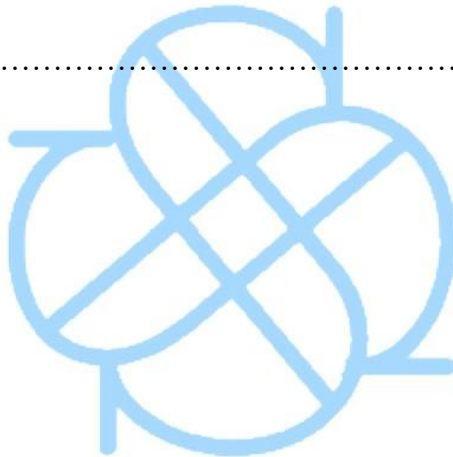


Basics of Accounting

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Contents:

Ch 1.....	2
Ch 2.....	6
Ch 3.....	8
Ch 4.....	9



Chapter 1

What is accounting and why do we need it?

Accounting is an information science that is used to collect and organize financial data for organizations and individuals

- collects, processes, and analyzes information
- quantitative and measures money
- More practical than theoretical
- helps organize and understand the financial decisions you make

What types of accounting are there?

- **Bookkeeping:** collection of information (**records business data**)
- **Financial accounting:** Allows you to see how many sales you have, **how it was financed**, etc.
- **Managerial accounting:** It is more detailed than financial accounting and contains **strategic information**. (Includes pricing, competition, budgeting, etc.) It is usually not told to those that are not within the business, so it can be kept private.
- **Tax accounting:** Determines the **amount of taxes** that a company needs to pay

Bookkeeping:

Bookkeeping allows society to actually function, and is the **foundation of accounting**.

Financial Accounting:

The **set of financial reports** that businesses use to track things such as: sales, profit, how much cost rates have increased/decreased.

- Also shows how much a **business owns**
- Without financial information, you wouldn't be able to look at how much your income is, your business provides, etc. Therefore, it is **extremely important that your business inserts financial accounting**

Benefits of Accounting:

- Helps ensure **financial stability**
- Helps maintain and create **numerous of systems** for recording and reporting finances
- Gives you a better understanding of the **financial status** of your business or another business' organization

Skills needed to major in accounting or become an accountant:

- **Management skills** as well as being able to be a leader
- Comfortable with public speaking
- **Deep understanding of taxes (modern taxes)**
- Being able to communicate with business owners, organizations, and bank owners as well

Traits needed:

- Integrity
- Persuasiveness
- Leadership
- Adaptability

- Social structures (Can vary depending on position)

Why is math important to accounting?

While you do not need to know all the factors to math, you must be able to **know the basic standards of math.**

Math skills you NEED to know:

- **Statistics** (recommended to take this course in high school)
- Basic adding, subtraction, multiplication, and division skills
- **Chart reading** (You need to be able to read a chart quick and fast as when business information is displayed, you must know how to read it and understand so you can discuss information with your team.)

While you do not need to be an expert with math, it is highly important that you have obtained stable grades throughout your education period.

Income Statement:

Your income statements will allow you to see **how profitable your performance** is throughout your company or organization

Revenue:

Revenue is the **amount of fees you have from your spendings.**

- **For example:** When you receive your paycheck, obviously you are going to need to use that money for basic necessities such as food, clothing, and water. However, you also need to look at what you can spend your money on for yourself. Although, when you get

your average income rate, make sure you are able to seek out what you will be actually getting for yourself rather than food, water, clothing, etc.

Another helpful aspect to look at with revenue is to **factor all of the stuff you know you will have to spend**. For example, if you are going to therapy weekly, you will need to be able to pay for that. So ensure you take this amount out of what you will be able to take in for yourself.

What is the difference between public accounting and public accounting?

Private accounting:

- **Employed directly from the businesses**, no needed license is required, and they perform tasks directly from the employer.

Public accounting:

- **Strict to government regulations** and requires individual state licenses.

The three form of business entities:

- **Sole proprietorship**
- **Partnership**
- **Corporations**

Chapter 2

Shareholders liability is closeted to their capital. All business acts MUST be recorded, if they are not recorded, you can end up fined or in extreme cases in jail.

- **Assets, liabilities, and owner's equity** are the basic structure of the accounting equations.
- All business transactions affect any of the basic structures of the accounting equations.

Income statement reports the amount of **net income or loss** calculated by the subtracting expenses from revenues during a certain time period.

- The **owner's equity** records the **changes in the value of the owner's equity**

Investments and net worth profits **increase the owner's equity.**

- Net profits or losses are obtained from the income statement
- The **balance sheet** displays all assets, liabilities, and owners equity
- Assets consist of cash, accounts receivable and prepaid expenses
- Liabilities are displayed by **due date** and short term liabilities

What does accounting help you with business wise?

- presents all viable features of the financial aspects of your business
- allows business owners to **view your fundings** and what investments you have also made
- allows business owners to see if your business is able to **financially form an alliance with your business**

Chart of Accounts:

- Assets
- Liabilities
- Owners equity
- Revenue
- Expenses

Flow of Data:

- Business transaction which requires documentation and recording
- The **entry** for the transaction
- The journal entry will then be posted to the business

Trial Balance and Errors

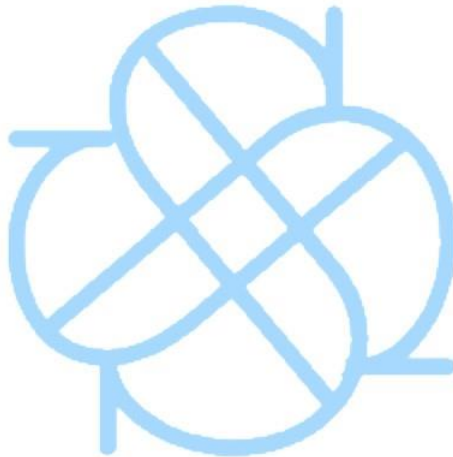
- Reveals mathematical errors that are taken place within transactions
- shows the preparation of financial statements.
- Trial balances, however, can NOT detect every aspect of the transaction

Chapter 3

There are **two methods of recording revenues and expenses** involving the income statement:

accrual basis and cash basis.

- **Accrual basis** is a *more accurate method* of matching revenues and expenses.
- **Cash basis** only records revenues and expenses when *cash is received or distributed*



Chapter 4:

There are **four types of financial statements** that are used to discuss financial information:

- Balance sheet
- Income statement
- State of retained earnings
- The statement of cash flows

Basic accounting Equation: Assets = Liabilities + Stockholders' Equity

Elements of the Balance Sheet:

- **Assets:** known as **economic resources** that have probable future benefits that are owned by the entity as a result of past transactions.
- **Liabilities:** Are **profitable debts or obligations** of the entity that results from past transactions, which will be paid with assets or services.
- **Stockholders:** The owners' **residual interest in net assets**.
 - (two categories: contributed capital and retained earnings)

Steps in Transaction Analysis:

Analyze: Identify which profits increase and decrease

Journalize: Debit is the left side of an account and credit is the right side of an account.

Ensure you reference the accounting equation

Posting: Transfer the journal entry amount to the proper accounts in the t-account.

Income Statement:

Revenues-Expenses= Net income *Net loss*

Adjusting Entries:

- Prepared due to **timing differences**
- Timing differences take place when cash is received before or after revenues are earned and the expenses are incurred

There are two types of adjusting entries:

- **Accruals:** When **revenues have been earned or expenses incurred**, however they have not been recorded in the journal.
- **Deferrals:** Shows the receipt of assets or the payment of cash before the revenue being earned or the expense is recognized.

Accounting for bad debts:

- **Bad debt expense:** reported as an **adjusting entry**
 - ❑ At the end of an accounting period
- When it is proven that a certain account is uncollectible, that account will be written off against the allowance
- **Current liabilities are short-term periods** that will be paid within the current operating cycle or one year, whichever is longer.
- Specific operating activities of companies are usually financed
- **Ease of Transfer:** Stock ownership can be transferred easily through establish markets

- **Limited liability:** The maximum a stockholder stands to lose is the investment in a certain stock

Dividends on Preferred Stock:

- Investors in preferred stock give up some rights compared to those in common stock
- Preferred Stocks enjoy a preference in dividends
- **Dividends must be:** allocated between both the **1. preferred shareholders and 2. common shareholders**
- **Two dividend preferences:**
 - ☐ Current Dividend preference
 - ☐ Cumulative dividend preference

Component Percentages:

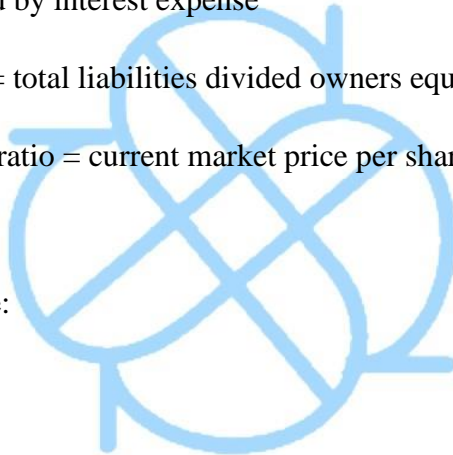
- Used to express each item on a **particular financial statement**
- The **base amount of the income statement is net worth and the base amount of the balance sheet is total assets**
- The component percentage is derived by dividing each statement by the base amount from that statement
- Then, the amount is **multiplied by 100** in order to change it into a percent.

Equations:

- **Return on Equity** = Net income/Average Owner's Equity
- **Return on Equity** = Net income + interest expense divided by average total assets

- **Earning per share** = Net Income divided by the average number of shares outstanding for the period
- **Profit margin** = net income divided by the net sales revenue
- Fixed asset turnover ratio = net sales revenue divided by the average net fixed assets
- Cash ratio = cash + cash equivalents divided by current liabilities
- Current Ratio = current assets divided by current liabilities
- Times Interest Earned Ratio = net income + interest expense + income tax expense divided by interest expense
- Debt-to-equity= total liabilities divided owners equity
- price /earnings ratio = current market price per share divided by the earnings per share

Below is an example of a table:



	ACCOUNT NUMBER	ACCOUNT TYPE	INCREASE	DECREASE
Balance Sheet <i>(As of a 'point in time')</i>	1-xxxx	Assets	DEBIT	CREDIT
	2-xxxx	Liabilities	CREDIT	DEBIT
	3-xxxx	Owner's Equity	CREDIT	DEBIT
Profit and Loss <i>(For a 'period of time')</i>	4-xxxx	Revenue	CREDIT	DEBIT
	5-xxxx	Cost of Goods Sold	DEBIT	CREDIT
	6-xxxx	Expenses	DEBIT	CREDIT
	8-xxxx	Other Income	CREDIT	DEBIT
	9-xxxx	Other Expenses	DEBIT	CREDIT

- An asset is anything you own in your business.
- Liabilities are the things you owe (Sales tax)
- An example of a Balance sheet will be provided below:

ABC Inc.
Balance Sheet
June 30, 20xx

Assets

Cash	\$1,301
Accounts Receivable	\$550
Inventory	<u>\$1,500</u>
Total Assets	<u>\$3,351</u>

Liabilities

\$ 0

Equity

Owners Investment	\$5,000
Current Year Earning	<u>(\$1,649)</u>
Total Equity	\$3,351

Total Liabilities and Equity **\$3,351**



** Example of a profit and loss statement below:**

ABC Inc.
Profit and Loss Statement
January 1, 20xx to June 30, 20xx

Revenue

Sales	\$2,950
COGS	<u>(\$1,500)</u>
Gross Profit	\$1,450

Expenses

Office Expense	\$2,299
Rent	<u>\$800</u>
Total Expenses	\$3,099

Net Income/(Loss)	<u>(\$1,649)</u>
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ABC Inc.
Profit and Loss Statement
January 1, 20xx to June 30, 20xx

Revenue

Sales		\$285,450
COGS	\$136,500	
Less: Purch Disc	<u>\$ 3,000</u>	
	<u>(\$133,500)</u>	

Gross Profit \$151,950

Expenses

Salary	\$1,000
Office Expense	\$2,299
Rent	\$1,600
Employer PR Tax Expense	\$ 77
Depreciation Expense	<u>\$ 208</u>
Total Expenses	\$5,184

Net Income/(Loss) \$146,766



** A complex balance sheet is listed below: **

**ABC Inc.
Balance Sheet
June 30, 20xx**

Assets

Cash	\$82,194
Accounts Receivable	\$60,550
Inventory	\$16,500
Office Furniture	\$ 1,900
Office Equipment	\$ 7,500
Accum. Depr – Off Equip	<u>(\$208)</u>

Total Assets \$168,436

Liabilities

Accounts Payable	\$9,400
Sales Tax Payable	\$7,200
Federal Inc Taxes Payable	0
FICA & Medicare Taxes Payable	0
State and Local Taxes Payable	\$ 70

Total Liabilities \$16,670

Equity

Owners Investment	\$5,000
Current Year Earnings	<u>\$146,766</u>
Total Equity	\$151,766

Total Liabilities and Equity \$168,436

- The profit and loss system is one of the most important financial statements.
- It is also known as the income statement.

Cash (1-xxxx)		
\$5,000	1.)	\$1,299
7.) \$1,000	3.)	\$1,500
8.) \$900	5.)	\$800
10.) \$500	6.)	\$1,000
15.) \$67,200	9.)	\$1,500
19.) \$162,500	16.)	\$800
	17.)	\$703
	18.)	\$304
	20.)	\$147,000

Accts Receivable (1-xxxx)		
4.) \$1,000	7.)	\$1,000
10.) \$550		
15.) \$60,000		

Inventory (1-xxxx)		
3.) \$1,500	4.)	\$600
9.) \$1,500	8.)	\$450
14.) \$150,000	10.)	\$450
	15.)	\$60,000
	19.)	\$75,000

Office Furniture (1-xxxx)		
11.) \$1,900		

Office Equipment (1-xxxx)		
12.) \$7,500		

Accumulated Depreciation - Office Furn & Equip (1-xxxx)		
	13.)	\$208

Accts Payable (2-xxxx)		
20.) \$150,000	11.)	\$1,900
	12.)	\$7,500
	14.)	\$150,000

Sales Tax Payable (2-xxxx)		
	15.)	\$7,200

Federal Income Taxes Payable (2-xxxx)		
18.) \$150	17.)	\$150

FICA & Medicare Taxes Payable (2-xxxx)		
18.) \$154	17.)	\$77
	17.) **	\$77

State and Local Taxes Payable (2-xxxx)		
	17.)	\$70

*** This additional entry for \$77 represents the employers' matching of the FICA/Medicare liability that is withheld from an employees paycheck. This expense is paid as part of your '941' deposit.*

Sales (4-xxxx)		
	4.)	\$1,000
	8.)	\$900
	10.)	\$1,050
	15.)	\$120,000
	19.)	\$162,500

COGS (5-xxxx)		
4.) \$600		
8.) \$450		
10.) \$450		
15.) \$60,000		
19.) \$75,000		

Purchase Discounts (5-xxxx)		
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