

# 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,

Page 1 of 4

- 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,

Page 2 of 4

- 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,

Page 3 of 4

- 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,

Page 4 of 4

- 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,

## Page 1 of 2

- 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,

## Page 2 of 2

### 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,

Page 1 of 2

- 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,

## Page 2 of 2

- 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,

## Page 1 of 3

- 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,

## Page 2 of 3

- 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,

Page 3 of 3

- 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,

## Page 1 of 4

- 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,

## Page 2 of 4

- 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,

## Page 3 of 4

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,

## Page 4 of 4

- 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

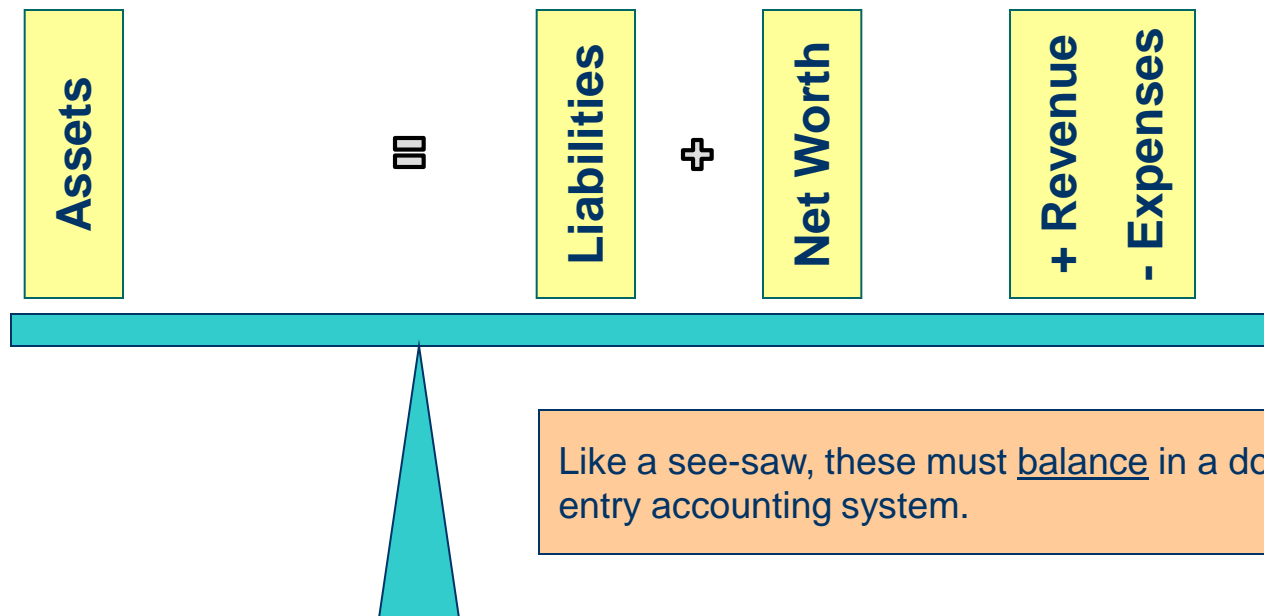
### **500 – Expenses**

- 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,

Page 1 of 3

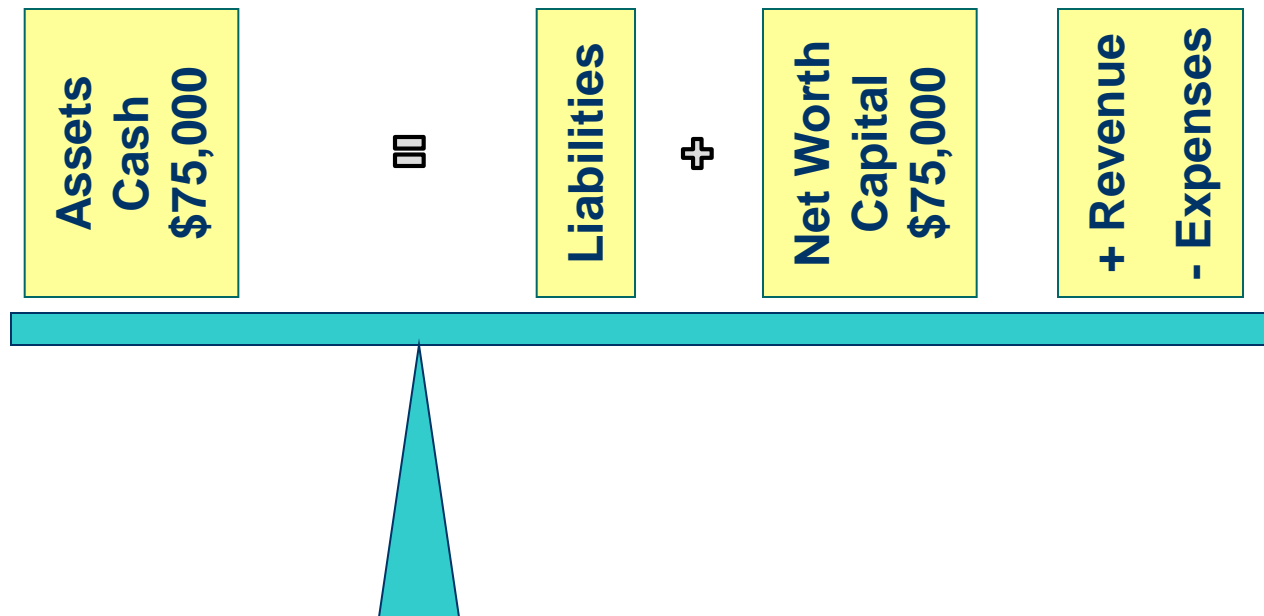
- A double-entry system requires the use of two or more accounts for each transaction



# Double-Entry Accounting,

Page 2 of 3

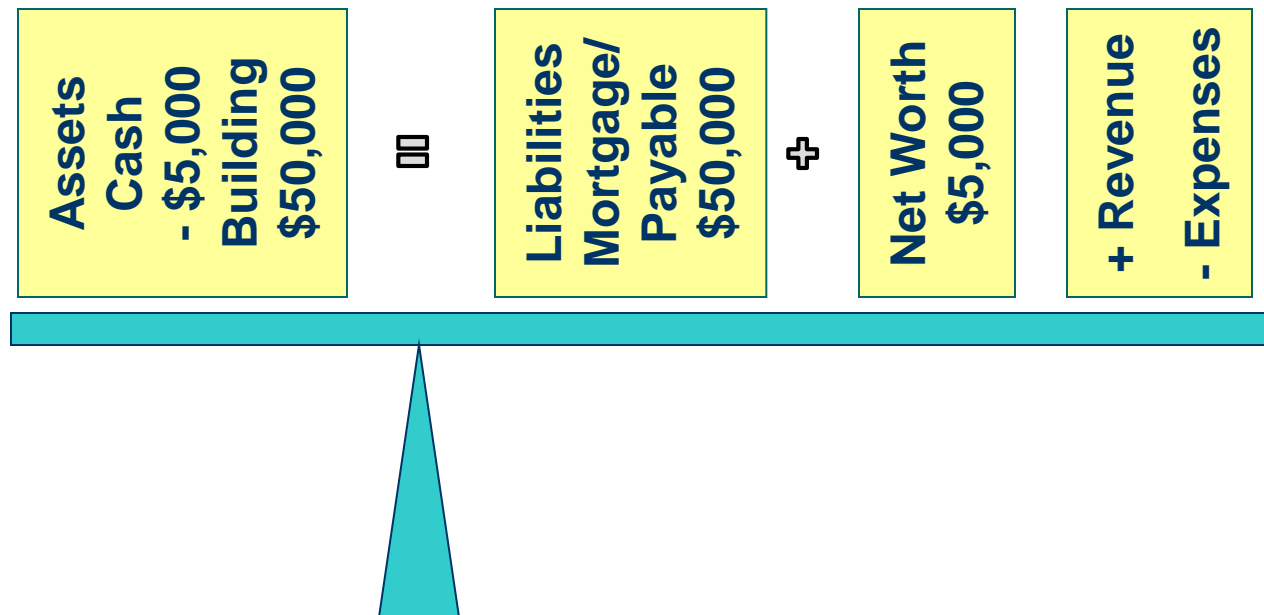
- Example 1 – A business starts with an investment of \$75,000 which is recorded (posted) as:



# Double-Entry Accounting,

## Page 3 of 3

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

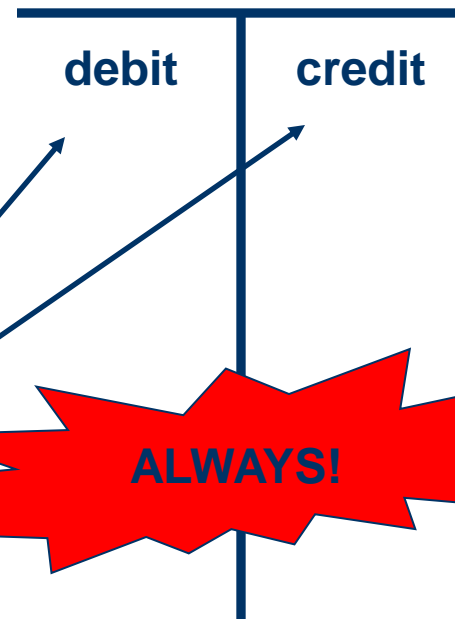


# Debits and Credits,

## Page 1 of 2

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,

## Page 2 of 2

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,

Page 1 of 5

- 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,

## Page 3 of 5

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)	

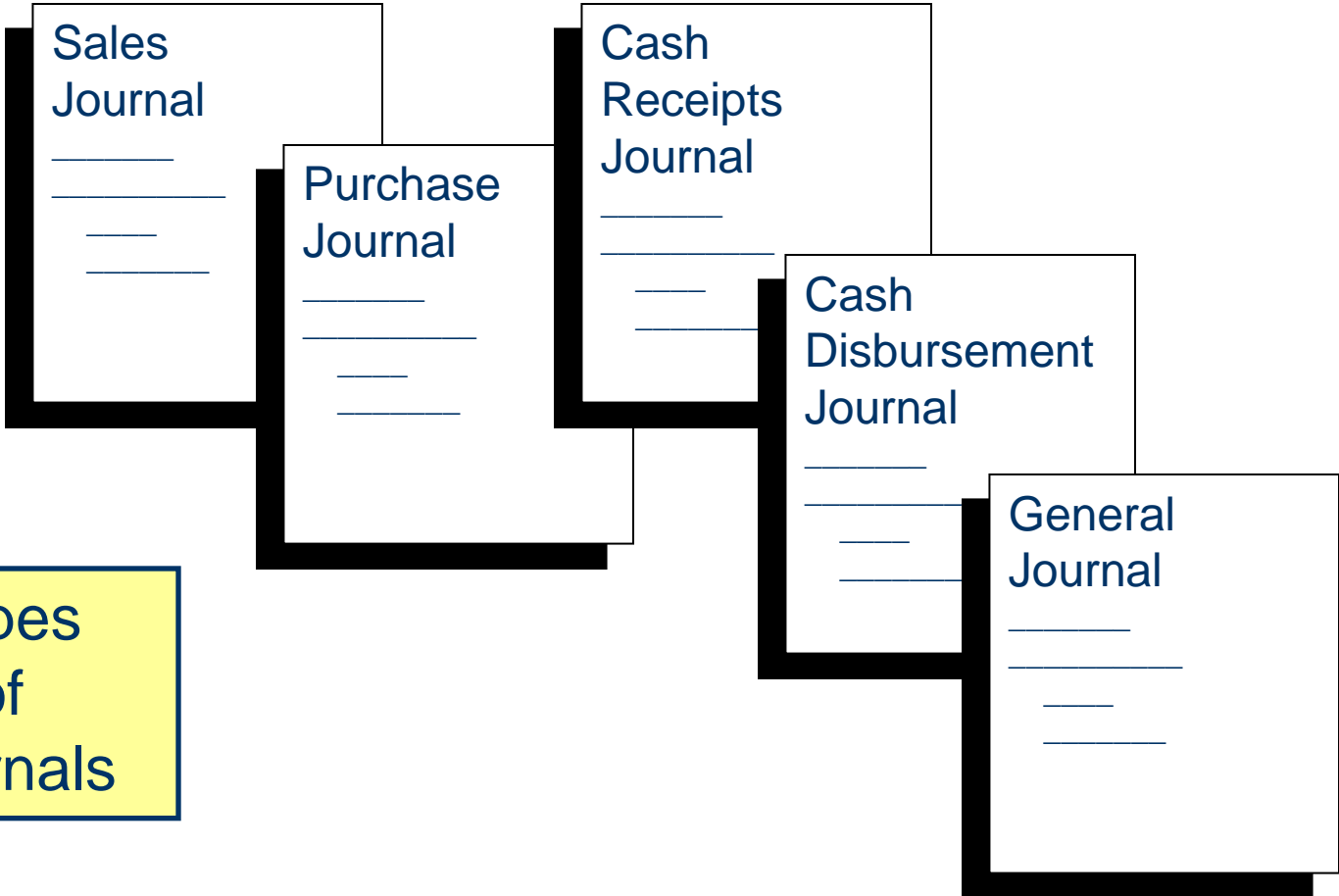
Cash	
10000	
Minus	
(decrease)	

Note Payable	
18000	
Plus	
(decrease)	

# The Journal,

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## Types of Journals



# The Journal,

## Page 5 of 5

Sales Journals

Record only sales on credit

Purchases  
Journals

Record everything bought on credit

Cash Receipts  
Journals

Record all incoming cash

Cash Disbursements  
Journals

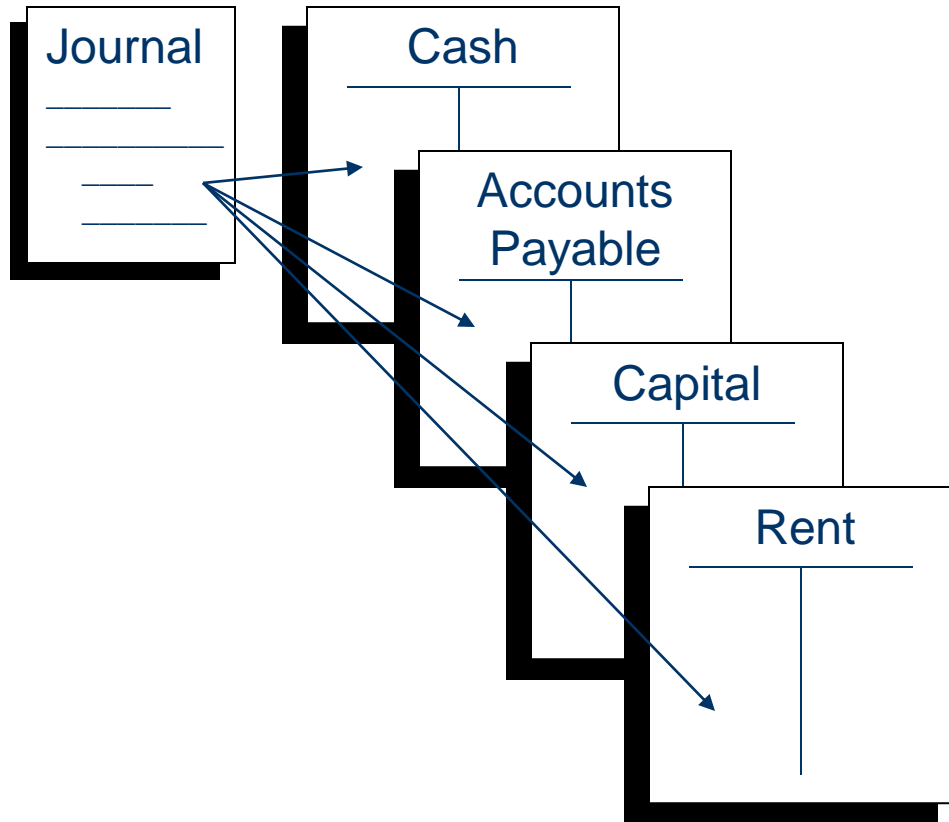
Record all outgoing cash

General Journal

Everything not recorded in the other Journals

# The Ledger,

## Page 1 of 2



- 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,

## Page 2 of 2

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/>

# Accounting Basics, Part 2

The Accounting Cycle,  
T-Accounts,  
Trial Balance, and  
from Ledger to  
Trial Closing Balance

# What's Here...

- Introduction
- The Accounting Cycle
- T-Accounts
- Trial Balance
- Adjusting Entries
- Closing Entries

# Introduction,

Page 1 of 2

- This *training* picks up where Part 1 left off. This one illustrates and discusses:
  - The Accounting Cycle
  - T-Accounts
  - Trial Balance
  - Adjusting Entries
  - Closing Entries
  - Trial Closing Balance

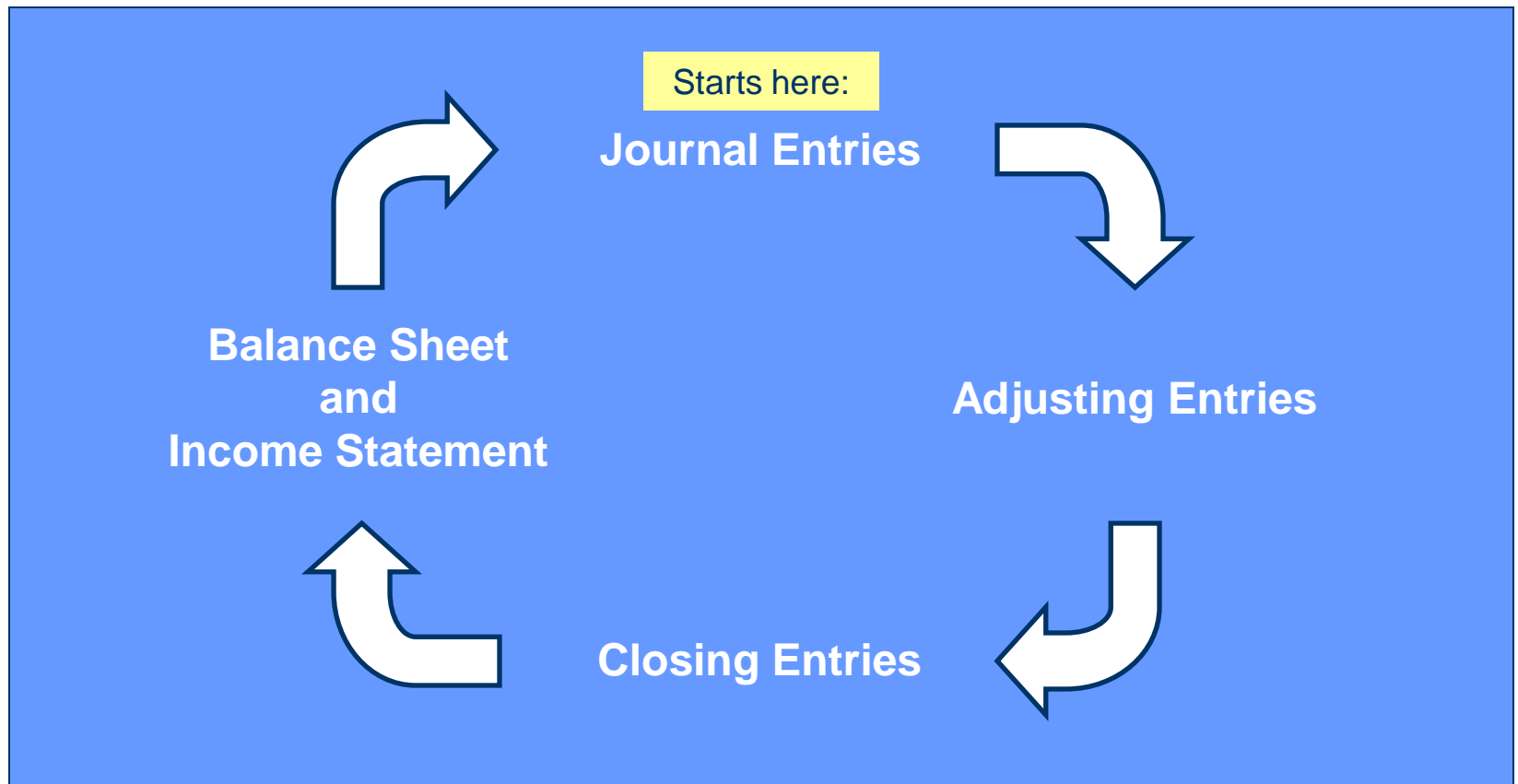
# Introduction,

## Page 2 of 2

- Part 1, started with the Basics by discussing:
  - 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
- Part 3, the next *training* in this series, illustrates and discusses the Balance Sheet, the Income Statement and analyzing financials

# Accounting Cycle

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# Accounting Cycle,

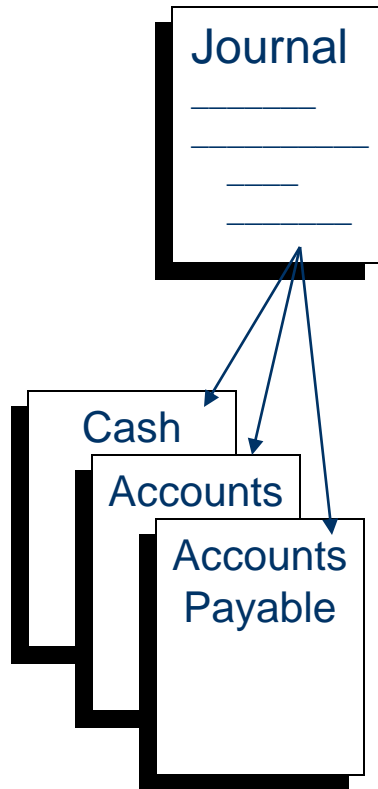
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- Step 1 Business transactions occur that result in source documents such as receipts, bills, checks, etc.
- Step 2 Business transactions are recorded in the Journal chronologically by account name
- Step 3 Information is posted (copied) from the Journal to the General Ledger (book in which *accounts* are recorded)

Steps are illustrated on next slide

# Accounting Cycle,

Page 3 of 9



Steps 1 and 2 – Transactions occur resulting in business revenue and expense details that are recorded in the Journal

Step 3 – Information from Journal is posted to applicable ledgers

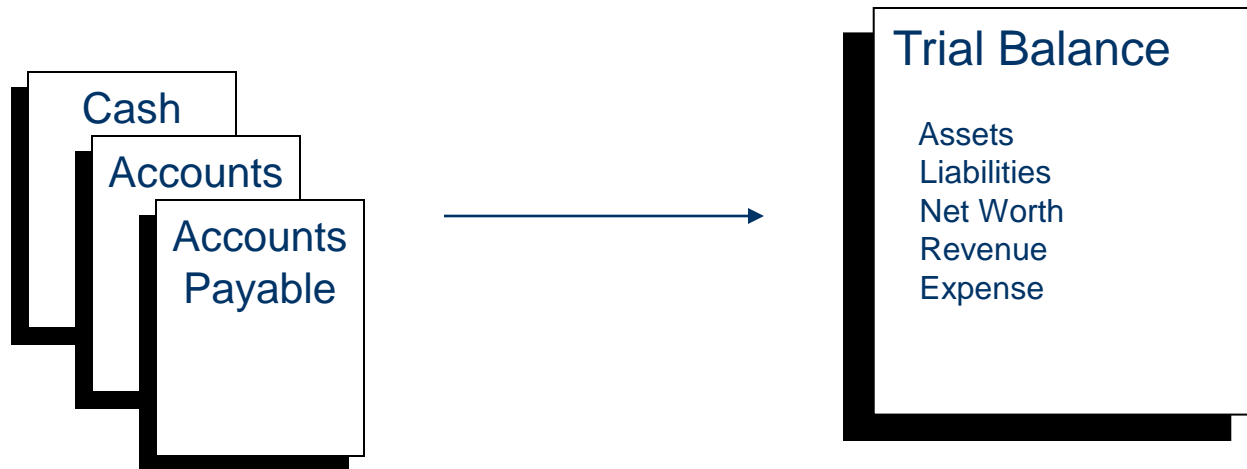
Recurring transactions are grouped together into like accounts (categories) such as cash, receivables, payables, equipment, etc.



# Accounting Cycle,

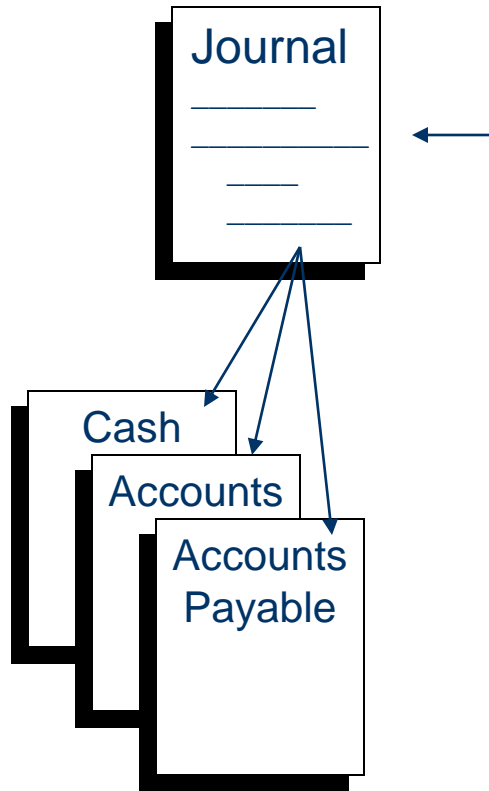
Page 4 of 9

Step 4 A trial balance is prepared which lists, in order, the ending monthly balances of all general ledger accounts



# Accounting Cycle,

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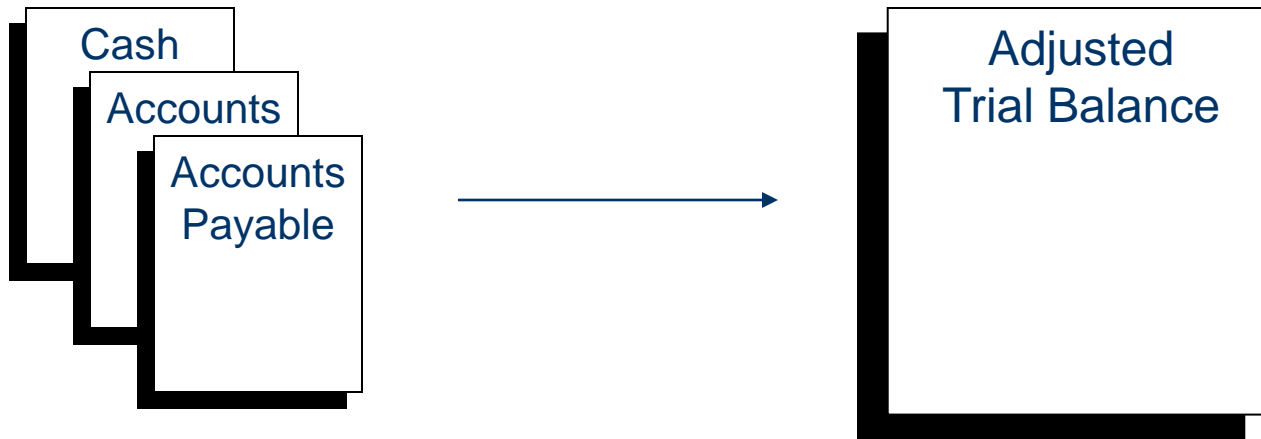
**Step 5** Adjusting entries are completed at the end of the accounting period (e.g., monthly) to match proper revenue with expenses in that period

**Step 6** Adjusting entries from the Journal are posted into the General Ledger

# Accounting Cycle,

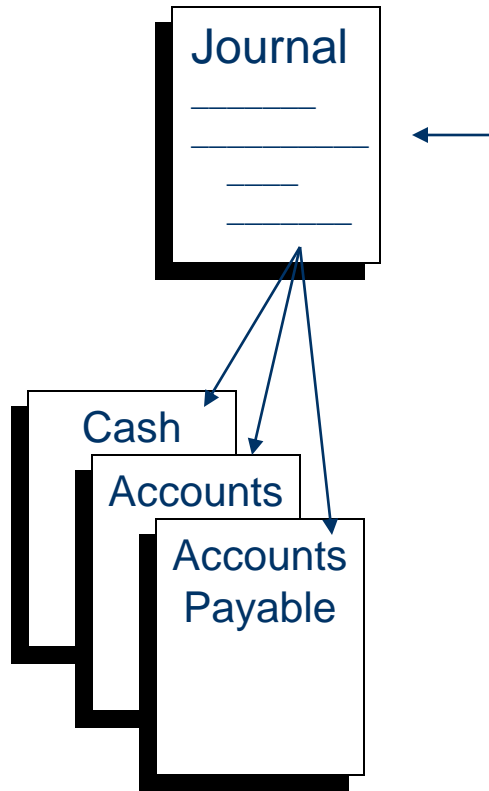
Page 6 of 9

Step 7 An adjusted trial balance is prepared that reflects only the adjusting entries. (If an error has occurred, it was made in posting.)



# Accounting Cycle,

Page 7 of 9



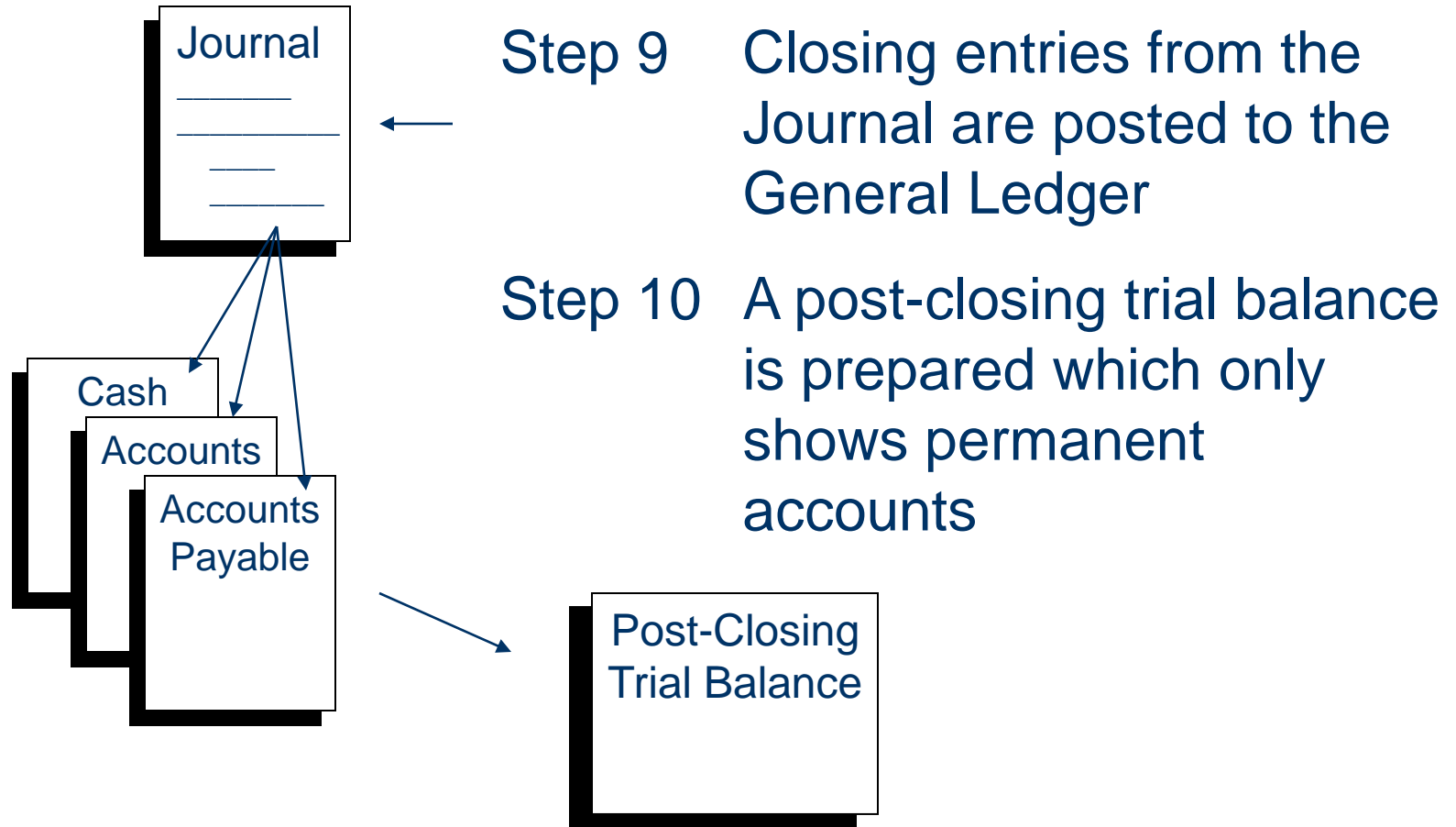
## Step 8

All temporary (nominal) accounts are closed and have a zero balance at the beginning of the next accounting period (month)

All closing entries at the end of the accounting period are recorded in the Journal

# Accounting Cycle,

Page 8 of 9



# Accounting Cycle,

## Page 9 of 9

Step 11 Monthly (or periodic) financial statements are prepared:

➤ Income Statement

$$\text{Revenue} - \text{Expenses} = \text{Net Profit/Loss}$$

➤ Balance Sheet

$$\text{Assets} = \text{Liabilities} + \text{Net Worth}$$

The Balance Sheet equation cannot balance until net income (or loss) is added to the Balance Sheet from the Income Statement.

# T- Accounts,

Page 1 of 7

## Cash

## Account No. 101

Date 20XX		Item	PR	Debit	Date 20XX		Item	PR	Credit
Jan	1		J1	2500	Jan	2		J1	250
					Jan	3		J1	175
				2500					452
Jan	xx	Balance	2048						

Standard Ledger Account ... the "T" Account

Footings (adding) helps balance the account.

Ending balance is difference between the footings.

# T- Accounts,

## Page 2 of 7

Assets = Liabilities + Net Worth      Revenue - Expenses

Assets		Liabilities	
Debit	Credit	Debit	Credit
+	-	-	+
Balance			Balance

Net Worth	
	Credit
	+

Revenue		Expenses	
	Credit	Debit	
	+	-	

Withdrawals

Withdrawals	
Debit	
+	

Balances are the differences between debits and credits in the accounts.

Normal balance for all asset accounts are debits.

Normal balance for liability accounts are credits.





# T- Accounts,

## Page 3 of 7

On Jan 1, 20XX, the business owner invested \$5000 cash and \$100 office equipment in the business.

Cash		Equipment		Capital	
Debit	Credit	Debit	Credit	Debit	Credit
5000		100			5100

On Jan 15, 20XX, the business bought a used truck for \$1000 cash and a note payable for \$4000.

Cash		Truck		Note Payable	
Debit	Credit	Debit	Credit	Debit	Credit
5000	1000	5000			4000

# T- Accounts,

## Page 4 of 7

On Jan 17, 20XX, the business earned \$2000 for services.

Cash		Revenue	
Debit	Credit	Debit	Credit
5000	1000		2000
2000			

On Jan 20, 20XX, the business paid utilities on the building for \$200.

Cash		Utilities Expense	
Debit	Credit	Debit	Credit
5000	1000	200	
2000	200		

# T- Accounts,

## Page 5 of 7

On Jan 21, 20XX, the business paid its monthly building/office rent of \$500.

Cash		Rent Expense	
Debit	Credit	Debit	Credit
5000	1000	500	
2000	200		
	500		

On Jan 22, 20XX, the business bought office supplies for \$250.

Cash		Office Supplies	
Debit	Credit	Debit	Credit
5000	1000	250	
2000	200		
	500		
	250		

# T- Accounts,

## Page 6 of 7

On Jan 24, 20XX, the business owner withdrew \$100 cash to pay personal expenses.

Cash		Withdrawals	
Debit	Credit	Debit	Credit
5000	1000	100	
2000	200		
	500		
	250		
	100		

# T- Accounts,

## Page 7 of 7

At the end of the month the business transactions were summarized.

Cash		Office Equipment		Business Capital		Utilities	
Debit	Credit	Debit	Credit	Debit	Credit	Debit	Credit
5000	1000	100			5100	200	
2000	200						
	500						
	250	Truck		Withdrawals		Rent	
	100	Debit	Credit	Debit	Credit	Debit	Credit
Balance		5000		100		500	
4950							
Office Supplies		Note Payable		Revenue			
Debit	Credit	Debit	Credit	Debit	Credit		
250			4000		2000		

...to Trial Balance



# Trial Balance,

## Page 1 of 2

Business Name Trial Balance Date		
	Debit	Credit
Cash	\$4,950	
Supplies	250	
Equipment	100	
Vehicle	5,000	
Note Payable		4,000
Capital		5,100
Withdrawal	100	
Revenue		2,000
Utilities	200	
Rent	500	
<b>TOTALS</b>	<b>\$11,100</b>	<b>\$11,100</b>

Debits = Credits

When the Trial Balance matches (equals), everything is fine.

But, when it doesn't the bookkeeper must backtrack and verify all entries against the business transaction documentation until the discrepancy is discovered.

Corrections are entered and annotated in the Journal, posted to the applicable ledger, and the Trial Balance.

# Trial Balance,

Page 2 of 2

- Prepared at the end of the accounting period
- Prepared from the general ledger
- Each account balance is recorded in order starting with assets, liabilities, net worth, revenue and expenses
- Totals for debits and credits are compared and should equal
- Journals, ledgers and business transaction documentation are reconciled

# Adjusting Entries,

Page 1 of 11

- Made at the end of the month or accounting period
- Made to:
  - Current Assets
  - Long-Term Assets
  - Liabilities
  - Revenue
  - Expense



# Adjusting Entries,

Page 2 of 11

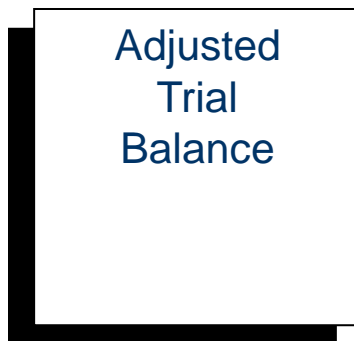
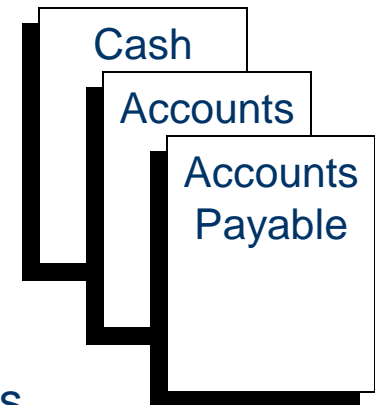
- Cash is never used in an adjusting entry
- An expense or revenue account is used in every transaction
- Expenses will normally be debits and revenue accounts will be credits
- Revenue and Expense Accounts that have been earned, but remain unrecorded, must be adjusted

# Adjusting Entries,

## Page 3 of 11

Date	Description of Entry	PR	Debit	Credit
20XX				
10	Cash		50000	
	Capital			50000
	Invested in the business			
10	Supplies		3500	
	Cash			3500
	Shirts for resale			

1. Adjustments are recorded in the Journal .. Then posted to ledgers



2. An adjusted trial balance is prepared to guard against errors.

# Adjusting Entries,

## Page 4 of 11

- Asset
  - Accounts such as prepaid insurance, office supplies, prepaid rent have been paid in advance and recorded as assets. These should be expensed as used.
- Liabilities
  - A unique liability may be created when services are paid in advance for something the business has not yet done. This receipt of cash increased the cash account and a liability called *Unearned Revenue* which remains in this account until “earned”. As it is “earned” it is transferred out of this account and into Revenue.

# Adjusting Entries,

## Page 5 of 11

- Accrued Expense
  - These are expenses that have been *incurred*, but *not yet paid*.
- Accrued Revenue
  - A job will not be completed for several months and the business won't get paid until the end of the job. At the end of the first month, an adjusting entry is needed for the amount of earnings in the current month, even though the job is not yet completed and no bill has been sent.

## Adjusting Entries, Page 6 of 11

Business Name: _____		Date _____
Trial Balance		
	Debit	Credit
Cash	1000.00	
Accounts Receivable	5000.00	
Prepaid Insurance	600.00	
Office Supplies	400.00	
Equipment	10000.00	
Automobiles	24000.00	
Buildings	80000.00	
Land	25000.00	
Accounts Payable		25000.00
Notes Payable		15000.00
Unearned Revenue		1500.00
Mortgage Payable		80000.00
Capital		27500.00
Withdrawals	12000.00	
Revenue (earnings)		90000.00
Wage Expense	48000.00	
Utilities Expense	12000.00	
Advertising Expense	6000.00	
Repair Expense	15000.00	
<b>TOTAL</b>	<b>239000.00</b>	<b>239000.00</b>

This sample trial balance will be used to demonstrate end-of-month/period adjusting entries for:

- Current Assets
- Long-Term Assets
- Current Liabilities
- Accrued Expense
- Accrued Revenue

While each of the examples are separate, all of these that are applicable would be made and an Adjusted Trial Balance prepared.

Adjustments will appear in blue.

## Adjusting Entries, Page 7 of 11

### Adjusting Current Assets:

Business Name: Adjusted Trial Balance	Date _____	
	Debit	Credit
Cash	1000.00	
Accounts Receivable	5000.00	
Prepaid Insurance	600.00	
Office Supplies	<del>400.00</del> 300.00	
Equipment	10000.00	
Automobiles	24000.00	
Buildings	80000.00	
Land	25000.00	
Accounts Payable		25000.00
Notes Payable		15000.00
Unearned Revenue		1500.00
Mortgage Payable		80000.00
Capital		27500.00
Withdrawals	12000.00	
Revenue (earnings)		90000.00
Wage Expense	48000.00	
Office Supplies Expense	100.00	
Utilities Expense	12000.00	
Advertising Expense	6000.00	
Repair Expense	15000.00	
<b>TOTAL</b>	<b>239000.00</b>	<b>239000.00</b>

Date			P.R.	Debit	Credit
Dec	31	Office Supplies Exp		100	
		Office Supplies			100

Current assets are adjusted by removing the used amount from the asset account and transferring it to the expense account.

# Adjusting Entries, Page 8 of 11

## Adjusting Long-Term Assets:

Date			P.R.	Debit	Credit
Dec	31	Depreciation Expense, Equip	J16	2000	
		Accumulated Depreciation	J17		2000
Dec	31	Depreciation Expense, Auto	J18	5000	
		Accumulated Depreciation	J19		5000
Dec	31	Depreciation Expense, Bldg	J20	4000	
		Accumulated Depreciation	J21		4000

Long-term assets need to be adjusted for the amount of depreciation (use) for the accounting period. AN account called Accumulated Depreciation is used. This account is a contra-asset account (credit balance) instead of a the normal debit balance of an asset.

The difference between cost and depreciation is known as *book value*. (e.g., equip cost 10000 – 2000 depreciation = 8000 book value.)

Business Name: _____		Date _____
Adjusted Trial Balance		
	Debit	Credit
Cash	1000.00	
Accounts Receivable	5000.00	
Prepaid Insurance	600.00	
Office Supplies	400.00	
Equipment	10000.00	
Accumulated Depreciation		2000.00
Automobiles	24000.00	
Accumulated Depreciation		5000.00
Buildings	80000.00	
Accumulated Depreciation		4000.00
Land	25000.00	
Accounts Payable		25000.00
Notes Payable		15000.00
Unearned Revenue		1500.00
Mortgage Payable		80000.00
Capital		27500.00
Withdrawals	12000.00	
Revenue (earnings)		90000.00
Wage Expense	48000.00	
Utilities Expense	12000.00	
Advertising Expense	6000.00	
Repair Expense	15000.00	
Depreciation Expense	2000.00	
Depreciation Expense	5000.00	
Depreciation Expense	4000.00	
<b>TOTAL</b>	<b>239000.00</b>	<b>239000.00</b>

## Adjusting Entries, Page 9 of 11

### Adjusting Current Liabilities:

Business Name: Adjusted Trial Balance	Date _____	
	Debit	Credit
Cash	1000.00	
Accounts Receivable	5000.00	
Prepaid Insurance	600.00	
Office Supplies	400.00	
Equipment	10000.00	
Automobiles	24000.00	
Buildings	80000.00	
Land	25000.00	
Accounts Payable		25000.00
Notes Payable		15000.00
Unearned Revenue		<del>1500.00</del>
		1000.00
Mortgage Payable		80000.00
Capital		27500.00
Withdrawals	12000.00	
Revenue (earnings)		<del>90000.00</del>
		90500.00
Wage Expense	48000.00	
Utilities Expense	12000.00	
Advertising Expense	6000.00	
Repair Expense	15000.00	
<b>TOTAL</b>	<b>239000.00</b>	<b>239000.00</b>

Date			P.R.	Debit	Credit
Dec	31	Unearned Revenue		500	
		Revenue			500

Earnings of \$500 are recorded as revenue from the liability account. The liability account was created when the company received cash in advance, but had not earned the amount. When the amount is earned, it is transferred to the revenue account.



## Adjusting Entries, Page 10 of 11

### Adjusting Accrued Expense:

Business Name: Adjusted Trial Balance	Date _____	
	Debit	Credit
Cash	1000.00	
Accounts Receivable	5000.00	
Prepaid Insurance	600.00	
Office Supplies	400.00	
Equipment	10000.00	
Automobiles	24000.00	
Buildings	80000.00	
Land	25000.00	
Accounts Payable		25000.00
Wage Payable		1500.00
Notes Payable		15000.00
Unearned Revenue		1500.00
Mortgage Payable		80000.00
Capital		27500.00
Withdrawals	12000.00	
Revenue (earnings)		90000.00
Wage Expense	<del>48000.00</del>	
	49500.00	
Utilities Expense	12000.00	
Advertising Expense	6000.00	
Repair Expense	15000.00	
<b>TOTAL</b>	<b>239000.00</b>	<b>239000.00</b>

Date			P.R.	Debit	Credit
Dec	31	Wage Expense		1500	
		Wage Payable			1500

This entry would be made by a company that pays payroll on the 5<sup>th</sup> and 20<sup>th</sup> of the month. The last days of the month would be recorded as a payable, because the expense had been incurred, but the company will not make a payment until the 5<sup>th</sup>.

## Adjusting Entries, Page 11 of 11

### Adjusting Accrued Revenue:

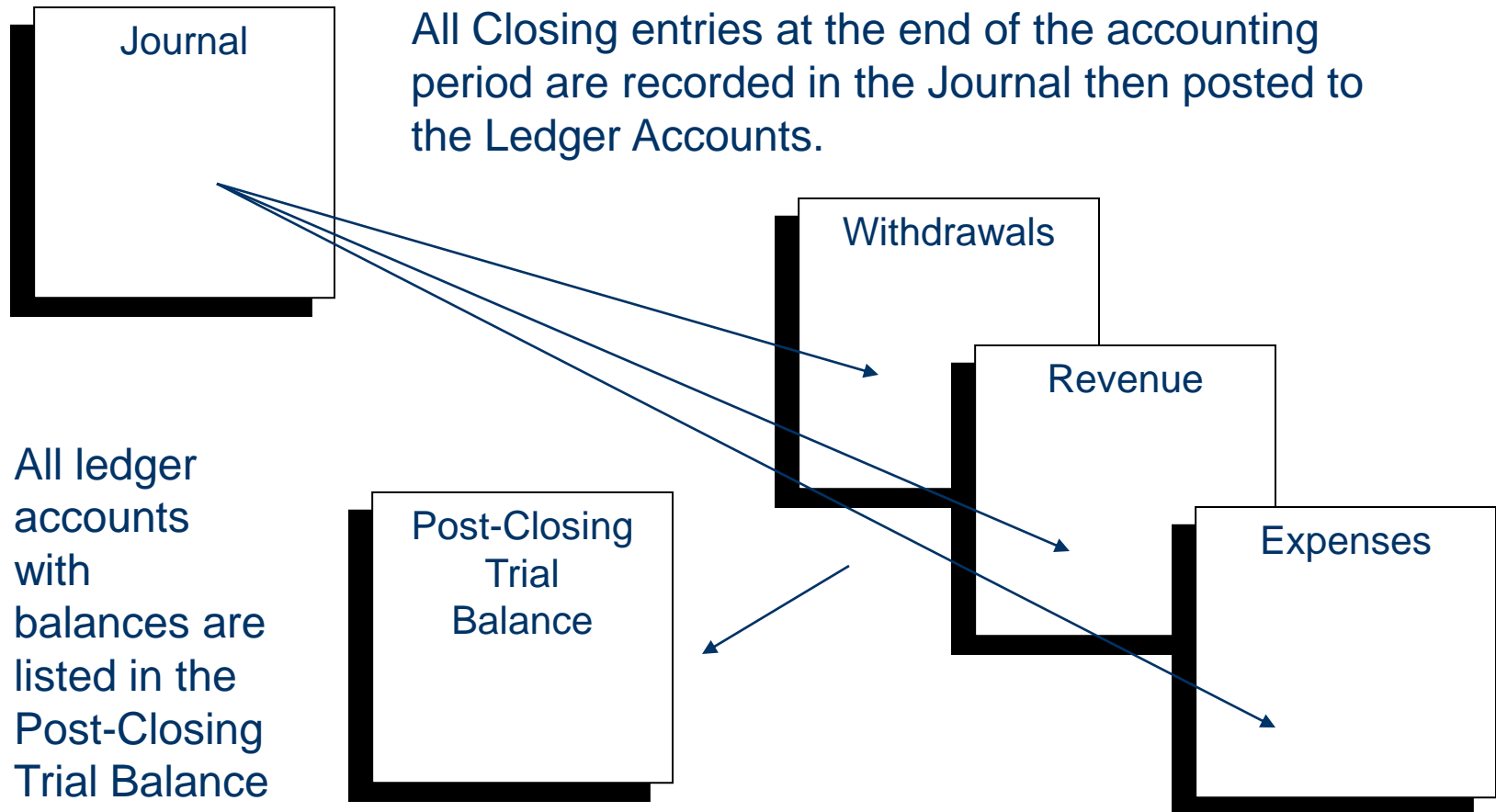
Business Name: Adjusted Trial Balance	Date _____	
	Debit	Credit
Cash	1000.00	
Accounts Receivable	5000.00	
	6000.00	
Prepaid Insurance	600.00	
Office Supplies	400.00	
Equipment	10000.00	
Automobiles	24000.00	
Buildings	80000.00	
Land	25000.00	
Accounts Payable		25000.00
Notes Payable		15000.00
Unearned Revenue		1500.00
Mortgage Payable		80000.00
Capital		27500.00
Withdrawals	12000.00	
Revenue (earnings)		90000.00
		91000.00
Wage Expense	48000.00	
Utilities Expense	12000.00	
Advertising Expense	6000.00	
Repair Expense	15000.00	
<b>TOTAL</b>	<b>239000.00</b>	<b>239000.00</b>

Date			P.R.	Debit	Credit
Dec	31	Accounts Receivable		1000	
		Revenue			1000

This entry is made for a job that is not completed by the end of the accounting period, but needs to be recorded since the service was performed in the accounting period.

# Closing Entries,

Page 1 of 4



# Closing Entries,

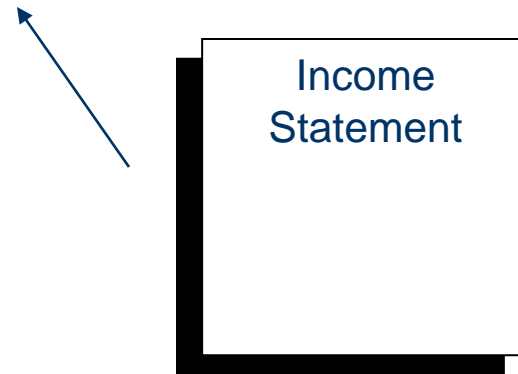
Page 2 of 4

- At the end of each month, the revenue, expense and withdrawal accounts are closed to zero balance
- Closing entries move the difference between revenue and expense from the income statement to net worth (owner's equity)

# Closing Entries,

Page 3 of 4

- $\text{Assets} = \text{Liabilities} + \text{Net Worth}$



The Balance Sheet equation can not balance without the amount of profit or loss from the Income Statement

# Closing Entries,

Page 4 of 4

- All revenue accounts start over at the end of each month. The revenue accounts are closed to the Expense and Income Summary
- All expense accounts are closed into the Expense and Income Summary
- The Expense and Income Summary account is closed to equity
- The Withdrawal Account is closed to equity

# Additional Information,

## Page 1 of 2

- Basic Accounting *Training* Part 1, covers:

- 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,

## Page 2 of 2

- Basic Accounting *Training* Part 3, covers:
  - Balance Sheet
  - Income Statement
  - Analyzing financial reports



# Accounting Basics, Part 3

The Income Statement,  
Balance Sheet and  
Basic Financial Analysis

# What's Here...

- Introduction
- Financial Statements
- Income Statement
- Balance Sheet
- Sample Statements
- Impacting the Business
- Analyzing Financials

# Introduction,

## Page 1 of 3

- This *training* picks up where Part 2 stopped.
- Part 1, started with the basics by discussing:
  - 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

# Introduction,

Page 2 of 3

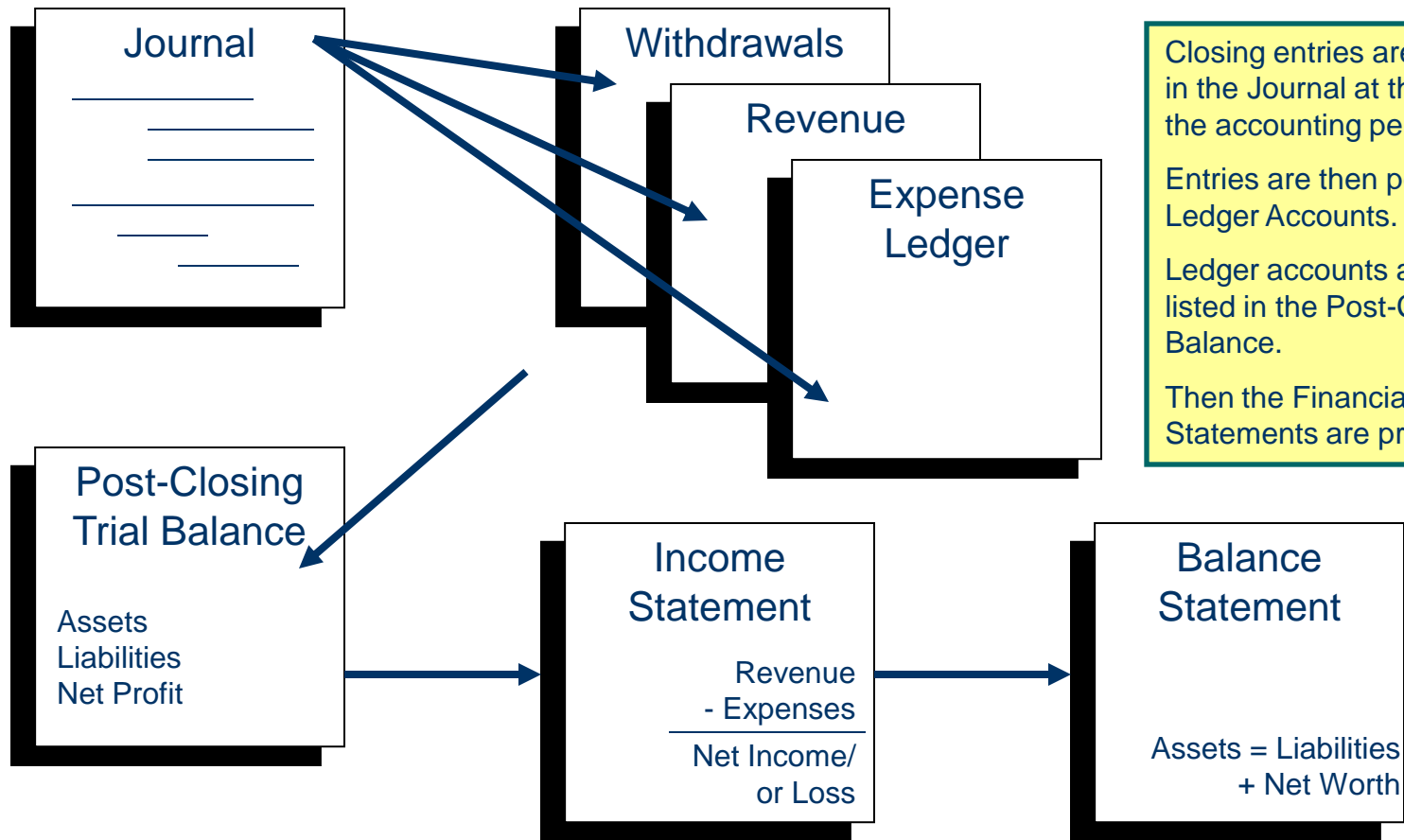
- Part 2, illustrated and discussed:
  - The Accounting Cycle
  - Adjusting Entries
  - Closing Entries
  - Trial Balance
  - Closing Balance

# Introduction,

## Page 3 of 3

- This *training* illustrates and discusses:
  - Financial Statements
  - The Income Statement
  - The Balance Sheet
  - Analyzing Financials

# Financial Statements



Closing entries are recorded in the Journal at the end of the accounting period.

Entries are then posted to Ledger Accounts.

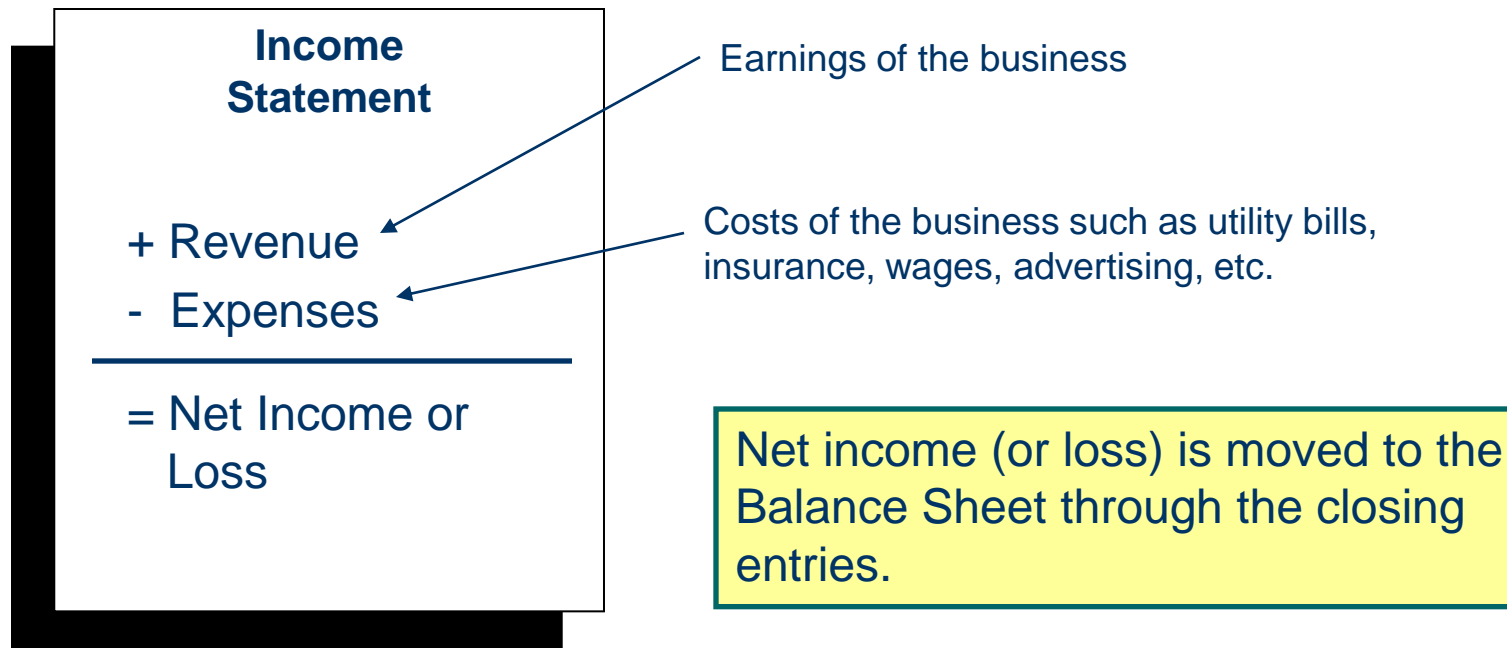
Ledger accounts are then listed in the Post-Closing Trial Balance.

Then the Financial Statements are prepared.

# Income Statement,

Page 1 of 3

- Information from the Post-Closing Trial Balance is entered in the Income Statement at the end of the accounting period:



# Income Statement,

## Page 2 of 3

- The Income Statement is also known as the Operating Statement
- Composed of two account categories:
  - Income shows sales-related gross revenue
  - Expense show all costs associated with the sales such as Cost of Goods Sold and Personnel costs
- The two operating statement categories, plus to the three Balance Sheet account categories, are the main categories of accounts



# Income Statement,

## Page 3 of 3

- Income (Operating) Statements cover a period of time
- Income and Expense are always recorded separately
- Both are used to record gross amounts – gross income and gross expense
- Profit or loss is not a consideration in the individual account elements – it is determined after the entries are made

# The Balance Sheet,

## Page 1 of 4

- The Balance Sheet can be prepared after the end-of-month adjustments are entered in the Journal and Ledgers and the adjusting Trial Balance prepared.
- The Balance Sheet shows what the business owns; what it owes; and its earnings (profits) or losses
- The Balance Sheet does NOT provide a clear breakdown of actual business activity

# The Balance Sheet,

## Page 2 of 4

- The Adjusted Trial Balance accounts include:

Cash  
Accounts Receivable  
Prepaid  
Office Supplies  
Equipment  
Accumulated Depreciation  
Vehicles  
Accumulated Depreciation  
Land  
Accounts Payable

Notes Payable  
Unearned Revenue  
Mortgage Payable  
Capital  
Withdrawals

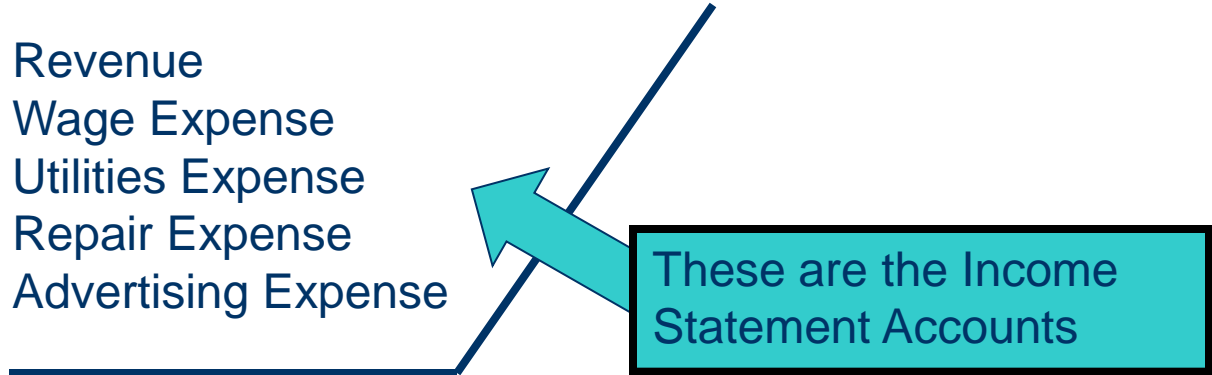
These are the Balance Sheet Accounts

# The Balance Sheet,

## Page 3 of 4

- The Adjusted Trial Balance accounts include:

Revenue  
Wage Expense  
Utilities Expense  
Repair Expense  
Advertising Expense



These are the Income Statement Accounts

The Income Statement Accounts are listed at the bottom of the adjusted trial balance, starting with revenue.

# The Balance Sheet,

Page 4 of 4

## Balance Sheet Statement

**Assets = Liabilities + Net Worth(\*)**

Cash, Accounts Receivable, Equipment, Buildings, Land, etc., elements that help the business generate income

Amounts owed others

The difference between Assets and Liabilities. This is the part of the business “owned”.

(\*) AKA Owner's Equity

# Sample Statements,

Page 1 of 2

**Business Name**  
**Income Statement**  
**For the Month Ended XXX XX, 20XX**

**Revenue:**

Service Income		\$16,520
Interest Income		250
Total Revenue		\$16,770

**Expenses:**

Rent	\$ 1,500	
Utilities	900	
Supplies	4,000	
Wage	10,000	
Total Expenses		\$ 16,400

**NET INCOME (LOSS)** **\$ 370** 

# Sample Statements,

## Page 2 of 2

**Business Name**

**Balance Sheet**

**For the Month Ended XXX XX, 20XX**

**ASSETS**

Cash	\$ 670
Accounts Receivable	3,500
Supplies	2,500

**\$ 6,670**

**LIABILITIES**

Accounts Payable	\$ 500
Notes Payable	1,000
<b>Total Liabilities</b>	<b>\$ 1,500</b>

**NET WORTH**

Owner Capital	\$5,000
Net Income	370
-Withdrawals	200
Owner Capital (ending)	<u>5,170</u>

**\$ 6,670**



# Impacting the Business

- A business owner can make the business grow by:
  - Investing personal cash and assets
  - Generating revenue from operations
  - Debt (borrowing to buy for the business)
- A business owner can make a business decline by:
  - Withdrawals for personal cash or assets
  - Generating expenses from operations
  - Too much debt



# Analyzing Financials,

Page 1 of 16

- In addition to the Balance Sheet and Income Statement, business owners / managers need to examine:
  - Cash Flow
  - Inventory
  - Cost of Good Sold
  - Profitability
  - Measures of Debt
  - Measures of Investment
  - Vertical and Horizontal Financial Statement Analysis
  - Ratios

# Analyzing Financials,

Page 2 of 16

- Financial Analysis typically considers:
  - Items in a single year's statement
  - Comparisons for periods of time
  - Comparisons to other similar businesses
- Net Working Capital is the excess of current assets over current liabilities (from the Balance Sheet). It is indication of a business's risk or lack of.

# Analyzing Financials,

Page 3 of 16

- A traditional method of “analyzing” financials is through relationships (ratios)

- **Balance Sheet = \$100,000**

- Cash = \$20,000
- Accounts Receivables = \$30,000
- Fixed Assets = \$50,000

- **Ratios:**

	<b>Ratio</b>	<b>Relationship</b>	<b>Percentage</b>
● Cash:	.2	.2:1	20%
● Accounts Receivables:	.3	.3:1	30%
● Fixed Assets:	.5	.5:1	50%

# Analyzing Financials,

## Page 4 of 16

- Liquidity / Net Working Capital:
  - Indicates ability to meet financial obligations
  - More net working capital equates to less risk

	<b>2006</b>	<b>2005</b>
Current Assets	28,000.00	18,500.00
Current Liabilities	-17,800.00	- 6,200.00
Net Working Capital	10,500.00	12,300.00

In this example, the business is at more risk in 2006 than in 2005, Even though its assets increase by nearly \$10k, its current liabilities also increased – by \$11,600!

# Analyzing Financials,

## Page 5 of 16

- Current Ratio:

$$\begin{array}{rcc} \text{Current Ratio} & = & \frac{\text{Current Assets}}{\text{Current Liabilities}} \\ \\ \begin{array}{r} 28000 \\ \hline 17800 \end{array} & \begin{array}{c} \text{2006} \\ = 1.57 \end{array} & \begin{array}{r} 18500 \\ \hline 6200 \end{array} & \begin{array}{c} \text{2005} \\ = 2.98 \end{array} \end{array}$$

The current ratio is a more dependable indication of liquidity than net working capital. Comparing current year's to past year's, the larger the ratio, the lower the risk.

A ratio of 2.0 is considered acceptable for most businesses.

# Analyzing Financials,

## Page 6 of 16

- Quick Ratio:

$$\text{Current Ratio} = \frac{\text{Current Assets} - \text{Inventory}}{\text{Current Liabilities}}$$

<b>2006</b>		<b>2005</b>	
28000 - 10000		18500 - 6800	
<hr/>	= 1.01	<hr/>	= 1.88
17800		6200	

Since inventory is difficult to liquidate quickly, it is subtracted from Current Assets. In this tougher test of liquidity, a ratio of 1.00 or greater is usually recommended. As you can see, the 2006 business example is very marginal. The business needs to reduce liabilities or increase assets.

# Analyzing Financials,

Page 7 of 16

- Profitability: Gross Profit Margin

$$\text{Gross Profit Margin} = \frac{\text{Gross Profit}}{\text{Sales}}$$

$$\text{2006} \quad \frac{2000}{8000} = 25\%$$

$$\text{2005} \quad \frac{2500}{5800} = 43\%$$

The gross profit margin indicates the percentage of each sales dollar remaining after the business has paid for its goods.

The higher the profit margin, the better.

This business did better in 2005 than in 2006.

# Analyzing Financials,

Page 8 of 16

- Profitability: Operating Profit Margin

$$\text{Operating Profit Margin} = \frac{\text{Income from Operations}}{\text{Sales}}$$

$$\text{2006} \quad \frac{1000}{8000} = 13\%$$

$$\text{2005} \quad \frac{1200}{5800} = 21\%$$

This ratio ignores interest and taxes.  
It represents pure operations.

The higher the Operating Profit Margin, the better.

This business did better in 2005 than in 2006.



# Analyzing Financials,

Page 9 of 16

- Profitability: Net Profit Margin

$$\text{Net Profit Margin} = \frac{\text{Net Profit}}{\text{Sales}}$$

$$\text{2006} \quad \frac{200}{8000} = 3\%$$

$$\text{2005} \quad \frac{975}{5800} = 17\%$$

The net profit margin is a measure of the business' success with respect to earnings on sales.

The higher the Net Profit Margin, the more profitable the business.

Clearly the example business is not doing well.

# Analyzing Financials,

Page 10 of 16

## Profitability Analysis:

- If the business' profit ratios are too low, you should ask:
  - Is there enough mark-up on goods? (Check gross profit margin)
  - Are operating expenses too high? (Check operating profit margin.)
  - Are interest expenses too high? (Check net profit margin.)

# Analyzing Financials,

Page 11 of 16

- Debt Measures: Debt Ratio

$$\text{Debt Ratio} = \frac{\text{Total Liabilities}}{\text{Total Assets}}$$

<b>2006</b>	48800	= 70%
	72900	
<b>2005</b>	26400	= 50%
	52500	

This ratio indicates the amount of “other people’s money” being used to generate profit

The more indebtedness, the greater the risk of failure!

Clearly the example business is not doing well.

# Analyzing Financials,

Page 12 of 16

- Investment Measures: Return-on-Investment

$$\text{ROI} = \frac{\text{Net Profit}}{\text{Total Assets}}$$

$$\text{2006} \quad \frac{200}{72900} = 0.3\%$$

$$\text{2005} \quad \frac{975}{52500} = 2\%$$

In addition to salary from the business, the owner should be earning additional money on his/her business investment.

The higher the ROI, the better.

Clearly, the ROI in this example is poor.

# Analyzing Financials,

Page 13 of 16

- Vertical Analysis:

- A percentage analysis of the current and past year's (or period's) Balance Sheets and Income Statements on a single statement
- Balance Sheet:
  - Each Asset is shown as a percentage of total assets
  - Each liability is shown as a percentage of total liabilities and equity
- Income Statement
  - Each element is shown as a percent of net sales.

See example income statement on next page.

**Business Name:**

**Date** \_\_\_\_\_

**Comparative Income Statement**

**For Years Ended 12/31/2006 and 12/31/2005**

	1998		1997	
	Amount	Percent	Amount	Percent
Sales	\$8,000	100.0%	\$ 6,000	100.0%
Cost of Goods Sold	-6,000	75.0%	- 3,900	65.0%
<b>Gross Profit</b>	<b>\$ 2,000</b>	<b>25.0%</b>	<b>2,100</b>	<b>35.0%</b>
Selling (Variable) Expense				
Advertising	\$ 100	1.3%	\$ 50	.8%
Freight	50	.6%	40	.7%
Salaries	150	1.9%	150	2.5%
<b>Total Selling Expense</b>	<b>\$ 300</b>	<b>3.8%</b>	<b>\$ 240</b>	<b>4.0%</b>
Administrative (Fixed) Expense				
Rent	\$ 450	5.6%	\$ 250	4.2%
Insurance	150	1.9%	125	2.1%
Utilities	150	3.8%	100	1.7%
<b>Total Administrative Expense</b>	<b>\$ 750</b>	<b>9.3%</b>	<b>\$ 475</b>	<b>8.0%</b>
<b>Income From Operations</b>	<b>\$ 950</b>	<b>11.9%</b>	<b>\$ 1,385</b>	<b>23.0%</b>
Interest Income	0	0.0%	0	0.0%
Interest Expense	- 720	9.0%	- 450	7.5%
<b>Net Income Before Taxes</b>	<b>\$ 230</b>	<b>2.9%</b>	<b>\$ 935</b>	<b>51.5%</b>
Taxes	- 150	1.9%	- 180	3.0%
<b>Net Profit (Loss) After Taxes</b>	<b>\$ 80</b>	<b>1.0%</b>	<b>\$ 755</b>	<b>12.5%</b>

Analyze Financials;  
**Vertical Analysis:**  
Example.  
Page 14 of 16

# Analyzing Financials,

Page 15 of 16

- Horizontal Analysis:

- A percentage analysis of the current and past year's (or period's) increases and decreases in the statement items shown on a single statement
- The actual increase or decrease of an item between current and past year (period) is listed
- The percentage increase or decrease is listed in the last (right hand) column

See example on next page.

**Business Name:** \_\_\_\_\_ **Date** \_\_\_\_\_  
**Comparative Income Statement**  
**For Years Ended 12/31/2006 and 12/31/2005**

	1998	1997	Increase / Decrease	
			Amount	Percent
Sales	\$8,000	\$ 6,000	\$ 2,000	33.3%
Cost of Goods Sold	6,000	3,900	-2,100	53.8%
<b>Gross Profit</b>	<b>\$ 2,000</b>	<b>2,100</b>	<b>(\$ 100)</b>	<b>(4.8%)</b>
Selling (Variable) Expense				
Advertising	\$ 100	\$ 50	\$ 50	100.0%
Freight	50	40	10	25.0%
Salaries	150	150	same	same
<b>Total Selling Expense</b>	<b>\$ 300</b>	<b>\$ 240</b>	<b>\$ 60</b>	<b>25.0%</b>
Administrative (Fixed) Expense				
Rent	\$ 450	\$ 250	\$ 200	80.0%
Insurance	150	125	25	20.0%
Utilities	150	100	50	50.0%
<b>Total Administrative Expense</b>	<b>\$ 750</b>	<b>\$ 475</b>	<b>\$ 275</b>	<b>57.9%</b>
<b>Income From Operations</b>	<b>\$ 950</b>	<b>\$ 1,385</b>	<b>(\$ 435)</b>	<b>(31.4%)</b>
Interest Income	0	0	0	0.0%
Interest Expense	720	450	270	60.0%
<b>Net Income Before Taxes</b>	<b>\$ 230</b>	<b>\$ 935</b>	<b>(\$ 705)</b>	<b>75.4%</b>
Taxes	150	180	30	16.7%
<b>Net Profit (Loss) After Taxes</b>	<b>\$ 80</b>	<b>\$ 755</b>	<b>(\$ 675)</b>	<b>(89.4%)</b>

Analyze Financials;  
**Horizontal Analysis:**  
 Example.  
 Page 16 of 16



# Summary, Page 1 of 3

- The financial statement is one tool to help you manage your business
- If financial results don't meet expectations, the owner must act
  - Is the data accurate and valid?
  - What can be done to immediately cut expenses?
  - What can be done to increase productivity of assets?

## Summary, Page 2 of 3

- If return on investment is too low, what can you do to increase return from existing assets?
- If profit is too low, is mark-up adequate and competitive? Also, are the operating expenses too high, proportionately? And are interest costs too high ... too much debt?

## Summary, Page 3 of 3

- Is liquidity low? This runs the risk of insolvency. Examine the composition of current assets and current liabilities.
- Use the vertical and horizontal analyses to identify trends and compositions that may signify trouble.

# Additional Information,

## Page 1 of 2

- Basic Accounting *Training Nugget*, Part 1, covers:
  - 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,

## Page 2 of 2

- Basic Accounting *Training* Part 2, covers:
  - The Accounting Cycle
  - Adjusting Entries
  - Closing Entries
  - Trial Balance
  - Closing Balance

# Accounting Definitions

Definitions

# What's Here...

- Introduction
- Definitions

# Introduction

- This *training* contains definitions of common accounting terms.
- If you come across accounting or financial terms with which you are unfamiliar, a web search will usually provide a suitable definition.



# Definitions, Page 1 of 35

- Accounts – A separate, distinct record showing its increases or decreases. A record of distinct transactions within one of the major accounting elements: assets, liability, net worth (owners' equity), revenue and expense.
- Accounts Payable – Amounts owed by the business to its creditors on open account for goods purchased or services provided.
- Accounting Period – Typically each month throughout the financial (fiscal) year. The period of time covered by the income statement and other financials that report operating results

# Definitions, Page 2 of 35

- Accounts Receivable – Amounts owed to the business on open account as a result of extending credit to a customer for goods purchased or services provided.
- Accrual Method – Logs transactions at the time a promise (or contract) is made, whether or not cash is transferred
- Accrued Expenses – Expenses that have been incurred but not paid. (Merchandise or services received, but not yet invoiced.)
- Accrued Income – Income that has been earned but not received

# Definitions, Page 3 of 35

- Adjusting Entries – Unpaid, unrecorded transactions at the end of the accounting period
- Aging – The classification of accounts receivable according to the length of time they have been outstanding. An appropriate rate of loss can then be applied to each age group in order to estimate probable loss from uncollectible accounts.
- Assets – Everything owned by or owed to a business that has a cash value

# Definitions, Page 4 of 35

- Balance Sheet – A “snapshot” of the business’s Assets, Liabilities and Net Worth; a report of the company’s financial position at a particular moment in time
  - Assets – Business property; what the business owns
  - Liabilities – What the business owes
  - Net Worth – The difference between assets and liabilities

## Definitions, Page 5 of 35

- Balance Sheet, cont. – A financial statement that shows the financial position of a business as of a fixed date – usually at the close of an accounting period.
- Bottom Line – Net profits or loss after taxes for a specific accounting period
- Budget – A set of financial projections for cash inflow and outflow and other balance sheet items

# Definitions, Page 6 of 35

- Capital Expenditure – A purchase of an item of property, plant, or equipment that has a useful life more than one year (fixed assets) and in NAF, a purchase price of \$2500 or more.
- Cash Flow Statement – See budget
- Cash Method – Logs transactions whenever you actually spend or receive cash
- Chart of Accounts – A list of numbers and titles of all general ledger accounts

# Definitions, Page 7 of 35

- Closing Entries – Entries made to zero-balance all temporary accounts (revenue and expense) at the end of the accounting period
- Closing Periods:
  - Monthly; month-end closing
  - Yearly; year-end closing
    - At year's end, revenue, expense and owner's withdrawals are “closed” so they start the next accounting period with a zero balance. (Their sum is transferred to an owner's capital account)

## Definitions, Page 8 of 35

- Cost of Goods Sold – The cost of inventory sold during an accounting period. It is equal to the beginning inventory for the period, plus the cost of purchases made during the period, minus the ending inventory for the period.



# Definitions, Page 9 of 35

- Credit – In double-entry accounting, a increase in liabilities or income, or an decrease in assets (possessions) or expenses.
  - An amount entered on the right side of an account in double-entry accounting.
  - A decrease in the asset and expense accounts.
  - An increase in the liability, capital and income accounts.

# Definitions, Page 10 of 35

- Current Assets – Cash, plus any assets that will be converted into cash within one year, plus any assets that you plan to use up within one year
- Current Liabilities – debts that must be paid within one year
- Current Ratio – A dependable indication of liquidity computed by dividing current assets by current liabilities. A ratio of 2.0 is acceptable for most businesses.

# Definitions, Page 11 of 35

- Debit – In double-entry accounting, a decrease in liabilities or income, or an increase in assets or expenses
- Declining Balance Method – An accelerated method of depreciation in which the book value of an asset at the beginning of the year is multiplied by an appropriate percentage to obtain the depreciation to be taken for that year.
- Depreciable Base – The cost of an asset used in computation of yearly depreciation expense

# Definitions, Page 12 of 35

- Direct Expense – Those expenses that relate directly to your product or service
- Double-entry Accounting – Logs each transaction as both a debit and as a credit; can be used with both cash and accrual methods. This is based on the premise that every transaction has two sides – at least one account must be debited and one account must be credited and the debit and credit totals must be equal.
- Expenses – The costs incurred through the sale or delivery of goods or services

## Definitions, Page 13 of 35

- FIFO – (First-In, First-Out) Tracks general quantities of inventory and calculates cost as if the oldest items in the inventory were sold first, so the existing inventory's value is based upon the most recent purchases
- Fiscal Year – Any 12-month accounting period used by a business

## Definitions, Page 14 of 35

- Fixed Asset – Items purchased for use in a business which are depreciable over a fixed period of time determined by the expected useful life of the purchase. Usually includes real property, vehicles and equipment not intended for resale. (Land is NOT depreciable, but is still listed as a fixed asset.)
- Fixed Asset Log – A record used to keep track of fixed assets purchased by a business during the financial year to be used to determine depreciation expense to be taken for tax purposes

# Definitions, Page 15 of 35

- Fixed Costs – Costs that do not vary in total during a period even though the volume of goods manufactured may be higher or lower than anticipated
- General Journal – Used to record, in chronological order, all transactions of a business. These are then posted to the General Ledger.
- General Ledger – In double entry accounting, the master reference file for the accounting system. A permanent, classified record is kept for each business account. Each account is maintained on a separate page of the ledger. (Book, binder, or AIM system...)

# Definitions, Page 16 of 35

- Gross Profit On Sales – The difference between net sales and the cost of goods sold.
- Gross Profit Margin % – An indicator of the percentage of each sales dollar remaining after a business has paid for its goods. Calculated by dividing the gross profit by sales.
- Income Statement – A report presenting the profit and loss of a business, based on earnings less expenses for a period of time; usually one month



## Definitions, Page 17 of 35

- Indirect Expense – Operating expenses that are not directly related to the sale of your product or service
- Interest – The price charged or paid for the use of money or credit
- Inventory – The stock of goods on hand for sale

## Definitions, Page 18 of 35

- Invoice – A bill for the sale of goods or services sent by the seller to the purchaser
- Ledger – In double entry accounting, a permanent reference file for all accounts
- LIFO – (Last-In, First Out) Calculates cost of inventory as if you sold your most recent inventory first. It provides a higher reported cost and lower net income whenever your sales prices rise

## Definitions, Page 19 of 35

- Liabilities – Amounts owed by a business to its creditors. The debts of the business.
- Liquidity – The ability of a company to meet its financial obligations. A liquidity analysis focuses on the balance sheet relationships for current assets and current liabilities
- Long-Term Liabilities – Liabilities that will not be due for more than a year in the future

# Definitions, Page 20 of 35

- Net Profit Margin % – The measure of a business's success with respect to earnings on sales. It is derived by dividing net profit by sales. A higher margin means the firm is more profitable.
- Operating Expense – Normal expenses incurred in the running of a business

# Definitions, Page 21 of 35

- Operating Profit Margin % – The ratio representing the pure operations profits, ignoring interest and taxes. It is derived by dividing the income from operations by the sales. The higher the percentage of operating profit margin, the better.
- Other Expenses – Expenses that are not directly connected with the operation of the business. The most common is interest expense.

## Definitions, Page 22 of 35

- Other Income – Income that is earned from non-operating sources. The most common is interest income.
- Petty Cash Fund – A cash fund from which non-check expenditures are reimbursed.

# Definitions, Page 23 of 35

- Physical Inventory – The process of counting inventory on hand at the end of an accounting period. The number of units of each item is multiplied by the cost per item resulting in inventory value.
- Posting – The process of transferring data from the journal to the ledger
- Prepaid Expense – Expense items that are paid for prior to their use. E.g., insurance, rent, prepaid inventory, etc.)

# Definitions, Page 24 of 35

- Principal – The amount shown on the face of a note or bond. Unpaid principal is the portion of the face amount remaining at any given time.
- Profit and Loss Statement – See Income Statement
- Quarterly Budget Analysis – A method used to measure actual income and expenditures against projections for the current quarter of the fiscal year and for the total quarters completed. The difference is usually expressed as the amount and percentage over or under budget ... variance!



# Definitions, Page 25 of 35

- Quick Ratio – A test of liquidity subtracting inventory from current assets and dividing the results by current liabilities. A quick ratio of 1.0 or greater is usually recommended.
- Property, Plant and Equipment – Assets such as land, buildings, vehicles and equipment that will be used for a number of years in the operations of the business and (with the exception of land) are subject to depreciation

# Definitions, Page 26 of 35

- Ratios: (using information from the financial statement and balance sheet)
  - Total liabilities divided by net worth is the debt to net worth ratio; a ratio over one is too high  
(net worth = assets – liabilities)
  - Net profit/loss divided by net worth is the return-on-investment ratio; a ratio of at least 12 indicates a healthy business  
(net profit/loss = revenues – expenses)

## Definitions, Page 27 of 35

- Real Property – Land, land improvements, buildings and other structures attached to the land
- Reconciling – The process used to bring the bank's (or other's) records, the accounts, and the business's checkbook into agreement at the end of the banking period

## Definitions, Page 28 of 35

- Retained Earnings – Earnings of a corporation that are kept in the business and not paid out in dividends. This amount represents the accumulated, undistributed profits of the corporation.
- Return-On-Investment (ROI) – The rate of profit an investment will earn. The ROI is equal to the annual net income divided by total assets. The higher the ROI, the better.

## Definitions, Page 29 of 35

- Revenue – The income that results from the sale of products, services, or property or earned from investments
- Revenue and Expense Journal – In single-entry accounting, the record used to keep track of all checks written by the business and all income received for the sale of goods or services

# Definitions, Page 30 of 35

- Single-Entry Accounting – Small-business recordkeeping system that tracks only income and expense accounts; not used with accrual accounting
- Straight-Line Depreciation – A method of depreciating assets by allocating an equal amount of depreciation for each year of its useful life

## Definitions, Page 31 of 35

- Sum-of-the-Years' – An accelerated method of depreciation in which a fractional part of the depreciable cost of an asset is charged to expense each year. The denominator of the fraction is the sum of the numbers representing the years of the asset's useful life. The numerator is the number of years remaining in the asset's useful life.

## Definitions, Page 32 of 35

- Tangible Personal Property – Machinery, equipment, furniture and fixtures not attached to the land
- Three-Year Income Projection – A pro-forma (projected) income statement showing anticipated revenues and expenses for a business



# Definitions, Page 33 of 35

- Unearned Income – Revenue that has been received, but not yet earned
- Variable Costs – Expenses that vary in relationship to the volume of activity of a business
- Vertical Analysis – A percentage analysis used to show the relationship of the components in a single financial statement. In vertical analysis of an income statement each item on the statement is expressed as a percentage of net sales

## Definitions, Page 34 of 35

- Wholesale Business – A business that sells its products to other wholesalers, retailers or volume customer son discount
- Work in Progress – Manufactured products that are only partially competed at the end of the accounting cycle

# Definitions, Page 35 of 35

- Working Capital – Current assets minus current liabilities. This is a basic measurement of a company's ability to pay its current obligations.