4. Liabilities and revenues normally have credit balances.

5. An LUA with a fund balance would have a credit balance in its fund equity account and a LUA with a fund balance deficit would have a debit balance in its fund equity account.

6. Debits increase asset balances and credits decrease asset balances.

7. Credits increase liability balances and debits decrease liability balances.

8. Credits increase fund equity balances and debits decrease fund equity balances.

9. Credits increase revenue balances and debits decrease revenue balances.

10. Debits increase expenditure or expense balances and credits decrease expenditure or expense balances.

11. Double entry accounting means that for every entry (or entries) made to the debit side of accounts, equal entry (entries) must be made to the credit side of the accounts.