

Accounting Basics, Part 1

Accrual, Double-Entry
Accounting, Debits & Credits,
Chart of Accounts,
Journals and,
Ledger

What's Here...

- Introduction
- Business Types
- Business Organization
- Professional Advice
- Accounting and Records
- Accrual Accounting
- Basic Bookkeeping
- Chart of Accounts
- Double-Entry Accounting
- Debits & Credits
- The Journal
- The Ledger
- Additional Information

Introduction,

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- Accounting is the bookkeeping methodology involved in creating a financial record of all business transactions and in preparing statements concerning the assets, liabilities and operating results of the business
- Accounting methods and terms have standard rules known as:
 - *Generally Accepted Accounting Principles (GAAP)*

Introduction,

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- Causes of recurring business difficulty and failure include:
 - Inadequate planning
 - Lack of business knowledge
 - Lack of capital
 - Poor management, judgment, and decisions
- Successful business managers understand their business information and make comparisons from month-to-month and year-to-year

Introduction,

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- Accounting collects, organizes and presents business information in a timely manner and standardized format
- This tutorial outlines accounting “basics” with a primary focus on manual, *double entry*, *accrual* accounting processes

Introduction,

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- In Part 2 of this series, we pick up where this one ends. It illustrates and discusses the accounting cycle, adjusting entries, closing entries, trial balance and closing balance.
- In Part 3, we illustrate and discuss the Balance Sheet, Income Statement and analyzing these financial reports.

Business Types


- Let's imagine you are going to open a new business – what will be its purpose?
 - Service
 - Sales
 - Manufacturing
- Why does this matter?
 - This is one important factor in deciding which type accounting systems, processes and methods to use

Business Organization

- How will you structure the business?
 - Sole proprietorship
 - Partnership
 - Corporation
 - Limited Liability Company
- Why does this matter?
 - This decision is another major factor in determining which type accounting systems, processes, and methods you will use

Professional Advice

- Accountants
- Attorneys
- Bankers
- Insurance Agents
- Investment Advisors
- Investors
- Partner/s
- Government agencies
- Vendors / suppliers
- Local business people
- Professional association members



**Starting and
operating a
business *without*
professional
assistance is ill-
advised**

Accounting and Records,

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- Cash-basis Accounting
- Single-entry record keeping
- Double-entry record keeping
- Accrual-basis Accounting

These each have merit, purpose, and applicability.

The business type/purpose and size and the ownership structure will determine which accounting method and record keeping system is most appropriate for your business venture.

Accounting and Records,

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Typical Business Records:

- Journals
- General Ledger
- Petty Cash Record
- Inventory Records
- Fixed Asset Log
- Accounts Receivable
- Accounts Payable
- Payroll Records
- Mileage Log
- Travel Record
- Entertainment Record
- Customer Records
- Business Checkbook
- Filing System

Accrual Accounting,

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- Businesses can record revenue and expenses in one of two ways – cash-basis or accrual-basis.
- Accrual accounting is used in businesses involved in production, purchase and sale of merchandise. Revenue is a factor.

Accrual Accounting,

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- In accrual-basis accounting, revenue is recorded when earned, expenses are recorded when they are incurred whether they are paid or not
- When transactions are posted may have nothing to do with when cash is received or payments are made
- Cash is not necessarily the same as revenue

Basic Bookkeeping,

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- Bookkeeping deals with five major accounting categories:
 - Assets
 - Liabilities
 - Owner's Equity (Equity/Capital/ Net Worth)
 - Revenue
 - Expense
- Accounting is the bookkeeping processes that records financial transactions and creates records and statements concerning the assets, liabilities, and operating results of a business

Basic Bookkeeping,

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- Basic bookkeeping process for each business transaction:
 - (1) Determine correct account category (assets, liabilities, net worth, revenue, or expense)
 - (2) Identify correct line item account (e.g., Salaries & Wages; Employer Share of FICA; Sick Leave Expense, Annual Leave Expense, etc.)
 - (3) Ensure correct amount used when recording (posting) the transaction
 - (4) Be consistent and accurate

Basic Bookkeeping,

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- Dollar signs are not used in journals or ledgers. They are used in financial reports.
- Commas used to show thousands of dollars are not required in journals or ledgers. They are used in financial reports.
- Decimal points are not required on ruled journals or ledgers. They are used in financial reports.

Chart of Accounts,

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- All accounting systems use a Chart of Accounts
 - A listing of accounts in a financial system generally using numeric or alpha-numeric characters to designate the transactions that comprise the Balance Sheet and Income Statement
 - The chart of accounts is used as the basis for preparing financial reports from an accounting system
 - The reports should be designed to capture financial information necessary to make good financial decisions

Chart of Accounts,

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- A Chart of Accounts could include the following account series (groups):
 - 100 - Assets
 - 200 - Liabilities
 - 300 - Net worth
 - 400 - Revenue
 - 500 - Expenses

Chart of Accounts,

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Assets	Liabilities	Net Worth	Revenue	Expenses
Cash Accounts receivable Automobile Equipment Building Land Supplies Accumulated depreciation	Accounts payable Note payable Mortgage payable Salaries payable	Capital Withdrawals	Sales Services income Interest earnings	Salaries and wages Utilities Supplies Repairs Rent Office Interest Insurance Advertising Depreciation expense Miscellaneous

Chart of Accounts,

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- Example Chart of Accounts:

100 - Assets

- 101 - Cash
- 102 - Accounts receivable
- 103 - Automobile
- 104 - Equipment
- 105 - Building
- 106 - Land
- 107 - Supplies
- 108 - Accumulated Depreciation

200 - Liabilities

- 201 - Accounts payable
- 202 - Note payable
- 203 - Mortgage payable
- 204 - Salaries payable

300 - Net worth

- 301 - Capital
- 302 - Withdrawals

400 - Revenue

- 401 - Sales
- 402 - Services Income
- 403 - Interest Earnings

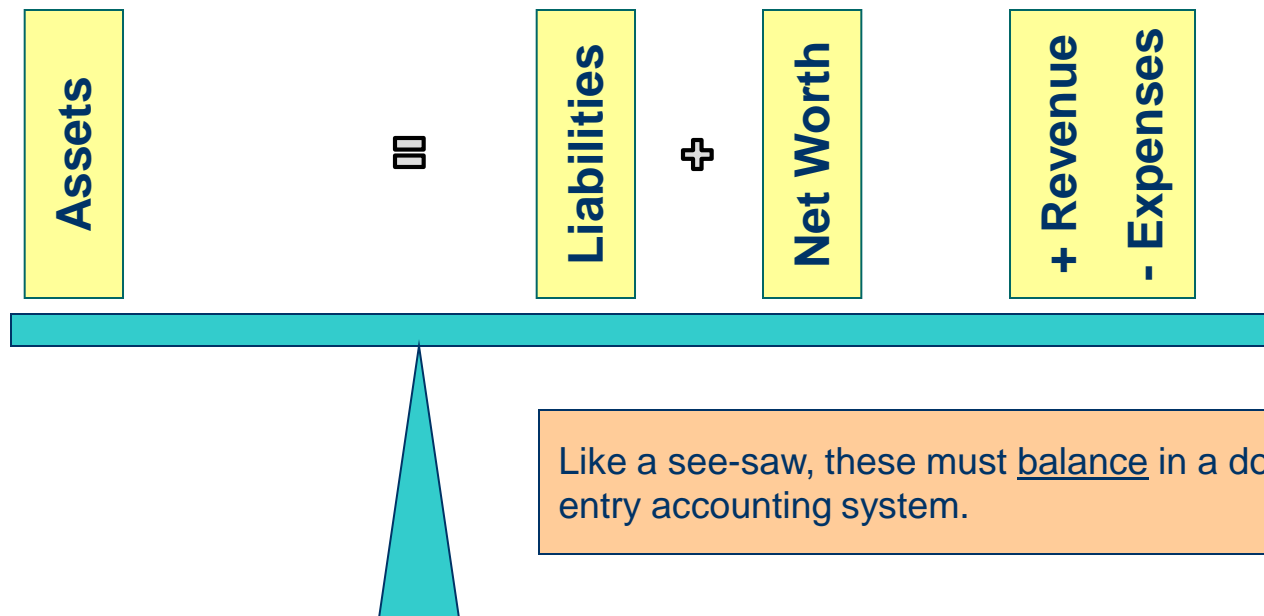
500 – Expenses

- 501 - Salaries and Wages
- 502 - Utilities
- 503 - Supplies
- 504 - Repairs
- 505 - Rent
- 506 - Office
- 507 - Interest
- 508 - Insurance
- 509 - Advertising
- 510 - Depreciation Expense
- 514 - Miscellaneous

Double-Entry Accounting,

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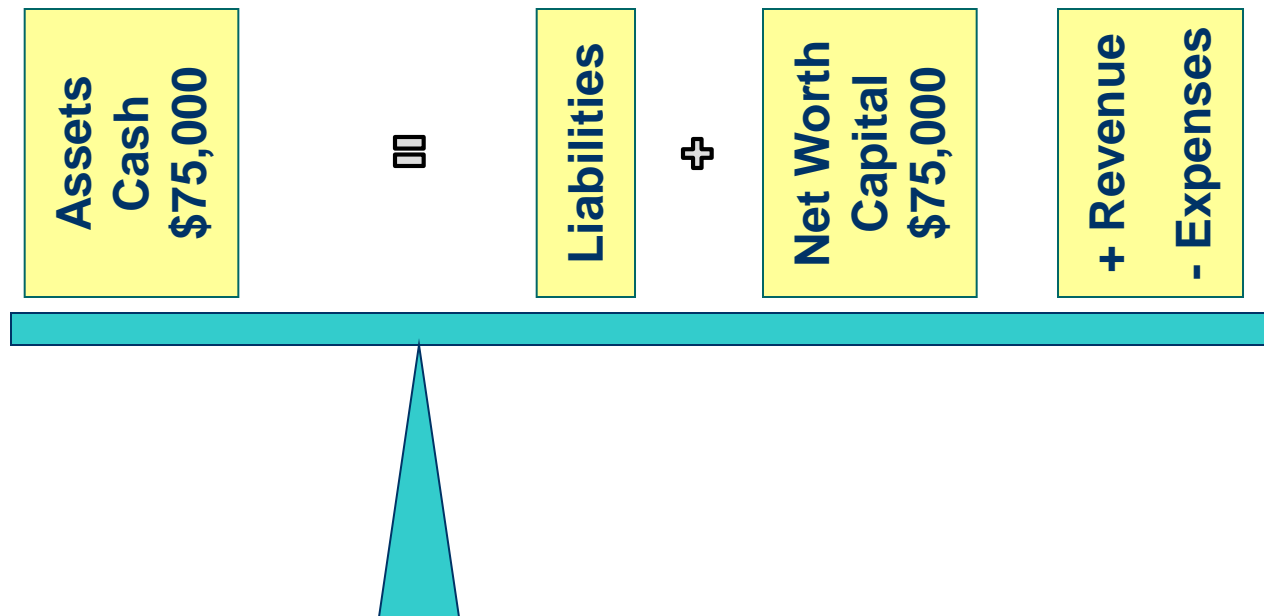
- A double-entry system requires the use of two or more accounts for each transaction



Double-Entry Accounting,

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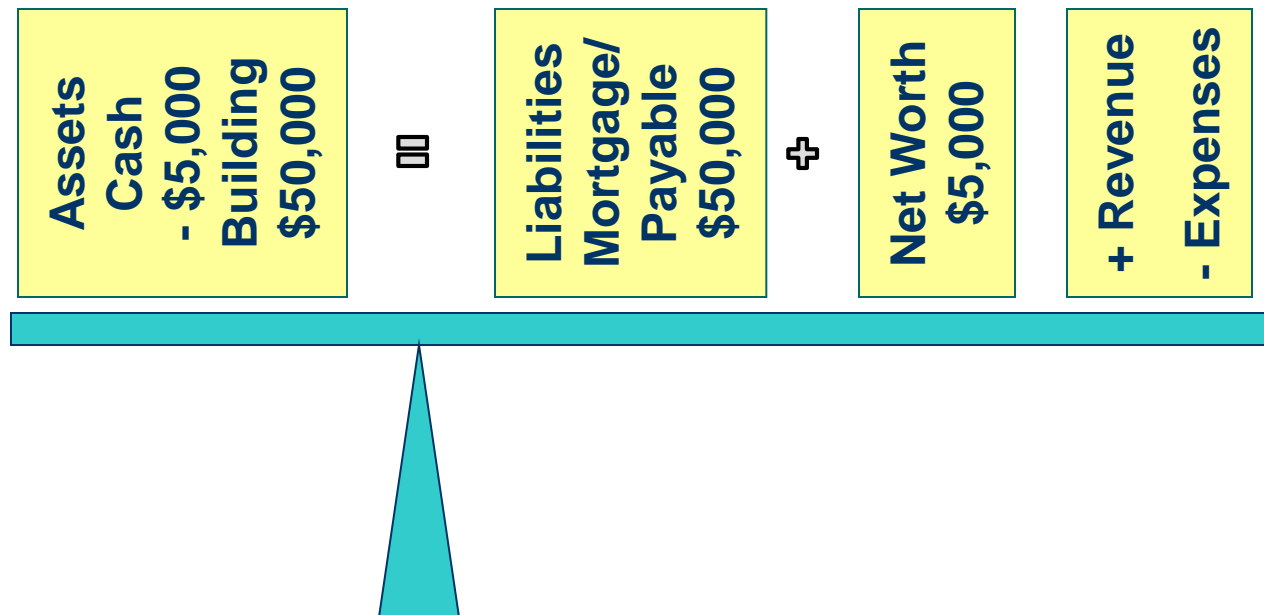
- Example 1 – A business starts with an investment of \$75,000 which is recorded (posted) as:



Double-Entry Accounting,

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- Example 2 – The business buys a \$55,000 building with \$5,000 cash and a mortgage which is posted as:

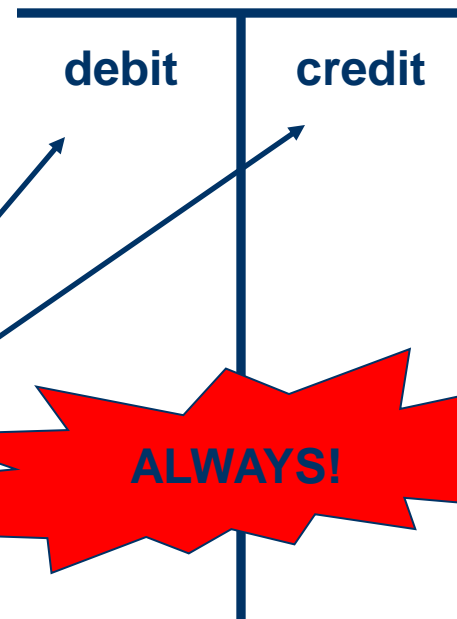


Debits and Credits,

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Accountants have used the terms *debit* and *credit* for hundreds of years to describe where numbers are placed in Journals and Ledger Books.

- Debit means left
- Credit means right



ALWAYS!

Latin Dr and Cr:

- Dr for Debit
- Cr for Credit

Debits and Credits,

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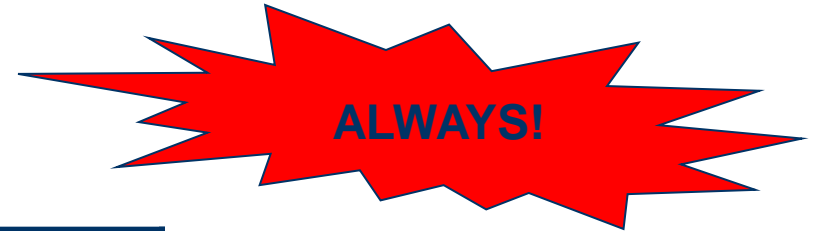
Asset	
Debit	Credit
+	-

Liabilities	
Debit	Credit
-	+

Net Worth	
Debit	Credit
-	+

Revenue	
Debit	Credit
-	+

Expenses	
Debit	Credit
+	-



When recording transactions in the Journal and Ledgers, the five major account categories are increased or decreased by debits or credits as shown.

The Journal,

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- The Journal or General Journal is used to record all transactions in chronological order
- The Journal is the *book of original entry*
- Entries are made on a daily basis, according to the time and date they occur
- The Journal records debits (left side) and credits (right side) as illustrated on the next slide

The Journal,

Page 2 of 5

Date		Description of Entry	PR	Debit	Credit
20XX					
Mar	1	Cash		40000	
		Capital			40000
		Invested in the business			
	2	Rent		600	
		Cash			600

Indent Credits

Explain transaction

Skip between entries

Record account number **after**
amount posted to ledger

The Journal,

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Date		Description of Entry	PR	Debit	Credit
20XX					
Apr	1	Truck		28000	
		Cash			10000
		Note payable			18000
		Purchase a new truck			

April 1 – bought new truck. Invested \$10,000 cash in truck with remainder on a note payable. The truck cost \$28,000.

Truck	
28000	
Plus	
(increase)	

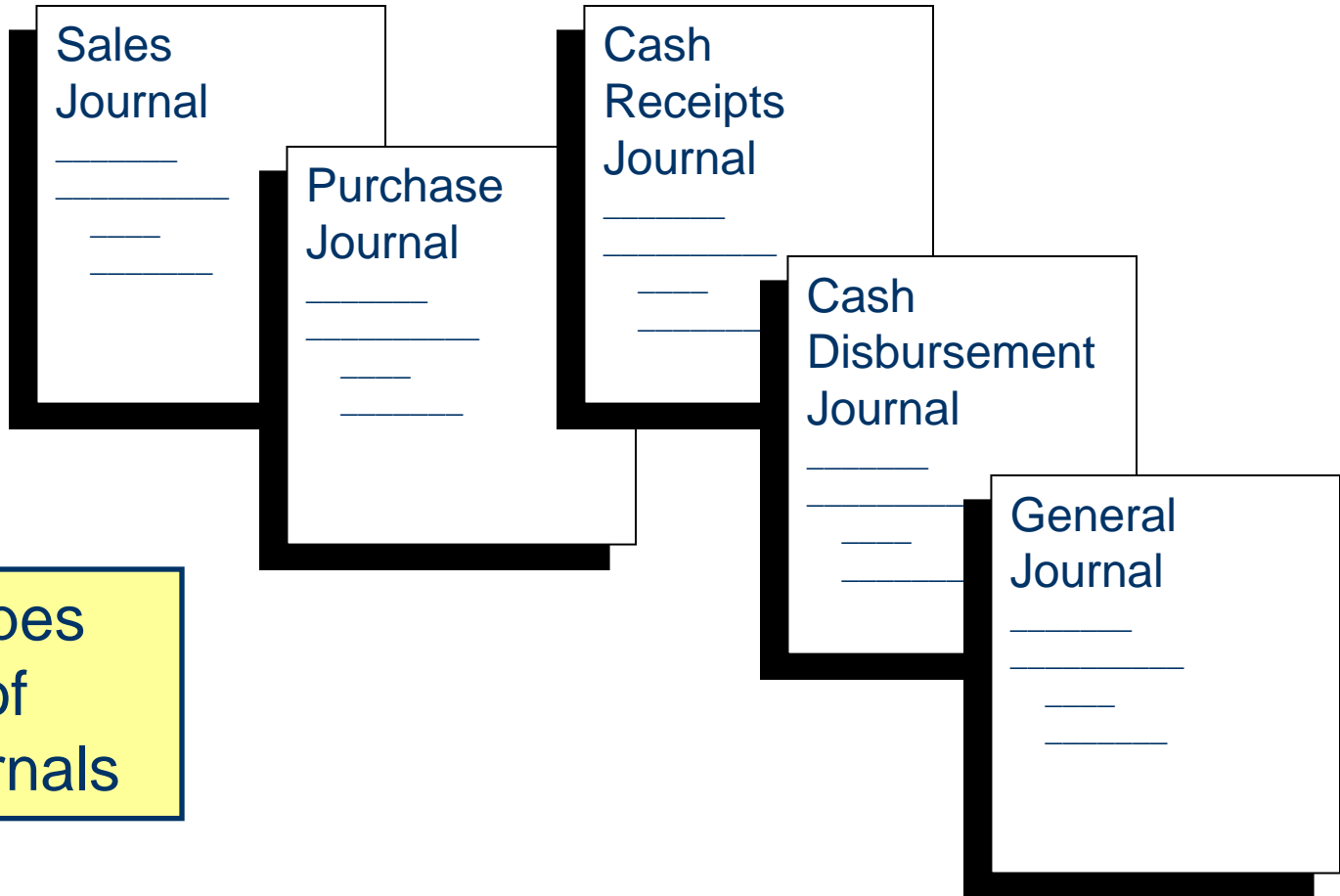
Cash	
10000	
Minus	
(decrease)	

Note Payable	
18000	
Plus	
(decrease)	

The Journal,

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Types of Journals



The Journal,

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Sales Journals

Record only sales on credit

Purchases
Journals

Record everything bought on credit

Cash Receipts
Journals

Record all incoming cash

Cash Disbursements
Journals

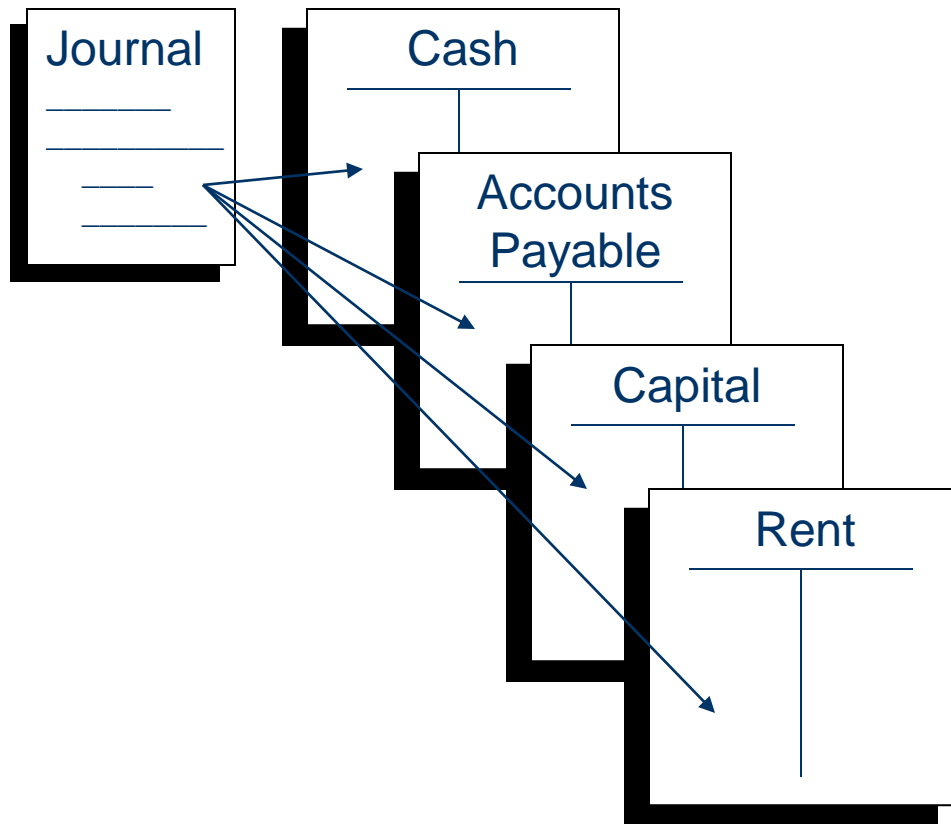
Record all outgoing cash

General Journal

Everything not recorded in the other Journals

The Ledger,

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- Each business transaction is recorded in the Journal, then posted (placed) into the applicable Ledger book.
- The Ledger has all the accounts listed in order (assets, liabilities, net worth, revenue, and expenses).

The Ledger,

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Transactions are typically recorded as follows:

- After reviewing details of the transaction, determine the accounts affected
 - Two or more accounts will be affected in a double-entry system
- Decide if the applicable accounts are increased or decreased by the transaction
- Place the correct amount on the proper side of the “T” account to reflect the increase or decrease

Truck	
28000	
Plus	
(increase)	

Cash	
	10000
	Minus
	(decrease)

Note Payable	
	18000
	Plus
	(decrease)

Additional Information,

- My Bean Counter website at:
<http://www.dwmbeancounter.com/>