Bean Counter's

So, you want to learn Bookkeeping !

Hello my name is Dave and yes I'm a bean counter. No I didn't say alcoholic, that's a soft drink not a beer in my hand, and this is not a meeting of Alcoholics Anonymous. For those of you that don't know a bean counter is slang sometimes used to refer to a bookkeeper or accountant. I've searched the web for good bookkeeping and accounting tutorials and courses and came to the conclusion that they're hard to find so this is my attempt to try and fill the void.

What qualifies me to attempt this task ? I guess you can tell it's not my fancy dress code. I have over 30 years experience in business and even taught at a small business college for a couple of years. My method of passing on knowledge is to make the subject easy to understand and to use simple examples and terminology to illustrate the concepts being presented. If you're anything like me I learn a lot easier when I can see an example of what we're talking about. Tell me and show me too.

Who is this Course for ?

This bookkeeping tutorial and course is geared to business owners, managers, and individuals who have not had any formal bookkeeping training or on the job experience and need or want to learn the basics of bookkeeping and accounting. Oh by the way, you can teach an "ole" dog new tricks. In other words, this bookkeeping tutorial is for beginners (newbies) or those needing a quick refresher and is only an introduction into the world of bookkeeping and accounting. They say a little knowledge is a dangerous thing. Well, my goal is to make you dangerous.

What's Included ?

Each of the bookkeeping lessons in this bookkeeping course builds on and uses terms and concepts from the previous lesson(s). Also, some of the bookkeeping lessons will reintroduce and discuss some important bookkeeping topics discussed in other lessons. This repetition is by design. The more times that you are exposed to bookkeeping terms and concepts improves your chance for learning what accounting and bookkeeping is all about. Bookkeeping Videos are included to emphasize key concepts. Bookkeeping Quizzes and tests are used to test your bookkeeping knowledge.

Cartoons are used to add a bit of humor to your Learning Experience. Who says that Learning Can't Be Fun ? Not Me !

What's Covered ?

The Introduction to Bookkeeping discusses the types of business organizations, types of business activities, users of financial information, bookkeeping systems, accounting rules, and the cash and accrual basis of accounting.

Lesson 1 The Bookkeeping Language introduces you to some of the terminology and definitions used in the accounting and bookkeeping language.

Lesson 2 The Accounting Equation discusses the Accounting Equations, double entry bookkeeping, and how business transactions affect the equation.

Lesson 3 Debits and Credits Introduces and explains Debits and Credits and how they affect the Accounting Equation and are used to record business transactions.

Lesson 4 Recording Business Transactions explains and uses examples to illustrate how business transactions are properly analyzed, recorded, and summarized.

Lesson 5 The General Ledger and Journals explains what General Ledger and Journals are, how they're used, and what bookkeeping purposes they serve.

Lesson 6 Financial Statements explains what financial statements are, how they're created,and how they're used.

Quick Review half way through the course reviews the major definitions, concepts, and bookkeeping records previously discussed and necessary for an understanding of bookkeeping.

Final Review at the end of the course also reviews the major definitions, concepts, and bookkeeping records previously discussed and necessary for an understanding of bookkeeping.

Learning Objectives

After completing this course, you should know or be able to perform the following:

Understand what accounting and bookkeeping is, why it's important, and the key terms needed to discuss and properly use financial information.

Understand what makes bookkeeping "work":

- Accounts/Chart Of Accounts
- Accounting Equation(s)
- Double Entry Accounting System
- Debits and Credits
- Rules
- Formal Records and Documents

How to analyze and record transactions using the formal financial records such as Journals and the General Ledger.

What Financial Statements are and how they are prepared and used.

Bookkeeping Videos and Tests

Bookkeeping Videos and Tests are included in the **Interactive Ebook Version** of the tutorial.

Learning Aids

Learning Aids to help in learning key bookkeeping concepts are included in the **Appendix**.

Let's begin our Journey into the World Of Bookkeeping !

Acknowledgements

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Why Learn Bookkeeping ?

Why would you want to learn bookkeeping and keep up to date financial records anyway ? Can't you hire an accountant to come after the end of the year and get your check book and shoe box and do your taxes ? Sure you can ! And yes you will have adequately fulfilled your taxpayer obligations.

But in order to run a business and know what, where, and when to take corrective actions requires business information. How do you get and where do you find this information ? You don't if you don't keep accurate and current records about your business financial activities (bookkeeping).

What is Bookkeeping & Accounting ?

Accounting is the art of analyzing, recording, summarizing, reporting, reviewing, and interpreting financial information.

Let’s also define what bookkeeping is and is not. I hate to admit this but I’m going to tell a true story about myself in high school. I thought I was fairly smart back in my high school days and took all the college prep classes. My high school offered bookkeeping classes but I had no clue as to what that course was about.

I thought bookkeeping was a course on how to properly organize and stack the reading books in the proper place and shelves in the library using that Dewey decimal code. That is keeping the books isn’t it ? Well kinda, but that’s not the bookkeeping you’re going to learn here. Bookkeeping is one of the components of accounting. Think of accounting as the mom and bookkeeping as one of her children.

Bookkeeping is the process of recording and classifying business financial transactions (activities). In simple language-maintaining the records of the financial activities of a business or an individual. Bookkeeping’s objective is simply to record and summarize financial transactions into a usable form that provides financial information about a business or an individual.

Accountants normally plan and set up the accounting and bookkeeping system for a business

and turn over the day to day record keeping to the owner or one of his/her employees. In this age of computers, more and more of the daily bookkeeping is being done using bookkeeping software and computers although some businesses still maintain manual records. Due to the reasonable cost of computers and software, I recommend an automated (computer) bookkeeping system. In order to illustrate and understand what is actually being recorded and summarized by a computer bookkeeping system (behind the scenes) my lessons will illustrate the manual method of recording a company's financial information.

Users Of Financial Information

Who needs financial information about a business besides the owner(s) ? Users can be grouped into two broad categories namely internal users and external users. Internal users are the managers and the owners and employees who actually work for the business. External users include lenders and other creditors (suppliers), investors, customers, and governmental regulatory and taxing agencies.

Why do they need financial information ?

All users need this information to make knowledgeable decisions.

Owner(s) and managers need information in order to properly manage and run a profitable business.

Lenders and other creditors want to make sure that they will be paid back for the credit that they have extended to a business. By analyzing financial information, they at least have something to base their lending or credit decision on.

The days of the "friendly" banker are gone. You need to provide them with financial information as a basis for their loan decisions. A "good ole boy" handshake won't cut it now.

Similarly, customers want to make sure that the business they're buying products or services from is going to be around and not be in such a poor financial position as to have to close its doors.

Government and taxing agencies need information to monitor compliance with laws and regulations.

Other users have their own reasons for using this financial information.

Do you actually need to know how to do the bookkeeping ? No, unless of course you're currently a bookkeeper or wanting to be one. Anyone in business; however, does at least need a basic knowledge !

Before we start our formal training, I need to present some preliminary information that you should be familiar with. The objective is to give you a little business background information before we dive right in to the lessons.

Types Of Business Organization

One of the first decisions that a person(s) needs to make is how the company should be structured. The four basic legal forms of ownership for small businesses are a Sole Proprietorship, Partnership, Corporation, and Limited Liability Company. There are advantages and disadvantages as well as income tax ramifications associated with each type of organization. We aren't going to delve in to this area but a brief description of the different types of organization and what they are is needed.

Sole Proprietorship

Most small business start out as sole proprietorships. These firms are owned by one person who is normally active in running and managing the business.

Partnership

A partnership is two or more people who share the ownership of a single business. In order to avoid misunderstandings about how profits/losses are shared , who's responsible for what, and other management, ownership, and operating decisions the partners normally have a formal legal partnership agreement.

Corporation

A corporation is an organization that is made up of many owners who normally are not active in the decision making and operations of the business. These owners are called shareholders or stockholders. Their ownership interest is represented by certificates of ownership (stock) issued by the corporation.

Two types of corporations:

Regular or "C" Corporation

Earnings are taxed to the corporation. Shareholders are not personally liable for income taxes unless dividends are paid.

Subchapter-S

A special type of corporation allowed by the Internal Revenue Service (IRS) that passes or transfers its earnings to the individual shareholders who personally pay the income taxes.

Limited Liability Company (LLC)

The LLC is a relatively new type of business structure that combines the benefits of a partnership and corporation.

Factors To Consider

Some Factors and a brief description of what to consider when choosing a type of organization:

Tax Consequences – Federal and State

What taxes do you have to pay to the federal and state taxing authorities ?

Is the business organization a pass-through (income only taxed once) or is the income taxed twice ?

Ease and cost of formation and recurring registration fees

What documents do you need to file and what are the initial and recurring costs for the

type of organization ?

Degree of control

Do you want to call all the "shots" ? As a sole owner you get to.

Liability (personal)

Do your personal assets need protection from legal liability ?

Are you willing to be liable for others (partners) ?

Ability to get money (capital)

Do you need other investors to get your business "off the ground" ?

Type of Business

If your type of profession requires a special license, is it limited to what type of organization that can be selected ?

All the different types of organizations listed above have some unique methods and rules for accounting for their transactions associated with their equity (ownership) accounts. This tutorial in order to keep it simple and since many small businesses start out organized as sole proprietorships will focus on bookkeeping for a **sole proprietorship**.

Types of Business Activity
Our society is made up of all kinds of different types of businesses.

Some sell products directly to the consumer and are known as retailers.

Other businesses called wholesalers warehouse and sell large quantities of products to the retailers who in turn sell it to us (consumer).

Businesses like myself provide and sell services to other businesses and individuals.

Some businesses even tackle the task of actually producing (make) the products and are called manufacturers.

Many of these businesses are required to maintain and account for inventories of the products that they stock or have on hand. Again this being an introductory tutorial we are not going to cover the practices and procedures used in accounting for inventories. That being the case, the examples in this tutorial will deal with a service type of business.

Accounting Period

Believe it or not, a business needs to select an annual tax year. Your two main choices are a calendar or fiscal tax year. A Calendar Tax Year is 12 consecutive months beginning January 1 and ending December 31. A Fiscal Tax Year is 12 consecutive months ending on the last day of any month except December 31. The calendar tax year is used by most businesses.

A reason a business might choose a fiscal tax year is that they could select an ending month for their fiscal year when business activity is low. This makes the process of what is called closing the books a little easier. Also if a business has inventories, there would be less they would have to count.

For us yanks, our Internal Revenue Service (IRS) has guidelines for what accounting periods can be used based on the types of business organizations such as a corporation, sole proprietorship, partnership, etc. Normally, choosing a calendar year is a safe choice.

In our next Section, we'll discuss the Types Of Bookkeeping System.

Bookkeeping Systems

Types of Bookkeeping Systems

A business needs to determine the type of bookkeeping system that will be used for recording their business transactions.

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Single Entry System

Many small businesses start out using the single entry system.

The single entry system is an "informal" accounting/bookkeeping system where a user of this system makes only one entry to enter a business financial transaction. It generally includes a daily summary of cash receipts and a monthly record of receipts and disbursements (worksheets). A checkbook, for example, is a single entry bookkeeping system where one entry is made for each deposit or check written. Receipts are entered as a deposit and a source of revenue. Checks and withdrawals are entered as expenses. If a manual system is used, in order to determine your revenues and expenses you have to prepare worksheets to summarize your income and categorize and summarize your different types of expenses. Bookkeeping software and spreadsheets are also available to do this for you. The emphasis of this system is placed on determining the profit or loss of a business.

It got its name because you record each transaction only once as either revenue (deposit) or as an expense (check). Since each entry is recorded only once, **debits and credits** (recording method required for the double entry system) **are not used** to record a financial event. For those interested, the Internal Revenue Service's Publication 583 – "Starting a Business and Keeping Records" has a detailed example of a single entry type of system. While the single entry system may be acceptable for tax purposes, it does not provide a business with all the financial information needed to adequately report the financial affairs of a business. In the near future, we'll probably see the single entry system follow the same path as the dinosaur – extinction.

Double Entry System

The double entry system is the standard system used by businesses and other organizations to record financial transactions. Since all business transactions consist of an exchange of one thing for another, double entry bookkeeping using debits and credits , is used to show this two-fold effect. Debits and credits are the device that provide the ability to record the entries twice and are explained in more detail later in this tutorial. The double entry system also has built-in checks and balances. Due to the use of debits and credits, the double-entry system is self-balancing. The total of the debit values recorded must equal the total of the credit values recorded. This system, when used along with the accrual method of accounting, is a **complete accounting system** and focuses on the income statement and balance sheet. This system has worldwide support as the system to use by businesses for recording their financial transactions.

It got its name because each transaction is recorded in at least two places (accounts) using debits and credits.

Accounting Methods

Another decision faced by a new business is what accounting/bookkeeping method is going to be used to track revenues and expenses. An accounting method is just a set of rules used to determine when and how income and expenses are reported.

If inventories are a major part of a business, the decision is made for the business owner by the Internal Revenue Service (IRS). Some business will be required to use the accrual method of accounting while others may be granted an exception and allowed to use the cash basis along with some special rules.

You're more than likely to encounter both the term method and basis used when this topic is discussed. In some cases you'll see the term cash method used and other cases see the term cash basis used. Likewise you'll see the term accrual method used and the term accrual basis used. They both refer to the same concept and are used interchangeably.

Cash Method

The cash method or basis of accounting recognizes revenues (earnings) in the period the cash is received and expenses in the period when the cash payments are made. Actually, two types of cash methods (basis) of accounting exist:

strict cash method (basis)

modified cash method (basis)

A **strict cash method** follows the cash flow exactly. A **modified cash method** includes some elements from the accrual method of accounting and provides special methods for handling items such as inventory and cost of goods sold, payroll tax expenses and liabilities, and recording and depreciating property and equipment.

Many small businesses, whether they know it or not, are actually using a modified cash method.

By concentrating on recording revenues and expenses, the purpose of the cash or modified cash method of accounting is on determining the net income or loss for a period based on the cash received and the cash spent.

Information, such as the amounts billed to customers for products and/or services and not paid, and the amounts billed by suppliers for their products and/or services and not paid is not normally recorded and maintained in the "books" using the cash method.

Many small businesses start out using the cash basis rather than the accrual basis of accounting.

Use of the cash basis generally is not considered to be in conformity with generally accepted accounting principles (GAAP). Is this necessarily bad ? No, if no need is foreseen for what are called audited financial statements there's no need for concern. In most cases, audited statements are only required for the "big boys" (companies whose ownership interests are publicly traded). The "little guys" like the ma and pa shops don't need to worry. Still, when possible, a business should strongly consider using the accrual method of accounting.

Accrual Method

The accrual method or basis of accounting records income in the period earned and records expenses and capital expenditures such as buildings, land, equipment, and vehicles in the period incurred.

The purpose of the accrual method of accounting is to **properly match income and expenses** in the correct period.

In order to accomplish this, the accrual method of accounting **records revenue as earned** when the product and/or service is shipped or rendered and invoiced (billed) to customers. Likewise, expenses and capital expenditures are **recorded as incurred** when the product and or service is shipped or rendered and invoiced (billed) by the supplier.

Information, such as the amounts billed to customers for products and/or services and not paid, and the amounts billed by suppliers for their products and/or services and not paid is recorded and maintained in the "books" using the accrual method. This is the accounting method that is required to be used in order to conform to generally accepted accounting principles (GAAP) in preparing financial statements for external users.

Difference Between The Two Methods

The difference between the two methods used for recording revenues and expenses results from when the business transaction is recorded in the "books" (timing). A business using the accrual method will record revenues and expenses in their "books" before a business using the cash method. In other words, unlike the cash method , they don't wait until they get paid by the customer or wait until they pay a supplier to record the transaction.

Comment: I've heard that "forewarned is forearmed" so here goes. Cash Flow and Profits are two different "animals". Due to the timing difference as to when revenue and expenses are recorded and when the cash resulting from the revenue and expenses is actually received or paid out , a business using the accrual method of accounting and reporting a "hefty" profit does not necessarily mean that they have the cash to pay their bills.

Even though the accrual method provides a better measure of profit and loss, many small businesses still use the cash basis of accounting. I think with the advent of easier to use computer accounting and bookkeeping software, we'll see more businesses adopting the accrual basis of accounting.

Relationship Between the Type of Bookkeeping System Used and the Accounting Method Used

What if any is the relationship between the type of bookkeeping system used and the method of accounting ?

The **Single Entry** bookkeeping system is used along with the Cash Method of accounting.

Debits and Credits are not used to record financial events.

The **Double Entry** bookkeeping system can be used with both the Cash and Accrual methods of accounting.

Debits and Credits are used to record financial events.

So You Know

You can use a **different accounting method**, the cash method or the accrual method, for each business that you set up.

Also, you can keep two sets of books, one on the cash basis and the other on the accrual basis, for the same business. You do; however, have to select one of the methods for tax purposes and continue to use it in the future. This is perfectly legal. It's when you keep two sets of books to hide your true earnings when the trouble begins.

Accounting and Bookkeeping Software

Let's muddy the water about the single and double entry accounting method at least as to how it relates to using bookkeeping and accounting software.

Single or Double Entry ?

Accounting and bookkeeping software programs actually allow the user to make a single (one) entry and the software handles creating the debit and credit entries "behind the scenes". The double-entry system is still there, but it's hidden from the user. The one exception is the general journal where the user does enter debits and credits.

Let's look at a sample transaction of invoicing (billing) a customer to illustrate what I'm talking about.. An invoice to a customer is created and printed and the resulting transaction is automatically recorded in the "books" as an increase to the amounts owed by customers and an increase to revenues (sales) using debits and credits.

Wow, since it's automatic, does that mean we don't need to learn about debits and credits later ?

Only in your dreams. Although an airplane can be flown on auto-pilot, would you want to be on that plane without a trained pilot ? The same applies to using accounting and bookkeeping software. You need a properly trained bookkeeper or accountant that is also familiar with the software product in order to properly use the software. That ole saying "GIGO" (Garbage In – Garbage Out) definitely applies here.

Let's also muddy the water regarding the cash method and accrual method of accounting. Some accounting software allows you to convert data back and forth between a cash basis and accrual basis of accounting. As I stated earlier, you do have to select one of the methods for tax purposes and continue to use it in the future.

What's the Recommended Type of Bookkeeping System and Accounting Method ?

Most accountants when asked will recommend that a business use the double entry bookkeeping system and the accrual basis or method of accounting which is based on the revenue realization principle and a principle called the matching concept. The revenue realization principle states that revenue should be recorded when actually earned.

Don't tell me accountants actually play matchmakers or promote a dating service! No the matching principle is recording the revenues earned during a period using the revenue realization principle and matching (offsetting) the revenues with the expenses incurred in generating this revenue. Why is this so important ? All businesses small and large need information to determine how well or badly they are performing; however, if this information is misleading it could lead to false conclusions and unnecessary actions.

Show me what you mean.

The following sample business transactions for a mowing and landscaping company will be used to illustrate the accrual basis of accounting/matching concept and the cash basis of accounting.

(1) January xxxx Billed $30,000 To Customers For Services Performed & Completed In January XXXX
(2) January xxxx Received Payments From Customers of $15,000

(3) January xxxx Billed $12,000 by Outside Contractors For Services Performed & Completed In January XXXX

(4) January xxxx Paid Outside Contractors $8,000

(5) February xxxx Received Payments From Customers of $15,000

(6) February xxxx Paid Outside Contractors $4,000

Cash Basis				Accrual Basis		
Period	Jan xxxx	Feb xxxx	Total	Jan xxxx	Feb xxxx	Total
Revenue	$15,000	$15,000	$30,000	$30,000	0	$30,000

Expenses	$8,000	$4,000	$12,000	$12,000	0	$12,000
Profit	$7,000	$11,000	$18,000	$18,000	0	$18,000

Possible Conclusions From The Cash Method

Made money in January and February.

Our company is making more profit on the same amount of revenues. We had revenues of $15,000 in both January & February but made a bigger profit in February.

In February, we must have implemented some expense saving measures or got cheaper prices on our contracted services.

Are any of these conclusions valid ? **No not a one !** The “real” world as illustrated by the accrual method shows we had a great January and made $18,000 but February was terrible. We celebrated our great January and sat on our “you know what” and didn’t go out and get additional business and mow some more yards and do some more landscaping.

Next, we'll learn about the Rules of the "Bookkeeping Game".

Bookkeeping Rules

Rules of The Accounting "Game"

In addition to the revenue realization and matching principles or concepts, accounting and bookkeeping is guided by some additional underlying rules.

Why Have Rules ?

All games such as football, baseball, basketball, etc. have rules. Why ? So that everyone plays the game the same way. Playing the Accounting "Game" is no different. What if owners and managers could prepare their business's financial statements the way they felt like ?

If a business was wanting a loan or credit, they would have a tendency to overstate the value of their assets and the value of their business. If it came to taxes (we don't like to have to pay them), let's expense and write off everything. As for measuring performance (profitability) and comparing businesses in the same industry, you'd have no idea as to who was actually doing well and who wasn't. You couldn't even compare your own business from year to year. As to coming up with a reasonable value for what a business was worth, your guess would be as good as mine.

So, to put all businesses on the same playing field, the accounting profession has established some rules and guidelines. Two notable accounting rule making and standards setting organizations are the United States' Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB). The current accounting rules and standards are continually reviewed, studied, changed, and added to in order to make financial presentations more consistent, comparable, meaningful, and informative.

The following are some of the **Rules** used to "play" the Accounting "Game":

Accrual Concept (discussed earlier)

Supports the idea that income and expenses should be measured and recorded at the time major efforts or accomplishments occur rather than when cash is received or paid.

Revenue Realization Concept (discussed earlier)

The revenue recognition principle requires companies to record revenue when it is realized or realizable and actually earned. In other words, at the time the goods are actually sold or the services are rendered.

Matching Concept (discussed earlier)

The Matching Principle goes hand in hand with the Revenue Realization Principle. The matching principle is recording the revenues earned during a period using the revenue realization principle and matching (offsetting) the revenues with the expenses incurred in generating this revenue.

Accounting Period Concept

This assumption assumes that business operations can be recorded and separated into different time periods such as months, quarters, and years. This is required in order to provide timely information that is used to compare present and past performance.

Money Measurement Concept

This assumption assumes accounting measures transactions and events in money and only transactions that can be monetized (stated in a monetary unit such as the dollar) are recorded and presented in financial statements. Simply stated, money is the common denominator (measurement unit) used for reporting financial information.

Business Entity Concept

This assumption requires every business to be accounted for separately from the owner. Personal and business-related transactions are kept apart from each other. In other words, the separate personal transactions of owners and others are not commingled with the reporting of the economic activity of the business. One of the first recommendations almost all accountants tell a client is to at least establish a business checking account and to use it to only record their business transactions.

Going Concern Concept

This assumption assumes that a business will continue operating and will not close or be sold. It assumes that a business will be in operation for a long time. Based on this assumption, actual costs instead of liquidation values are used for presenting financial information. This assumption is abandoned in the event that a business is actually going out of business.

Cost Concept

This principle requires that most assets are recorded at their original acquisition cost and except for a relatively few exceptions (marketable securities) no adjustment is made for increases in market value.

In other words, the value of an asset is never "written up" even though the asset may actually be worth more than its cost. On the other hand, the cost is sometimes "written down" for example marketable securities and inventory. See Conservatism Concept.

Conservatism Concept

Revenues and gains are recognized slower and expenses and losses are recognized quicker.

Accountants have a tendency to stray away from painting too rosy a picture. In other words, if in doubt, err to the side of caution. While accountants don't want to misinform users of financial information, they also don't want to be sued.

Consistency Concept

The same accounting methods should be applied from period to period and all changes to more acceptable methods should be well explained and justified. Deviations in measured outcomes from period to period should be the result of deviations in performance not changes in methods.

Comparable

Information must be measured and reported in a similar manner by all types of businesses. This allows comparison of the financial statements of different entities (businesses) or comparisons for the same entity (business) over different periods.

Materiality Concept

The significance and importance of an item should be considered in order to determine what is reported. Insignificant events need not be measured and recorded.

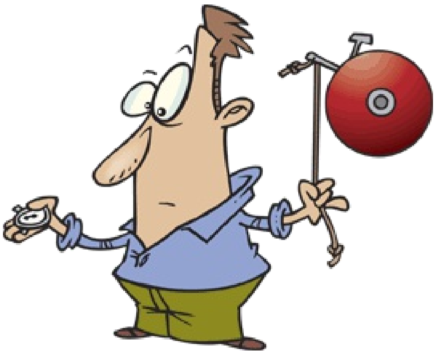
Cost-Benefit Convention

The benefit of providing the financial information should also be weighed against the cost of providing it.

Industry Practices Convention

When customary industry practices exists they should be followed and used for financial reporting.

All lessons and examples in the remainder of this tutorial are all based on the **accrual method of accounting** , the **double entry method of bookkeeping**, and the **sole proprietor** type of business organization.

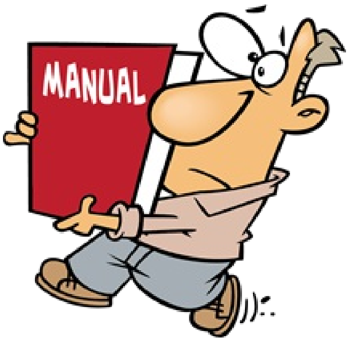


I'm not going to ring the bell on you; but, when you feel ready after the Videos and Tests move on to Learning The Bookkeeping Terminology

Bookkeeping Terms

Bookkeeping Language

In order to discuss your business with your accountant, bookkeeper, banker, or other business associates you need to understand the language. Think back to when you were first learning to read and write. Hopefully for you it's not as long ago as it is for me. You began learning your ABC's.



After mastering your alphabet and doing a little off key singing, you moved on to learn to use these letters to make words. You then proceeded to learn to make sentences from words and then on to paragraphs, documents, and even term papers. This tutorial is going to use this same approach for introducing you into the world of bookkeeping.

Learning definitions and terminology is about as much fun as watching grass grow; but, it is necessary to the understanding of bookkeeping.

All I can say is hold your nose, take your medicine, and swallow. After completing the lesson, if you need to, take two aspirin and go to bed.

Your ABC's for this lesson are the terminology and definitions used in the **Bookkeeping Language**. No not ALL of them; just the ONES that you need for this tutorial and those that will enable you to PARTICIPATE and UNDERSTAND when you are discussing financial matters concerning your

business.

If you’re anything at all like me, you like things simple. People also don’t need to dazzle and impress me with their wealth of knowledge by using big words that I don’t understand. I don’t think I’m one that could dazzle you even if I wanted to.

Some of the definitions and terminology you will be presented will have a formal and an informal definition. The formal definition is a definition you would find in an accounting textbook or formal course. The informal definition is my attempt to simplify.

In addition, in instances where additional clarification is needed, I’ll try to provide an example(s) that you can relate to that will help you attach this term to one of your many brain cells. If you were paying attention, you will have noticed that I did say many. Even though you don’t know bookkeeping yet ,I’m sure you’re a smart gal or guy.

Let's start with our **Major Categories** that are used to organize our financial information.

Major Accounts

Major Types or Categories of Accounts

The types that are used to organize our financial information are Assets, Liabilities, Owner's Equity, Revenue, Expenses, and Draws.

All Detail Accounts are assigned to a Major Account Group or Type.

Well we used the term **Account**, so what is an Account ?

An Account is a separate record for each type of Asset, Liability, Owner’s Equity, Revenue, Expense, and Draw used to show the beginning balance and to record the increases and decreases for a period and the resulting ending balance at the end of the period.

Notice we used the term type. These categories are not the accounts but the account categories or groups that the Detailed Accounts are assigned to.

Don’t worry the next lesson defines and illustrates Detail Accounts.

<table>
<tr><td>A</td><td>L</td><td>OE</td><td colspan="3" rowspan="2"></td></tr>
<tr><td>|
Assets</td><td>|
Liabilities</td><td>|
Owner's Equity</td></tr>
<tr><td colspan="3" rowspan="2">| ____</td><td>R</td><td>E</td><td>D</td></tr>
<tr><td>Revenue</td><td>Expense</td><td>Draws</td></tr>
</table>

The above diagram is made up of two terms **ALOE** and **RED**. These are the basis for the acronym **ALOE-RED** which helps us remember the major types of accounts. **ALOE**-represents Assets, Liabilities, and Owner's Equity. **RED**-represents Revenues, Expenses, and Draws/Dividends.

Associate these terms with a day at the beach when you get a **RED** sunburn and use **ALOE** (the ointment) to ease the pain.

Watch the Video for additional Help.

ALOE-RED Video

Account Major Types or Categories

Assets

Formal Definition:The properties used in the operation or investment activities of a business.

Informal Definition:All the good stuff a business has (anything with value). The goodies.

Additional Explanation:

The good stuff includes tangible and intangible stuff. Tangible stuff you can physically see and touch such as vehicles, equipment and buildings. Intangible stuff is like pieces of paper (sales invoices) representing loans to your customers where they promise to pay you later for your services or product. Examples of assets that many individuals have are cars, houses, boats,furniture, TV's, and appliances. Some examples of business type assets are cash, accounts receivable, notes receivable, inventory, land, and equipment.

Liabilities

Formal Definition:Claims by creditors to the property (assets) of a business until they are paid.

Informal Definition:Other's claims to the business's good stuff. Amounts the business owes to others.

Additional Explanation:

Usually one of a business's biggest liabilities (hopefully they are not past due) is to suppliers where a business has bought goods and services and charged them. This is similar to us going out and buying a TV and charging it on our credit card. Our credit card bill is a liability. Another good personal example is a home mortgage. Very few people actually own their own home. The bank has a claim against the home which is called a mortgage. This mortgage is another example of a personal liability. Some examples of business liabilities are accounts payable, notes payable, and mortgages payable.

Owner's Equity also called Owner's Capital

Comment: Both terms may be used interchangeably. In my tutorial lessons, I may refer to both terms or just use one or the other.

Formal Definition:The owner's rights to the property (assets) of the business; also called proprietorship and net worth.

Informal Definition:What the business owes the owner. The good stuff left for the owner assuming all liabilities (amounts owed) have been paid.

Additional Explanation:

Owner's Equity (Capital) represents the owner's claim to the good stuff (assets). Most people are familiar with the term equity because it is so often used with lenders wanting to loan individuals money based on their home equity. Home equity can be thought of as the amount of money an owner would receive if he/she sold their house and paid off any mortgage (loan) on the property.

Revenues, expenses, investment, and draws are sub categories of owner's equity (capital).

Think of owner's equity as a mom named Capital with four children to keep up with (I know she's only got one clinging to her leg but she left Expense, Investment, and Draws at home). The kids are named Revenue, Expense, Investment, and Draws and each kid has one job that they are responsible for in order to earn their allowance.

Kid Revenue is responsible for keeping track of increases in owner's equity (Ma Capital) resulting from sales.

Kid Expense is responsible for keeping track of decreases in owner's equity (Ma Capital) resulting from business operations.

Kid Draws has the job of keeping up with decreases in owner's equity (Ma Capital) resulting from owner withdrawals for living expenses and other personal expenses.

And lastly, Kid Investment has the job of keeping up with increases in owner's equity (Ma Capital) resulting from additional amounts invested in the business.

Revenue also called Income

Formal Definition:The gross increase in owner's equity (capital) resulting from the operations

and other activities of the business.

Informal Definition:Amounts a business earns by selling services and products. Amounts billed to customers for services and/or products.

Additional Explanation:

Individuals can best relate by thinking of revenue as their earnings/wages they receive from their job. Most business revenue results from selling their products and/or services.

Expenses also called Cost

Formal Definition:Decrease in owner's equity (capital) resulting from the cost of goods, fixed assets, and services and supplies consumed in the operations of a business.

Informal Definition:The costs of doing business. The stuff we used and had to pay for or charge to run our business.

Additional Explanation:

Some examples of personal expenses that most individuals are familiar with are utilities, phone, clothing, food, gasoline, and repairs. Some examples of business expenses are office supplies, salaries & wages, advertising, building rental, and utilities.

Owner’s Investments

Formal Definition:Increase in owner’s equity (capital) resulting from additional investments of cash and/or other property made by the owner.

Informal definition:Additional amounts, either cash or other property, that the owner puts in his business.

Additional Explanation:

Although these amounts can be kept up with as a separate item, they are usually recorded directly in the Owner’s Capital Account. In other words, immediately put into Ma Equity’s purse.

Owner’s Drawing

Formal Definition:Decrease in owner’s equity (capital) resulting from withdrawals made by the owner.

Informal definition:

Amounts the owner withdraws from his business for living and personal expenses.

Additional Explanation:

The owner of a sole proprietorship does not normally receive a “formal” pay check from the business, but just like most of the rest of us needs money to pay for his house, car, utilities, and groceries. An owner’s draw is used in order for the owner to receive money or other “goodies” from his business to take care of his personal bills.

Now, we'll move on to our Detail Types Of Accounts.

Detail Accounts

Types Of Detailed Accounts

OK, you've now been served the meat or as I like to refer to them, "The Big Three and Equity's Kids", so get ready for the potatoes. Personal examples were used to help clarify the terms, but from here on out it's all business terminology and concepts.

Types of Detail Asset Accounts

Cash-Monetary items that are available to meet current obligations of the business. It includes bank deposits, currency & coins, checks, money orders, and traveler's checks.

Accounts Receivable-Business claims against the property of a customer arising from the sale of goods and/or services on account.

Notes Receivable-Formal written promises given by customers or others to pay definite sums of money to the business at specified times.

Inventory-Expenditures for items held for resale in the normal course of a business's operations.

Office Supplies-Expenditures for maintaining a supply of on hand supplies such as typewriter, copier, and computer paper, pens, pencils, and special forms.

Land-Expenditures for parcels of the earth. It includes building sites, yards, and parking areas.

Buildings-Expenditures for structures erected on land and used for the conduct of business.

Vehicles & Equipment-Expenditures for physical goods used in a business, such as machinery and vehicles. Equipment is used in a business during the production of income.

Furniture includes items needed in a business office such as tables, desks, chairs, and cabinets.

Types Of Detail Liability Accounts

Accounts Payable-Creditor's claims against the business's property arising from the business's purchase of goods and/or services on account.

Notes Payable-Formal written promises to pay definite sums of money owed at specified times.

Mortgage Payable-Notes payable which are secured by a lien on land, buildings, equipment, or other property of the borrower (your company).

Types of Detail Revenue (Income) Accounts

Sale of Products-Amounts earned from the sale of merchandise.

Sale Of Services-Amounts earned from performing services.

Rental Income-Amounts earned from renting properties.

Interest Income-Amounts earned from investments.

Types of Detail Expense Accounts

Supplies-Expenditures for incidental materials needed in the conduct of business, such as office supplies.

Salaries-Expenditures for work performed by employees.

Payroll Taxes-Expenditures for taxes based on wages paid to employees.

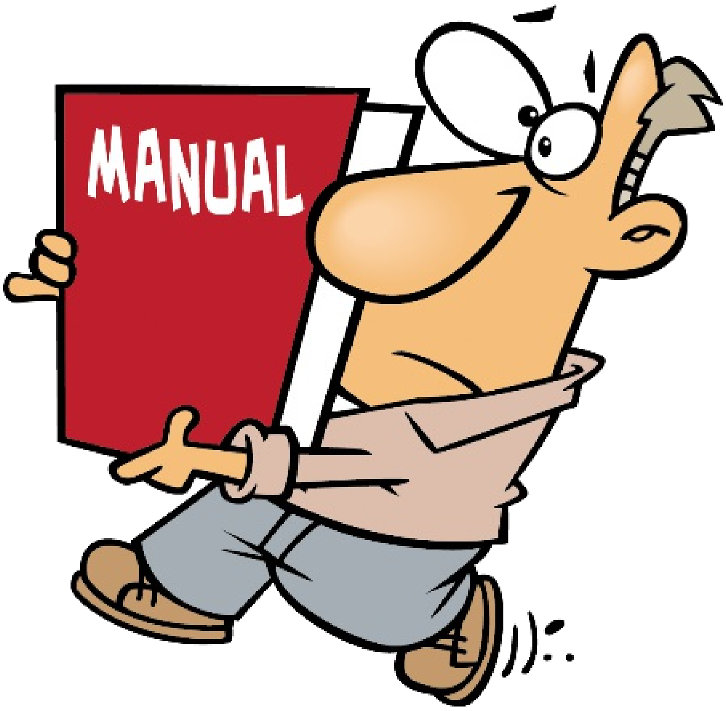
Advertising-Promotional expenditures, such as newspapers, handbills, television, radio and mail.

Utilities-Expenditures for basic services needed to function in the modern world, such as water, sewer, gas, electricity and telephone. Most businesses track the amount spent for each type of utility service.

Building Rental-Expenditures paid to an owner of property (building) for use of the property. A rental agreement called a lease contains the terms.

Maintenance & Repairs-Expenditures paid to repair and or maintain buildings and/or equipment.

Let's keep on rolling and learn about our Major Terms



Major Terms

Major Bookkeeping Terms

The Major Terms are critical to understanding bookkeeping and accounting.

Terms are one of the stepping stones to understanding bookkeeping and accounting.

Account -a separate record for each type of asset, liability, equity, revenue, expense, and draw used to show the beginning balance and to record the increases and decreases for a period and the resulting ending balance at the end of a period.

Accounting Equation -mathematical expression of the relationship of property and property rights.

Also called the **Balance Sheet Equation**.

The equation may be expressed in three forms:

Abbreviated or Simple Version:

Property = Property Rights

Expanded Version:

Assets = Liabilities + Owner's Equity (Capital)

Fully Expanded Version:

Assets = Liabilities + Beginning Owner's Equity (Capital) + Additional Owner Investments + Revenues – Expenses – Draws

Transaction -Any event or condition that must be recorded in the books of a business because of its effect on the financial condition of the business, such as buying and selling. A business deal or agreement.

Double Entry -Type of accounting/bookkeeping system that requires every transaction to be recorded in at least two places (accounts) using a debit and a credit. Every transaction is recorded in a "formal" journal as a debit entry in one account, and as a credit entry in another account. Periodically, usually monthly, the summarized balances from the journals are posted (transferred) to a formal business record called the general ledger.

Accrual Method (Basis) of Accounting -method of accounting that records income in the period earned and records expenses and capital expenditures such as buildings, land, equipment, and vehicles in the period incurred.

Debit -An entry in the financial books of a firm that increases an asset, draw or an expense or an entry that decreases a liability, owner's equity (capital) or income. Also, an entry entered on the left side (column) of a journal or general ledger account.

Let's combine the two above definitions into one complete definition. An entry (amount) entered on the left side (column) of a journal or general ledger account that increases an asset, draw or an expense or an entry that decreases a liability, owner's equity (capital) or revenue.

Credit – An entry in the financial books of a firm that increases a liability, owner's equity (capital) or revenue, or an entry that decreases an asset, draw, or an expense. Also, an entry entered on the right side (column) of a journal or general ledger account.

Let's combine the two above definitions into one complete definition. An entry (amount) entered on the right side (column) of a journal or general ledger account that increases a liability, owner's equity (capital) or revenue, or an entry that decreases an asset, draw, or an expense.

Don't worry double entry, debits, and credits are discussed and explained in future lessons. I only wanted to introduce and make you aware of these terms because they are critical terms for understanding the double entry bookkeeping system.

On to even More Bookkeeping Terms

Other Bookkeeping Terms

While the major terms are critical to understanding bookkeeping and accounting, some other terms and concepts also need to be understood.

Single Entry-Type of "informal" accounting/bookkeeping system where a user of this system makes only one entry to enter a business financial transaction. It generally includes a daily summary of cash receipts and a monthly record of receipts and disbursements (worksheets).

Cash Method (Basis) of Accounting-method of accounting that recognizes revenues (earnings) in the period the cash is received and expenses in the period when the cash payments are made.

Posting -Process of transferring balances from bookkeeping records called journals to a "final" bookkeeping record called the general ledger.

T-Account -a skeleton outline of an account which provides the same basic data as a formal ledger account. Used as a teaching aid.

Contra Account-an account which offsets and reduces or offsets the balance of another account.

A contra-asset account has a credit balance and offsets and decreases the debit balance of the related asset account. An example account is Accumulated Depreciation which reduces the equipment account to arrive at the equipment's net value.

A contra-liability account has a debit balance and offsets and decreases the credit balance of the related liability account. An example accounts is the bond discount account that reduces the bonds payable account to arrive at the bond's net value.

Balance Sheet Account -a type of account that is included in the Balance Sheet; namely the Assets, Liabilities, and permanent Equity Accounts.

Permanent or Real Account -another term used to refer to the balance sheet accounts.

Income Statement Account -a type of account that is included in the Income Statement; namely the Revenue and Expense Accounts.

Temporary Account -another term used to refer to the income statement accounts. The accounts are called temporary due to the fact that their balances are set to zero when the books are closed.

Closing the Books -process of transferring the balances from the temporary income statement accounts (revenues and expenses) to the permanent balance sheet equity account(s).

Profit -amount a business's revenues exceed (greater than) expenses. In other words, the amounts we earned were greater than our expenses.

Loss -amount a business's expenses exceed (greater than) revenues. In other words, we earned less than we spent.

Property -is another term for assets. In future lessons the term property and assets both mean the same thing-all the good stuff a business has.

Current Asset-cash and other assets normally expected to be converted to cash or used up usually within a year.

Current Liability-amounts owed (liabilities) that need to be paid or settled usually within a year.

Working Capital-net difference between current assets and current liabilities.

Working Capital = Current Assets – Current Liabilities

Cost Of Goods Sold- the accumulated total of all costs used to create a product or service, which has been sold.

Accounting Cycle is the name given to the collective process of recording and processing the accounting events of a company. The series of steps begin when a transaction occurs and end with its inclusion in the financial statements.

Let's see what Bookkeeping Records are needed

Bookkeeping Records

Documents and Records

In addition to terms and concepts, you also need to know what documents and records are used to properly perform bookkeeping.

General Ledger -A book containing the accounts and balances for all of a business's assets, liabilities, equity, revenue, and expense accounts.

Chart Of Accounts -A coded listing of all the accounts in the general ledger.

Journals -A preliminary record where business transactions are first entered into the accounting system. The journal is commonly referred to as the book of original entry.

Specialized Journals -Journals used to initially record special types of transactions such as sales, cash disbursements, and cash receipts in their own journal.

Trial Balance -A worksheet listing of all the accounts appearing in the general ledger with the dollar amount of the debit or credit balance of each. Used to make sure the books are "in balance" -total debits and credits are equal.

Subsidiary Ledgers-A separate record set up to record the individual items relating to a single general ledger account (control account). Examples include an accounts receivable and accounts payable ledger.

Worksheets-Forms which are used to summarize all the information necessary to complete the end-of-period financial reports and prepare other financial analysis.

Invoice-a business document showing the names and addresses of the buyer and the seller; the date and terms of the sale; the description, quantity, unit price, and total price of goods purchased or sold and the method of delivery.

Selling business refers to this document as a **Sales Invoice**.

Buying business refers to this document as a **Supplier Invoice**.

Receiving Report-A document originated by the buying business listing the quantities and condition of the goods and/or services received from a supplier.

Sales Order-A documented originated by the seller listing the goods and/or services ordered by a customer and other information such as prices and delivery dates.

Purchase Order-A document originated by the purchaser (buyer) requesting the supplier to ship goods or perform services.

Check Book-Formal record of all checks written, deposits, bank charges, and miscellaneous charges and credits.

Check-A written order directing a bank to pay cash from the account of the writer (drawer) of the check.

Bank Reconciliation-The process of bringing the checkbook and bank statement balances into agreement.

Bank Statement-A copy of the bank's record of the business's account showing the balance of the account at the beginning of the month, the deposits and withdrawals (mostly checks) made during the month, service charges, and the balances at the end of the month.

Next, Our Report Cards on the health of our business - Financial Statements

Financial Statements

Financial Statements are the end result of financial accounting and are used as scorecards to evaluate the financial performance of a business.

Financial Statements -Accounting reports prepared periodically to inform the owner, creditors, and other interested parties as to the financial condition and operating results of the business.

The four basic financial statements are:

Balance Sheet -The financial statement which shows the amount and nature of business assets, liabilities, and owner's equity (capital) as of a specific point in time. It is also known as a Statement Of Financial Position or a Statement Of Financial Condition.

Income Statement -The financial statement that summarizes revenues and expenses for a specific period of time, usually a month or a year. This statement is also called a Profit and Loss Statement or an Operating Statement.

Capital Statement -The financial report that summarizes all the changes in owner's equity (capital) that occurred during a specific period.

Cash Flow Statement -The financial statement that reports the sources and uses of cash for a specific period of time, normally a year.

The definitions and terminology presented in this lesson are by no means all the terminology that is used in the field of accounting, but are some of the major terms that you might encounter and are needed to complete this tutorial.

Don't Panic if you don't understand every definition that has been presented in this lesson. I tossed you in the water to get you wet, but I'm not going to let you drown. Swimming instructions will be provided in other lessons and your lifeguard (me) will be watching out for you. The lessons that follow will clear up some of the more complex definitions and concepts with examples and additional discussions.

OK, that’s enough of having fun watching the grass grow, let’s move on.

Accounting Equations

Your chef, namely me, is about to divulge a secret recipe. I know you've been waiting to get the Colonel's secret recipe for Kentucky fried chicken. Sorry to disappoint you, but this recipe is actually a simple equation and lays the foundation on which double entry bookkeeping is built.

This equation is called the **ACCOUNTING EQUATION** and is also referred to as the **Balance Sheet Equation**.

The equation may be expressed in three forms:

1. Abbreviated or Simple Version:

Property = Property Rights

2. Expanded Version:

Assets = Liabilities + Owner's Equity (Capital)

3. Fully Expanded Version:

Assets = Liabilities + Beginning Owner's Equity (Capital) + Additional Owner Investments + Revenues – Expenses – Draws

Double Entry Bookkeeping System

Do you also recall that term double entry that we mentioned also in an earlier lesson ? **Double Entry** is a type of accounting/bookkeeping system that requires every transaction to be recorded in at least two places (accounts) using debits and credits (discussed later) to represent increases and decreases.

Well this equation is what double entry is all about. We make two entries for every business transaction. These entries represent increases or decreases in property (assets) and/or property rights (liabilities and owner's equity).

In other words the double entry system based on the Accounting Equation allows us to track:

(1) What We Got and What Went (Property)

Assets The "Good Stuff"

and

(2) From Whom and To Whom (Property Rights)

Claims To The Assets ("Good Stuff")

Who has a right or claim to the business's property ? Claims to the property (assets) arise from two sources:

Creditors of the business (liabilities)

Those from whom the business borrows from or buys from on credit are called creditors. The creditors have a claim to the property (assets) of the business until they are paid. These creditor claims are called liabilities. Two common types of creditors are a business's suppliers and bankers.

Owner(s) of the business (owner's equity)

Yes the owner(s) also has a claim to the property (assets) for property (assets) invested into their business and any increases or decreases resulting from operating the business.

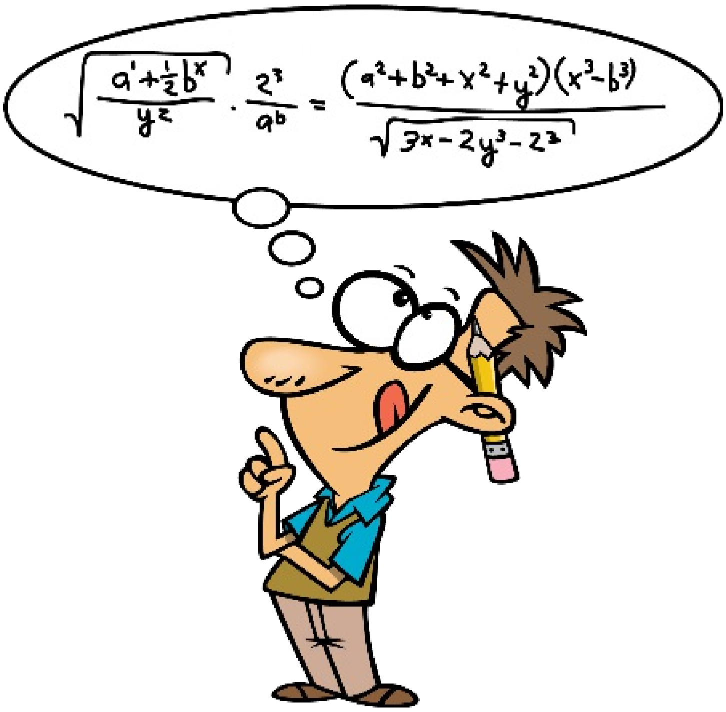
Remember we previously discussed Owner's Equity ("Ma Capital") and also her four kids Revenue, Investment, Expense, and Draws. If you recall, we learned that revenues and additional owner investments increase owner's equity while expenses and draws decrease owner's equity.

Another way to think about these increases and decreases to equity is to relate it to your personal financial situation. Your earnings (revenue) increase your personal wealth (equity) and your living expenses and draws (money you give your wife) decrease your personal wealth (equity). Sorry gals that I picked on you for my example of draws.

Besides monitoring and keeping up with the activity of her four "Kids", "Ma Capital" also has the responsibility of summarizing the activity of her four kids (revenue, expense, investment, and draws) for a period of time (monthly or yearly).

Think of Owner's Equity (Capital) as Ma's Purse. Ma summarizes all the increases and decreases resulting from revenues, expenses, investments, and draws and puts the balance in her purse (capital). This summarizing activity is called Closing the Books . Closing The Books will be discussed more in a later lesson.

It should now be apparent that the assets (property) are subject to two kinds of claims (property rights), those arising from the rights (claims) of creditors (liabilities) and those arising from the rights (claims) of the owner (owner's equity).



Developing Our Different Versions

Of the Accounting Equation

and No, you don't need an extensive knowledge of mathematics to understand !

Since

(1) Property = Assets and

(2) Property Rights (Claims to the Property) = Liabilities + Owner's Equity (Capital),

the simple or abbreviated accounting equation **Property = Property Rights** expanded or restated now becomes

Assets = Liabilities + Owner's Equity (Capital).

We're now going to concentrate on the **Owner's Equity (Capital)** section of the equation. If you recall, the balance of Owner's Equity ("Ma Capital") is affected by her kids Revenue, Expense, Investment, and Draws.

Businesses normally operate with the objective of making a profit. Profit is determined by using two of "Ma Capital's Kids" (Revenue and Expense) and subtracting the expenses from revenue (income). Any profits made by a business go to the owner. Therefore, the effects of revenue (income) and expenses are shown under the Owner's Equity section of the accounting equation.

An increase in revenues represents an increase in profit and therefore an increase in Owner's Equity ("Ma Capital"). An increase in expenses represents a decrease in profits and therefore a decrease in Owner's Equity ("Ma Capital").

"Kid Draws" and "Kid Investment" also affect the Owner's Equity ("Ma Capital") section of the accounting equation. Draws decrease Owner's Equity ("Ma Capital") and additional investments increase Owner's Equity ("Ma Capital").

Summary of The Effects of "Ma's Kids" on Owner's Equity ("Ma Capital"):

Owner Investments ("Kid Investment") **increase** Owner's Equity ("Ma Capital")

Revenues ("Kid Revenue") **increase** Owner's Equity ("Ma Capital")

Expenses ("Kid Expense") **decrease** Owner's Equity ("Ma Capital")

Owner's Draws ("Kid Draws") **decrease** Owner's Equity ("Ma Capital")

Using the above information we can present this information in the following equation:

Current Owner's Equity (Capital) = Beginning Owner's Equity (Capital) + Owner's Investments + Revenues – Expenses -Draws

This new **Owner's Equity Equation** illustrates the relationships and effects investments, revenue, expense, and draws have on **Owner's Equity (Capital)** .

Let's take this one final step to arrive at our **Fully Expanded Accounting Equation** which includes all the components that make up and affect Owner's Equity (Capital).

Our **Expanded Accounting Equation,** Assets = Liabilities + Owner's Equity (Capital) expanded or restated now becomes our **Fully Expanded Version**

Assets = Liabilities + Beginning Owner's Equity (Capital) + Additional Owner Investments + Revenues – Expenses – Draws.

In the Expanded Version of the Accounting Equation, "Ma Capital's Kids" are hiding behind her skirt. They're there; you just don't see them. The fully expanded version brings them out of hiding and shows you their effects on Owner's Equity ("Ma Capital").

While all three of the equations illustrate the relationship of property and property rights, the accounting equation **most often used and referred to** is the **Expanded Equation or Basic Equation**:

Assets = Liabilities + Owner's Equity

Observation: In using the expanded accounting equation, if two of the three components are known, the third can easily be calculated by using some simple Algebra to rearrange the equation. Don't worry, you're not going to get an Algebra Lesson.

The accounting equation can be expressed in the following different ways:

Asset emphasis:

Assets = Liabilities + Owner's Equity

Equity emphasis:

Owner's Equity = Assets – Liabilities

Liability emphasis:

Liabilities = Assets – Owner's Equity

So, You Can:

- **Calculate Assets** if Liabilities and Owner's Equity are known

Assets = Liabilities + Owner's Equity (Normal Formula)

- **Calculate Owner's Equity** if Assets and Liabilities are known

Owner's Equity = Assets – Liabilities

- **Calculate Liabilities** if Assets and Owner's Equity are known

Liabilities = Assets – Owner's Equity

Let's see if I fibbed.

If Liabilities are 70,000 and Owner's Equity is 30,000 what is the value of the Assets ?

Assets = Liabilities + Owner's Equity

Assets = 70,000 + 30,000

Assets= 100,000

If Assets are 100,000 and Liabilities are 70,000 what is the value of our Owner's Equity ?

Owner's Equity = Assets – Liabilities

Owner's Equity = 100,000 – 70,000

Owner’s Equity = 30,000

And lastly, if Assets are 100,000 and Owner’s Equity is 30,000 what is the value of our Liabilities ?.

Liabilities = Assets – Owner’s Equity

Liabilities = 100,000 – 30,000

Liabilities = 70,000

Let's learn How Transactions affect the Simple Accounting Equation
- Property & Property Rights

Transactions Simple Equation

Property = Property Rights

Let's use our simple or abbreviated accounting equation

Property = Property Rights and get an overview of the types of transactions that can occur and their effects on our simple equation.

The table below illustrates the **four basic types of transactions** represented by the **letters (a) (b) (c) and (d)** and their effects on our **Simple or Abbreviated Accounting Equation.**

A **result of a transaction** can:

- Increase both sides of the equation.
- Decrease both sides of the equation
- Increase and Decrease the same side of the equation.

Property =	**Property Rights**	**Types Of Transactions Examples-See Transaction Number in Table Below**
Left Side =	**Right Side**	
(a) Increase In Property	(a) Increase In Property Rights	#1, #2, #4, #5, #10
(b) Decrease In Property	(b) Decrease In Property Rights	#3, #6, #7

(c) Increase In One Type Of Property		#8
(c) Decrease In Another Type Of Property		#8
	(d) Increase In One Type Of Property Rights	#9
	(d) Decrease In Another Type Of Property Rights	#9

What does the table tell us ?

Transactions may require **increases to both sides of the equation** (left and right side both increase) – **transaction type (a)** ,

Transactions may require **decreases to both sides of the equation** (left and right side both decrease)- **transaction type (b)** ,

Transactions may require an **increase and decrease on the same side of the equation** (increase and decrease on the left side – **transaction type (c)**.

Transactions may require an **increase and decrease on the same side of the equation** (increase and decrease on the right side - **transaction type (d)**.

Regardless of the type of transaction, the **Accounting Equation must always balance** .

Did you also notice we made two entries for each of the example transactions illustrated in our table ? There's that **double entry thing** again. The table also illustrates that by using double entry bookkeeping the dollar amount of the property will at all times equal the dollar amount of the property rights.

Business Transactions and Their Effects on The Accounting Equation

The remainder of this lesson will be examples used to demonstrate recording transactions using the double entry bookkeeping system in conjunction with our accounting equation.

Our analysis will use the **Simple or Abbreviated Accounting Equation** to demonstrate the transaction effects.

ABC Transactions

We are now going to analyze the effects of typical types of business transactions and how they affect our Accounting Equation. We will use the fictional ABC business which is a service type business (lawn mowing), sole proprietorship, uses double entry accounting, and the accrual basis of accounting for our example.

A brief analysis of the effects follows each transaction. A more in depth analysis is presented in later lessons.

1. ABC mows a client's yard and receives a check from the customer for $50 for the service provided.

The property cash is increased and the owner's property rights (claims to the property) are increased.

2. ABC purchases $100 worth of office supplies for inventory and stores them in their storage room. The office supply store gives them an invoice that allows them to pay for them in 15 days (on account).

The property office supplies is increased and the creditor's property rights (claims to the property) are increased.

3. ABC places an ad in the local newspaper receives the invoice from the supplier and writes a check for $25 to the newspaper.

The property cash is decreased and the owner's property rights (claims to the property) are decreased.

4. ABC purchases five mowers for $10,000 and finances them with a note from the local bank.

The property equipment (mowers) is increased and the creditor's property rights (claims to the property) are increased.

5. ABC mows another customer's yard and sends the customer a bill (invoice) for $75 for the service they performed. They allow their customer 10 days to pay them for this service (on account).

The property amounts owed by customers is increased and the owner's property rights (claims to the property) are increased.

6. The owner of ABC needs a little money to pay some personal bills and writes himself a check for $500.

The property cash is decreased and the owner's property rights (claims to the property) are decreased.

7. ABC pays the office supply company $100 with a check for the office supplies that they charged (promised to pay).

The property cash is decreased and the creditor's property rights (claims to the property) are decreased.

8. ABC receives a check from the customer who they billed (invoiced) $75 for services and allowed 10 days to pay.

The property cash is increased and the property amounts owed by customers are reduced. This is actually a swap of one type of property for another.

9. ABC purchased some mulch for $60 and received an invoice from their supplier who allows them 15 days to pay. The mulch was used on a customer's yard.

The property right amount owed a supplier is increased and the owner's claim on the property rights (claims to the property) is decreased.

10. ABC bills (prepares an invoice) the customer $80 for the mulch and mowing his yard and receives a check for $80 from the customer.

The property cash is increased and the owner's property rights (claims to the property) are increased.

Transaction Analysis Using the **Simple (Abbreviated) Accounting Equation**

Property = Property Rights

	Property =		Property Rights	
	Left Side =		Right Side	

Transactions	Increase	Decrease	Decrease	Increase
1. ABC mows a client's yard and receives a check from the customer for $50 for the service provided. The property cash is increased and the owner's property rights (claims to the property) are increased.	50			50
Type (a) Transaction Increases Both Sides of the Equation				
2. ABC purchases $100 worth of office supplies for inventory and stores them in their storage room. The office supply store gives them an invoice that allows them to pay for them in 15 days (on account). The property office supplies is increased and the creditor's property rights (claims to the property) are increased.	100			100
Type (a) Transaction Increases Both Sides of the Equation				
3. ABC places an ad in the local newspaper receives the invoice from the supplier and writes a check for $25 to the newspaper. The property cash is decreased and the owner's property rights (claims to the property) are decreased.		25	25	
Type (b) Transaction Decreases Both Sides of the Equation				
4. ABC purchases five mowers for $10,000 and finances them with a note from the local bank. The property equipment (mowers) is increased and the creditor's property rights (claims to the property) are increased.	10,000			10,000
Type (a) Transaction Increases Both Sides of the Equation				
5. ABC mows another customer's yard and sends the customer a bill (invoice) for $75 for the service they performed. They allow their customer 10 days to pay them for this service (on account).	75			75

The property amounts owed by customers is increased and the owner's property rights (claims to the property) are increased.				
Type (a) Transaction Increases Both Sides of the Equation				
6. The owner of ABC needs a little money to pay some personal bills and writes himself a check for $500. The property cash is decreased and the owner's property rights (claims to the property) are decreased.		500	500	
Type (b) Transaction Decreases Both Sides of the Equation				
7. ABC pays the office supply company $100 with a check for the office supplies that they charged (promised to pay). The property cash is decreased and the creditor's property rights (claims to the property) are decreased.		100	100	
Type (b) Transaction Decreases Both Sides of the Equation				
8. ABC receives a check from the customer who they billed (invoiced) $75 for services and allowed 10 days to pay. The property cash is increased and the property amounts owed by customers are reduced. This is actually a swap of one type of property for another.	75	75		
Type (c) Transaction Increases and Decreases Left Side of the Equation				
9. ABC purchased some mulch for $60 and received an invoice from their supplier who allows them 15 days to pay. The mulch was used on a customer's yard. The property right amount owed a			60	60

supplier is increased and the owner's claim on the property rights (claims to the property) is decreased.				
Type (d) Transaction Increases and Decreases Right Side of the Equation				
10. ABC bills (prepares an invoice) the customer $80 for the mulch and mowing his yard and receives a check for $80 from the customer. The property cash is increased and the owner's property rights (claims to the property) are increased.	80			80
Type (a) Transaction Increases Both Sides of the Equation				
Total	10,380 Increase	700 Decrease	685 Decrease	10,365 Increase
Total Net Changes	9,680 Increase			9,680 Increase

Now let's use our **Expanded Accounting Equation** to illustrate the types of transactions that can occur and their effects on our expanded equation.

Transactions Expanded Equation

Assets = Liabilities + Owner's Equity

Now let's use our **Expanded Accounting Equation** and get an overview of the types of transactions that can occur and their effects on our expanded equation.

The table below illustrates the **four basic types of transactions** represented by the **letters (a) (b) (c) and (d)** and their effects on our **Expanded Accounting Equation**.

A **result of a transaction** can:

- Increase both sides of the equation.
- Decrease both sides of the equation
- Increase and Decrease the same side of the equation.

Assets =	**Liabilities + Owner's Equity**	**Types Of Transactions Examples-See Transaction Number in Table Below**
Left Side =	**Right Side**	
(a) Increase In Assets	(a) Increase In Liabilities or Owner's Equity	#1, #2, #4, #5, #10
(b) Decrease In Assets	(b) Decrease In Liabilities or Owner's Equity	#3, #6, #7
(c) Increase In One Type Of Asset		#8
(c) Decrease In Another Type Of Asset		#8
	(d) Increase In One Type Of Liability or Owner's Equity	#9

	(d) Decrease In Another Type Of Liabilty or Owner's Equity	#9

What does the table tell us ?

Transactions may require **increases to both sides of the equation** (left and right side both increase) – **transaction type (a)** ,

Transactions may require **decreases to both sides of the equation** (left and right side both decrease)- **transaction type (b)** ,

Transactions may require an **increase and decrease on the same side of the equation** (increase and decrease on the left side – **transaction type (c)**.

Transactions may require an **increase and decrease on the same side of the equation** (increase and decrease on the right side - **transaction type (d)**.

Regardless of the type of transaction, the **Accounting Equation must always balance** .

Did you also notice we made two entries for each of the example transactions illustrated in our table ? There's that **double entry thing** again. The table also illustrates that by using double entry bookkeeping the dollar amount of the property will at all times equal the dollar amount of the property rights.

Transaction Analysis Using the **Expanded Accounting Equation**

Assets = Liabilities + Owner's Equity

Transactions	**Assets =**		**Liabilities +**		**Owner's Equity**	
	Left Side =		**Right Side**			
	Increase	**Decrease**	**Decrease**	**Increase**	**Decrease**	**Increase**
1. ABC mows a client's yard and	50					50

receives a check from the customer for $50 for the service provided. The asset cash is increased and the owner's equity is increased.						
Type (a) Transaction Increases Both Sides of the Equation						
2. ABC purchases $100 worth of office supplies for inventory and stores them in their storage room. The office supply store gives them an invoice that allows them to pay for them in 15 days (on account). The asset office supplies is increased and the liabilities are increased.	100			100		
Type (a) Transaction Increases Both Sides of the Equation						
3. ABC places an ad in the local newspaper receives the invoice from the supplier and writes a check for $25 to the newspaper. The asset cash is decreased and the owner's equity is decreased.		25			25	
Type (b) Transaction Decreases Both Sides of the Equation						
4. ABC purchases five mowers for $10,000 and finances them with a note from the local bank. The asset equipment (mowers) is increased and the liabilities are increased.	10,000			10,000		
Type (a) Transaction Increases Both Sides of the Equation						
5. ABC mows another customer's yard and sends the customer a bill (invoice) for $75 for the service they performed. They allow their customer 10 days to pay them for this service (on account). The asset amounts owed by customers is increased and the owner's equity is increased.	75					75

Type (a) Transaction Increases Both Sides of the Equation						
6. The owner of ABC needs a little money to pay some personal bills and writes himself a check for $500.		500			500	
The asset cash is decreased and the owner's equity is decreased.						
Type (b) Transaction Decreases Both Sides of the Equation						
7. ABC pays the office supply company $100 with a check for the office supplies that they charged (promised to pay). The asset cash is decreased and the liabilities are decreased.		100	100			
Type (b) Transaction Decreases Both Sides of the Equation						
8. ABC receives a check from the customer who they billed (invoiced) $75 for services and allowed 10 days to pay. The asset cash is increased and the asset amounts owed by customers is reduced. This is actually a swap of one type of asset for another.	75	75				
Type (c) Transaction Increases and Decreases Left Side of the Equation						
9. ABC purchased some mulch for $60 and received an invoice from their supplier who allows them 15 days to pay. The mulch was used on a customer's yard. The liabilty amount owed a supplier is increased and the owner's equity is decreased.				60	60	
Type (d) Transaction Increases and Decreases Right Side of the Equation						
10. ABC bills (prepares an invoice) the customer $80 for the mulch and mowing his yard and receives a check for $80 from the customer.	80					80

The asset cash is increased and the owner's equity is increased.						
Type (a) Transaction Increases Both Sides of the Equation						
Total	10,380 Increase	700 Decrease	100 Decrease	10,160 Increase	585 Decrease	205 Increase
Net Changes	9,680 Increase		10,060 Increase		380 Decrease	
Total Net Changes	9,680 Increase		9,680 Increase			

In the previous table, we entered all the transactions that affected Owner's Equity under one heading; namely, Owner's Equity and disregarded whether it was a revenue, expense, or draw item.

The following table is provided to help illustrate the effects that "Ma Capital's Kids", Revenue, Expense, and Draws have on Owner's Equity ("Ma Capital"). Of course only the sample transactions that affect Owner's Equity have been included.

Instead of recording transactions directly to "Ma Capital" (Owner's Equity), proper bookkeeping actually uses her kids revenue, expense, and draws to record the increases and decreases to "Ma Capital" (Owner's Equity) in order to provide us with the answers to how and why the owner's claim to the business assets (property) increased or decreased.

Equity Table

Analysis of the Effects of Revenue, Expense, and Draws (Ma Capitals's Kids) on Owners Equity

	"Ma Capital"		Ma's Kid's"		
Proper Recording Actually Uses Revenue, Expenses & Draws Instead of Owner's Equity	Original Recording		Proper Recording Uses		
	Owner's Equity Right Side		Revenue	Expense	Draw
	Decrease	Increase	Revenue Increases Resulting in	Expenses Increase Resulting in	Draws Increase Resulting in a

Transactions			an Increase to Equity	a Decrease to Equity	Decrease to Equity
1. ABC mows a client's yard and receives a check from the customer for $50 for the service provided. The asset cash is increased and revenue is earned.		50	50		
3. ABC places an ad in the local newspaper receives the invoice from the supplier and writes a check for $25 to the newspaper. The asset cash is decreased and the owner's equity is reduced due to the increase in expenses incurred.	25			25	
5. ABC mows another customer's yard and sends the customer a bill (invoice) for $75 for the service they performed. They allow their customer 10 days to pay them for this service (on account). The asset amounts owed by customers is increased and revenue and owner's equity are increased.		75	75		
6. The owner of ABC needs a little money to pay some personal bills and writes himself a check for $500. The asset cash is decreased and the owner's equity is decreases resulting from the increase in owner's draws.	500				500
9. ABC purchased some mulch for $60 and received an invoice from their supplier who allows them 15 days to pay. The mulch was used on a customer's yard. The liability amount owed a supplier is increased and the owner's equity is decreased resulting from the increase in expenses.	60			60	
10. ABC bills (prepares an invoice) the customer $80 for the mulch and mowing		80	80		

his yard and receives a check for $80 from the customer. The asset cash is increased and the revenue and owner's equity are increased.					

What should we pick up and learn from these tables ?

Here's What

1. How different types of transactions affect the Accounting Equation.

2. How each transaction was recorded twice illustrating double entry bookkeeping.

3. The total amounts for the tables prove the self-balancing nature of the Accounting Equation.

4. How transactions may require increases to both sides of the equation (increase left side and increase right side), decreases to both sides of the equation (decrease left side and decrease right side), or an increase and decreases on the same side of the equation (increase and decrease the left side or increase and decrease the right side), but the equation must always balance.

5. The Equity Table illustrates that, while transactions that affect Owner's Equity could be entered using only one column, additional useful information is obtained by breaking Owner's Equity into its component parts (kids) using the revenue, expense, and draws categories to record the transactions.

6. That revenues increase owner's equity while expenses and draws decrease owner's equity.

Rescue Me I'm ready for a break ! Since we've covered quite a bit about the Accounting Equations in this lesson, I'll have to agree that you do deserve a break.

Debits Credits Defined

Debits and Credits

For Every Action There Is An Opposite Reaction

I thought about calling this lesson "The Revenge of The Nerds". The nerds, in this case, being us accountant types.

Students and others studying accounting and bookkeeping probably think that debits and credits are our (accountants) way of paying them back for poking fun at our profession. Actually, there's really nothing difficult about debits and credits. It's just our method used to record business transactions.

Stop Right Here ! You're not going to start teaching physics are you ? No; but, accounting and bookkeeping have a similar rule. Accounting and Bookkeeping's similar rule is:

Debits = Credits

Or

For Every Debit There Is A Credit

This rule is the basis for the double entry bookkeeping system. If you recall, the **double entry system** is an accounting system that requires at least two entries to record a financial transaction.

What enables the **double entry accounting system** to work ? In two words **Debits and Credits**

We learned that the **double entry system** based on the **Accounting Equation** allows us to track:

(1) What We Got and What Went (Property)

and

(2) From Whom and To Whom (Property Rights)

We've already discussed transactions and how they increase or decrease the assets, liabilities, and owner's equity of a business and their effects on the Accounting Equation in a prior lesson. All we're going to do now is give these increases and decreases an official bookkeeping name and definition. Can you guess the names of the terms that we're going to associate with increases and decreases ? I hope you said **debit** and **credit**.

Definitions of Debits and Credits

Debit (Left)

An entry in the financial books of a firm that increases an asset, draw, or an expense or an entry that decreases a liability, owner's equity (capital) or income.

Also, an entry entered on the left side (column) of a journal or general ledger account.

Let's combine the two above definitions into **one complete definition**.

An entry (amount) entered on the left side (column) of a journal or general ledger account that increases an asset, draw or an expense or an entry that decreases a liability, owner's equity (capital) or revenue.

Credit (Right)

An entry in the financial books of a firm that increases a liability, owner's equity (capital) or revenue, or an entry that decreases an asset, draw, or an expense.

Also, an entry entered on the right side (column) of a journal or general ledger account.

Let's combine the two above definitions into **one complete definition**.

An entry (amount) entered on the right side (column) of a journal or general ledger account that increases a liability, owner's equity (capital) or revenue, or an entry that decreases an asset, draw, or an expense.

Many accounting text books discuss debits and credits by concentrating on the simplistic definition of debits and credits. Debit means left, credit means right. In other words, a debit is a number written on the left side of an account and a credit is a number written on the right side of an account. While this is true, it only tells us on what side of an account we should place an entry. We also need to know **when is an entry a debit** (entered on the left side) and **when is an entry a credit** (entered on the right side) and how the entry **affects the account**.

This is where the key terms **increase** and **decrease** and the **type of account** (asset, liability, owner's equity, revenue, expense, and draws) come into play. The term debit does not mean increase or decrease, nor does the term credit mean increase or decrease until the term is also **associated with a type of account**. In other words, debit does not always mean an increase nor does credit always mean a decrease , or vice versa. Also, the terms debit and credit do not refer to something good or bad.

In my opinion, good usable definitions of the terms debit and credit contain all **three of the elements** we just discussed:

- Left Side / Right Side
- Increase / Decrease
- Associated Type Of Account

Can you guess what definitions I prefer to use for debit and credit from the three definitions that I presented earlier ? The ones that contains all three elements.

Debit

An entry (amount) entered on the **left side (column)** of a journal or general ledger account that **increases an asset, draw or an expense** or an entry that **decreases a liability, owner's equity (capital) or revenue.**

Credit

An entry (amount) entered on the **right side (column)** of a journal or general ledger account that **increases a liability, owner's equity (capital) or revenue** , or an entry that **decreases an asset, draw, or an expense**.

Let's shake things up and learn about Debits & Credits and the Basic Accounting Equation

Debits & Credits

and

The Accounting Equation

Let's See How Debits and Credits are Related

To Our Accounting Equations

Remember our Accounting Equations ?

Abbreviated or Simple Version:

Property = Property Rights

and our

Expanded Version:

Assets = Liabilities + Owner's Equity

These versions of the accounting equation simply state that assets, also called property, equals what is owed to creditors (liabilities) and the owners (owner's equity). Liabilities and Owner's Equity are also called property rights.

How do Debits and Credits relate to our Accounting Equations ? They're the tools used to keep our equations balanced.

The Balance of the **Left Side** of the Equation (Asset Accounts) will normally have a **DEBIT** Balance and the Balance of the **Right Side** (Liability and Permanent Equity Accounts) will normally have a **CREDIT** Balance.

Left Side =	**Right Side**	
Property =	Property Rights	
Assets =	Liabilities +	Owner's Equity
Debit Balances =	**Credit** Balances +	**Credit** Balances
Debit Increases	**Credit Increases**	
Credit Decreases	**Debit Decreases**	

Notice in our table that a debit increases the balances on the left side of the accounting equation (assets) and has the opposite effect and decreases the balances on the right side of the equation (liabilities and owner's equity). Likewise, a credit decreases the balances on the left side of the accounting equation (assets) and has the opposite effect and increases the balances on the right side of the accounting equation (liabilities and owner's equity).

Generally, anything that increases the left side of the equation (assets) or decreases the right side of the equation (liabilities and equity) is considered a debit and anything that increases the right side of the equation (liabilities and equity) or decreases the left side of the equation (assets) is considered a credit.

What we're doing here is relating the **types of accounts** (assets, liabilities, owner's equity, revenue, expense, and draws) and the terms **increases and decreases** to the terms **debits and credits**. The terms debit and credit by themselves **do not mean an increase or a decrease**. The terms have to be **associated with the types of accounts** in order to gain their meaning.

In other words, whether a debit or credit is an increase or decrease **depends on the type of account**.

Before we continue our discussion of debits and credits, let's take a look at how the terms are used with the major types of accounts. First we'll discuss assets, liabilities and owner's equity and then revenue, expense, and draws.

They say a picture's worth a thousand words !

Let's revisit our Expanded Accounting Equation Types of Transactions Table used in a prior lesson and modify it slightly to include our new terms debit and credit. Our following new table illustrates the types of transactions that can occur and the effects of debits and credits on our expanded accounting equation.

Assets =	**Liabilities + Owner's Equity**	**Types Of Transactions Examples-See Transaction Number in Table Below**
Left Side =	**Right Side**	
(a) Increase In Assets **Debit**	(a) Increase In Liabilities or Owner's Equity **Credit**	#1, #2, #4, #5, #10
(b) Decrease In Assets **Credit**	(b) Decrease In Liabilities or Owner's Equity **Debit**	#3, #6, #7
(c) Increase In One Type Of Asset **Debit**		#8
(c) Decrease In Another Type Of Asset **Credit**		#8
	(d) Increase In One Type Of Liability or Owner's Equity **Credit**	#9
	(d) Decrease In Another Type Of Liabilty or Owner's Equity **Debit**	#9

Take note, this small table illustrates that each transaction is recorded by using a debit and a credit:

Transaction Type **(a)** Increases an Asset Account on the Left Side using a Debit and Increases a Liability or Owner's Equity Account on the Right Side using a Credit.

Transaction Type **(b)** Decreases an Asset Account on the Left Side using a Credit and Decreases a Liability or Owner's Equity Account on the Right Side using a Debit.

Transaction Type **(c)** Increases an Asset Account on the Left Side using a Debit and also Decreases an Asset Account on the Left Side using a Credit.

Transaction Type **(d)** Increases a Liability or Owner's Equity Account on the Right Side using a Credit and also Decreases a Liability or Owner's Equity Account on the Right Side using a Debit.

The result of this debit and credit "scheme" is that the **accounting equation will always be in balance**.

Transaction Analysis Using The Simple (Abbreviated) and Expanded Accounting Equations and Debits and Credits

Let's also revisit the tables from a prior lesson where we analyzed the effects of business transactions on the accounting equation. In that lesson we had a table analyzing transactions using the simple or abbreviated accounting equation and another table that used the expanded accounting equation. This table presents both accounting equations in one table and adds our terms debit and credit to illustrate the effect of debits and credits on our accounting equations.

Simple Abbreviated Accounting Equation	Property =		Property Rights			
Expanded Accounting Equation	Assets =		Liabilities +		Owner's Equity	
Side of the Accounting Equation	Left Side =		Right Side			
Increase/Decrease Columns	Increase	Decrease	Decrease	Increase	Decrease	Increase
Our New Terms In Action	Debit	Credit	Debit	Credit	Debit	Credit
Description of Transactions and Their Effects On The Equation						
1. ABC mows a client's yard and receives a check from the customer for $50 for the service provided. The asset cash is increased and the owner's equity is increased.	50					50
Transaction Type (a) Increase In Assets-Debit and Increase In Owner's Equity-Credit						
2. ABC purchases $100 worth of office supplies for inventory and stores them in their storage room. The office supply store gives them an invoice that allows them to pay for them in 15 days (on account). The asset office supplies is increased and the liabilities are increased.	100			100		

Transaction Type (a) Increase In Assets-Debit and Increase In Liabilities-Credit						
3. ABC places an ad in the local newspaper receives the invoice from the supplier and writes a check for $25 to the newspaper. The asset cash is decreased and the owner's equity is decreased.		25			25	
Transaction Type (b) Decrease In Assets-Credit and Decrease In Owner's Equity-Debit						
4. ABC purchases five mowers for $10,000 and finances them with a note from the local bank. The asset equipment (mowers) is increased and liabilities are increased.	10000			10000		
Transaction Type (a) Increase In Assets-Debit and Increase In Liabilities-Credit						
5. ABC mows another customer's yard and sends the customer a bill (invoice) for $75 for the service they performed. They allow their customer 10 days to pay them for this service (on account). The asset amounts owed by cusctomers is increased and owner's equity is increased.	75					75
Transaction Type (a) Increase In Assets-Debit and Increase In Owner's Equity-Credit						
6. The owner of ABC needs a little money to pay some personal bills and writes himself a check for $500. The asset cash is decreased and owner's equity is decreased.		500			500	
Transaction Type (b) Decrease In Assets-Credit and Decrease In Owner's Equity-Debit						
7. ABC pays the office supply company $100 with a check for the office supplies that they charged (promised to pay). The asset cash is decreased and the liabilities are decreased.		100	100			
Transaction Type (b) Decrease In Assets-Credit and Decrease in Liabilities-Credit						
8. ABC receives a check from the customer who they billed (invoiced) $75 for services and	75	75				

allowed 10 days to pay. The asset cash is increased and the asset amounts owed by customers are reduced. This is actually a swap of one type of asset for another.						
Transaction Type (c) Increase In One Type Of Asset-Debit and Decrease In Another Type Of Asset-Credit						
9. ABC purchased some mulch for $60 and received an invoice from their supplier who allows them 15 days to pay. The mulch was used on a customer's yard. The liability an amount owed a supplier is increased and the owner's equity is decreased.				60	60	
Transaction Type (d) Increase In Liabilities-Credit and Decrease In Owner's Equity-Debit						
10. ABC bills (prepares an invoice) the customer $80 for the mulch and mowing his yard and receives a check for $80 from the customer. The asset cash is increased and the owner's equity is increased.	80					80
Transaction Type (a) Increase In Assets-Debit and Increase In Owner's Equity-Credit						
Totals	$10,380 Increase	$700 Decrease	$100 Decrease	$10,160 Increase	$585 Decrease	$205 Increase
Net Change	$9,680 Increase			$10,060 Increase	$380 Decrease	
Total Net Changes	$9,680 Increase			$9,680 Increase		

Let's see if you've been fibbing to me about those debits and credits.

Account Type	Debits	Credits
Asset Transactions	10,380	700
Liability Transactions	100	10,160

Equity Transactions	585	205
Totals	11,065	11,065

By golly those debits and credits **do equal each other**.

Let's not forget "Ma Capital's (Owner's Equity) Kids" ! We also borrowed another table from a prior lesson and included the terms debit and credit in the table.

Equity Table

Analysis of the Effects of Debits and Credits and Revenue, Expense, and Draws on Owner's Equity

In the previous table, we entered all the transactions that affected Owner's Equity under one heading; namely, Owner's Equity and disregarded whether it was a revenue, expense, or draw item. The following table illustrates where the transactions affecting Owner's Equity would actually be entered.

Instead of recording transactions directly to Owner's Equity ("Ma Capital"), proper bookkeeping actually uses her "Kids" Revenue, Expense, and Draws to record the increases and decreases to "Ma Capital" (Owner's Equity) in order to provide us with the answers to the how and why the owner's claim to the business's property increased or decreased.

This table also illustrates the effects of debits and credits on "Ma Capital's Kids" Revenue, Expense, and Draw. Of course only the sample transactions that affect Owner's Equity (Revenue, Expense, and Draws) have been included.

Equity Table					
Effects Of Revenue, Expense, & Draws on Owner's Equity	Owner's Equity "Ma Capital"		"Ma's Kids"		
Proper Recording Actually Uses Revenue, Expense & Draws Instead Of Owner's Equity	Original Recording		Proper Recording Uses		
Transactions	Owner's Equity Right Side		Revenue	Expense	Draws
	Decrease	Increase	Revenue Increases Resulting In	Expenses Increase Resulting In a	Draws Increase Resulting in a Decrease to

			an Increase to Equity	Decrease to Equity	Equity
Our New terms In Action	Debit	Credit	Credit	Debit	Debit
1. ABC mows a client's yard and receives a check from the customer for $50 for the service provided. The asset cash is increased and revenue is earned.		50	50		
3. ABC places an ad in the local newspaper receives the invoice from the supplier and writes a check for $25 to the newspaper. The asset cash is decreased and the owner's equity is reduced due the increase in expenses incurred.	25			25	
5. ABC mows another customer's yard and sends the customer a bill (invoice) for $75 for the service they performed. They allow their customer 10 days to pay them for this service (on account). The asset amounts owed by customers is increased and revenue and owner's equity are increased.		75	75		
6. The owner of ABC needs a little money to pay some personal bills and writes himself a check for $500. The asset cash is decreased and the owner's equity is decreases resulting from the increase in owner's draws.	500				500
9. ABC purchased some mulch for $60 and received an invoice from their supplier who allows them 15 days to pay. The mulch was	60			60	

used on a customer's yard. The liability amount owed a supplier is increased and the owner's equity is decreased resulting from the increase in expenses.					
10. ABC bills (prepares an invoice) the customer $80 for the mulch and mowing his yard and receives a check for $80 from the customer. The asset cash is increased and the revenue and owner's equity are increased.		80	80		

What should we pick up and learn from these tables and example transactions recorded in the tables ?

Here's What

1. How different types of business transactions affect the Accounting Equation.

2. How it associates increases and decreases and the types of accounts with the terms debits and credit.

3. How each transaction was recorded twice illustrating double entry bookkeeping.

4. The total amounts for the tables prove the self-balancing nature of the Accounting Equation.

5. How transactions may require increases to both sides of the equation (increase left side using a debit and increase right side using a credit), decreases to both sides of the equation (decrease left side using a credit and decrease right side using a debit), or an increase and decrease on the same side of the equation (increase using a debit and decrease using a credit on the left side or increase using a credit and decrease using a debit on the right side of the equation), but the equation must always balance.

6. The Equity Table illustrates that, while transactions that affect Owner's Equity could be entered using only one column, additional useful information is obtained by breaking Owner's Equity into its component parts (kids) using the revenue, expense, and draws categories to record the transactions.

(a) That revenues increase owner's equity while expenses and draws decrease owner's equity.

(b) It illustrates that we could use only the Main Account Types Assets, Liabilities, and Owner's Equity (Capital) contained in our Basic Expanded Accounting Equation (Assets = Liabilities + Owner's Equity) to record our transactions and not use "Ma Capital's Kids" – Revenue , Expense , and Draws .

The **drawback of just using "Ma Capital"** (the Owner's Equity Account) is that the Owner's Equity (Capital) Account would require a **great deal of analysis and time** in order to determine the income or loss for a period and the reasons for this income or loss.

From here on out , transactions will be recorded using "Ma's Kids" revenue, expense, and draws.

Take the Plunge ! Can you guess what we're going to discuss next ?

How about the **Fully Expanded Version of our Accounting Equation and debits and credits**.

Debits Credits Fully Expanded Equation

Debits and Credits

Fully Expanded Version

of The Accounting Equation

In a prior lesson, we discussed, developed, and explained the Fully Expanded Accounting Equation. I also said that we would be revisiting this topic in another lesson. Well, I'm a man of my word.

If you recall, since

(1) Property = Assets and

(2) Property Rights (Claims to the Property) = Liabilities + Equity,

the **simple or abbreviated accounting equation**

Property = Property Rights

expanded or restated became

Assets = Liabilities + Owner's Equity.

We also concentrated on the **Owner's Equity (Capital)** portion of the equation and discussed how the balance of Owner's Equity ("Ma Capital") is affected by her "kids" **Revenue, Expense, Investments, and Draws**.

Let's review these effects one more time:

Owner Investments (Kid Investment) increase Owner's Equity

Revenues (Kid Revenue) increase Owner's Equity

Expenses (Kid Expense) decrease Owner's Equity

Owner's Draws (Kid Draws) decrease Owner's Equity

Using the above information we arrived at the following equation:

Current Owner's Equity = Beginning Owner's Equity + Owner's Investments + Revenues – Expenses -Draws

Our new owner's equity equation illustrated the relationships and effects investments, revenue, expense, and draws have on **Owner's Equity** .

Taking this one step further, we arrived at our **Fully Expanded Accounting Equation** which included all the components that make up and affect Owner's Equity.

Our Expanded Accounting Equation

Assets = Liabilities + Owner's Equity

expanded or restated became our

Fully Expanded Accounting Equation

Assets = Liabilities + Beginning Owner’s Equity + Additional Owner Investments + Revenues – Expenses – Draws.

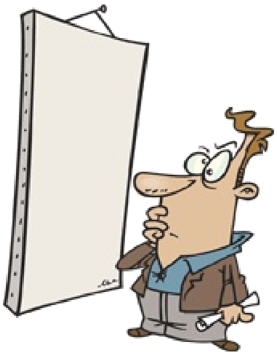
In the Expanded Version of the Accounting Equation, “Ma Capital’s Kids” are hiding behind her skirt. They’re there; you just don’t see them. The **fully expanded version** unhides them and shows you their affects on Owner’s Equity (“Ma Capital”).

Effects Of Debits and Credits					
Assets	Liabilities	Beg Equity	Revenue	Expense	Draws
Normal Balance Debit	Normal Balance Credit	Normal Balance Credit	Normal Balance Credit	Normal Balance Debit	Normal Balance Debit
Debit Increase	Credit Increase	Credit Increase	Credit Increase	Debit Increase	Debit Increase
Credit Decrease	Debit Decrease	Debit Decrease	Debit Decrease	Credit Decrease	Credit Decrease

We'll use the following table as an aid to see how all the pieces of the game called bookkeeping fit together.

Normal Debit Balances	Normal Credit Balances	Normal Debit **and** Credit Balances	Profit or Loss
Assets =	Liabilities +	**Beginning** Owner's Equity (Normal **Credit** Balance)	
		+ Additional Owner Investments (Normal **Credit** Balance)	

	+ Revenue (Normal **Credit** Balance)	**+ Revenue**
	- Expenses (Normal **Debit** Balance)	**- Expenses**
		=Profit or Loss
	- Draws (Normal **Debit** Balance)	
	= **Ending** Owner's Equity (Normal **Credit** Balance)	



Just from looking at the above tables and not even knowing anything about bookkeeping, **what should you be able to tell me ?**

1. Assets = Liabilities + **Ending Owner’s Equity**

2. Revenues – Expenses = **Profit or Loss**

3. **Beginning Owner’s Equity** + Owner’s Contributions + Revenue – Expense – Draws = Ending Owner’s Equity

4. Asset Accounts normally have **Debit Balances and are increased with a debit and decreased with a credit.**

5. Liability Accounts normally have **Credit Balances and are increased with a credit and decreased with a debit.**

6. Owner’s Equity (Capital) Account normally has a **Credit Balance and is increased with a credit and decreased with a debit.**

7. Two of Ma's Equity Kids, Expense and Draws, normally have a **Debit Balance and are increased with a debit and decreased with a credit**.

8. Two of Ma's Equity Kids, Revenue and Investments normally have a **Credit Balance and are increased with a credit and decreased with a debit**.

9. Revenues i**ncrease** Owner's Equity (Capital) because they're **added** to Owner's Equity.

10. Expenses **decrease** Owner's Equity (Capital) because they're **subtracted** from Owner's Equity.

11. Draws **decrease** Owner's Equity (Capital) because they're **subtracted** from Owner's Equity.

Besides the Owner's Original Investment in his/her business, at times, the owner may have to contribute or invest additional assets which **increase** Owner's Equity.

Note: Additional owner investments are normally added directly (credited) to the Owner's Capital Account Balance.

Owner Draws **are not used** to figure the profit or loss of the business.

Note: The owner's draws could be equal, less than, or more than the profit / loss of the business.

12. Additional Owner Contributions, Revenues, Expenses, and Draws eventually are all merged together and become a part of the Ending Owner's Equity Balance. If you've heard the phrase **Closing The Books** , believe it or not, this is all that's basically involved in Closing The Books.

Comment: Before we end our discussion of equations, another equation that you may run across is what I call the **Debit and Credit Equation** . The Debit and Credit Equation is just a variation (rearranged version) of the Fully Expanded Accounting Equation. Some simple Algebra was used to rearrange the major types of accounts.

So you know it looks like this:

Debit and Credit Equation

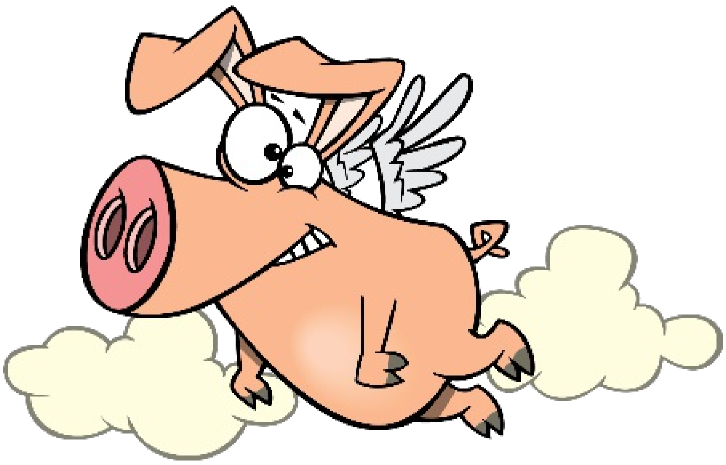
Assets + Draws + Expenses = Liabilities + Owner's Equity + Revenue

Normal Debit Balances	=	Normal Credit Balances
Debit Balance Accounts	=	Credit Balance Accounts

In this equation all the **normal debit balance accounts are on the left side** of the equal sign and **all the normal credit balance accounts** are on the right side of the equal side. This equation is sometimes used to help understand Debits and Credits which we’ll be discussing in our next lesson.

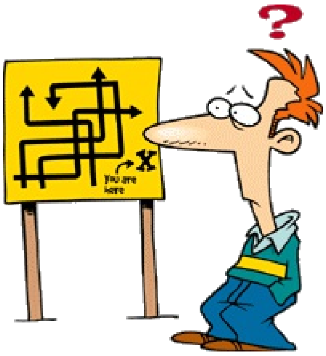
Sometimes a picture is worth a thousand words.

<table>
<tr><th colspan="6">Debit and Credit Equation</th></tr>
<tr><th colspan="3">Left Side</th><th colspan="3">= Right Side</th></tr>
<tr><td>Assets +</td><td>Draws +</td><td>Expenses</td><td>= Liabilities +</td><td>Owner's Equity +</td><td>Revenue</td></tr>
<tr><td colspan="3">Normal Debit Balances</td><td colspan="3">= Normal Credit Balances</td></tr>
<tr><td colspan="3">Debit Balance Accounts</td><td colspan="3">= Credit Balance Accounts</td></tr>
</table>



Next, let's find out when to Debit and Credit and yes you'll understand before Pigs Fly.

Debit or Credit



Debit or Credit -When ?

What to Debit or Credit or as William Shakespeare might have said

"To Debit or Credit that is the question"

All the stuff that you've told me is great; but, how do I determine what to debit or credit when recording transactions ? And here I am thinking you won't ask.

Let's revisit some terms and concepts from prior lessons.

Account Definition

An **Account** is a separate record for each type of asset, liability, equity, revenue, and expense used to show the beginning balance and to record the increases and decreases for a period and the resulting ending balance at the end of a period.

You should be aware that **All Accounts** :

- Can Be Debited and Credited
- Have an Increase Side (Column) and a Decrease Side (Column)
- Have a Debit Side (Column) and a Credit Side (Column)
- Debit Side is the Left Side (Left Column)
- Credit Side is the Right Side (Right Column)
- Have a Type and are classified as an Asset, Liability, Equity, Revenue, Expense, or Draw
- Are Either a Balance Sheet or Income Statement Account
- Have a Normal Balance Amount that is normally a Debit Balance or a Credit Balance

Formal Definitions of Debit and Credit

Debit

An entry (amount) entered on the **left** side (column) of a journal or general ledger account that increases an asset, draw or an expense or an entry that decreases a liability, owner's equity (capital) or revenue.

Credit

An entry (amount) entered on the **right** side (column) of a journal or general ledger account that increases a liability, owner's equity (capital) or revenue, or an entry that decreases an asset, draw, or an expense.

Fully Expanded Accounting Equation and Debit Credit Equation

Assets = Liabilities + Beginning Equity + Revenues - Expenses - Draws

In the Expanded Version of the Accounting Equation, "Ma Capital's (Equity) Kids" are hiding behind her skirt. They're there; you just don't see them. The **fully expanded version** unhides them Revenue, Expense, and Draws and shows you their affects on Owner's Equity ("Ma Capital").

Rearranging the Fully Expanded Version (Simple Algebra) it becomes the **Debit Credit Equation**

Assets + Expenses + Draws = Liabilities + Beginning Equity + Revenue

From our formal definition you can see that:

The term **Debit** refers to the **Left** and the term **Credit** refers to the **Right**.

Using this knowledge, the type of accounts on the **Left Side** of our **Debit and Credit Equation** have **normal Debit Balances**.

All the types of accounts on the **Right Side** of our **Debit and Credit Equation** have normal **Credit Balances**.

The Left Side Normal Debit Balance Accounts = Right Side Normal Credit Balance Accounts

Again, a picture is worth a thousand words.

Debit and Credit Equation					
Left Side			**= Right Side**		
Assets +	Draws +	Expenses	= Liabilities +	Owner's Equity +	Revenue
Normal Debit Balances			= Normal Credit Balances		
Debit Balance Accounts			= Credit Balance Accounts		

With this information in hand, knowing when to debit or credit just requires knowing three things. The **Type of Account**, whether the account **Increases** or **Decreases,** and the **Account's Normal Balance**.

How To Use and Apply The Debit and Credit Rules:

(1) Determine the types of accounts the transactions affect-asset, liability, revenue, expense or draw account.

(2) Determine the account's normal balance.

(3) Determine if the transaction increases or decreases the account's balance.

(4) Apply the debit and credit rules based on the type of account , its normal balance, and whether the balance of the account will increase or decrease.

What's an **Easy Way To Remember** the **Type Of Accounts** ? Let's revisit the acronym **ALOE-RED.**

<table>
<tr><td>A</td><td>L</td><td>OE</td><td colspan="3" rowspan="2"></td></tr>
<tr><td>|
Assets</td><td>|
Liabilities</td><td>|
Owner's Equity</td></tr>
<tr><td colspan="3" rowspan="2">| ______</td><td>R</td><td>E</td><td>D</td></tr>
<tr><td>Revenue</td><td>Expense</td><td>Draws</td></tr>
</table>

The above diagram is made up of two terms **ALOE** and **RED**. These are the basis for the acronym **ALOE-RED** which helps us remember the major types of accounts. **ALOE**-represents Assets, Liabilities, and Owner's Equity. **RED**-represents Revenues, Expenses, and Draws/Dividends.

Associate these terms with a day at the beach when you get a **RED** sunburn and use **ALOE** (the ointment) to ease the pain.

Now, we have our **Major Types Of Accounts:**

Assets , Liabilities, Owner's Equity, Revenue, Expense, and Draws.

Step 1 is to Identify the Major Type Of Accounts affected by the transaction.

Assets , Liabilities, Owner's Equity, Revenue, Expense, or Draws.

Step 2 is to determine the accounts Normal Balance.

What is a **Normal Balance ?**

The **Normal Balance** is the **debit** or **credit balance** that an account is **expected to have**. The **normal balance** is also the **side of the account** that **increases** the balance of the account.

What's an **Easy Way to Remember** an **Account's Normal Balance** ?

(1) Using our six Major Types of Accounts alphabetize and organize them into two equal Groups

We determined that we have (6) six Major Account Types - Assets , Liabilities, Owner's Equity, Revenue, Expense, and Draws.

Assuming that we wanted to group these 6 (six) account types into 2 (two) equal groups, how many account types would be included in each group ? If my math is correct 6/2 (six divided by two) is equal to 3 (three).

(2) Also assuming that we wanted to **Alphabetize** our account groups, our listing would appear as **Assets, Draws, Expenses, Liabilities, Owner's Equity, and Revenue**.

(3) Now, dividing this listing into our 2 (two) groups with three Account Types in each we have:

Group 1

Assets, Draws, and Expenses

This group is the types of accounts that normally have a **Debit Balance and Use The Left Side of an Account to increase the Account's Balance**.

Group 2

Liabilities, Owner's Equity, and Revenue

This group is the types of accounts that normally have a **Credit Balance and use the Right Side of an Account to increase the Account's Balance**.

Organizing these types of accounts into the two equal groups, we end up with our **Debit Credit Equation** that we discussed earlier.

Assets	+ Draws	+ Expenses	= Liabilities	+ Owner's Equity	+ Revenue

Group 1		Group 2
Left Side	=	Right Side
Normal Balance - Debit	=	Normal Balance - Credit
Debit - Increases		Credit - Increases

Step 3 is to determine whether the balances of the accounts affected by the transaction increase or decrease.

All you have to remember is that:

1. Group 1 types of accounts Assets, Draws, and Expenses all normally have a Debit Balance (Left Side) and their balances are increased by using a Debit and entering the amount on the Left Side of an account.

2. Group 2 types of accounts Liabilities, Owner's Equity, and Revenue all normally have a Credit Balance (Right Side)and their balances are increased by using a Credit and entering the amount on the Right Side of an account.

3. Just use the other term (reverse) to record the decrease for each group. In other words, if a debit (left side) increases the balance of a type of account in the group, then a credit (right side) is going to decrease the balance of the type of account in the group. Likewise, if a credit (right side) increases the balance of a type of account in the group, then a debit (left side) is going to decrease the balance of the type of account in the group.

Step 4 you apply the debit and credit rules based on the type of account , its normal balance, and whether the balance of the account will increase or decrease.

The **Normal Balance Of An Account** determines whether a Debit or Credit **Increases** an Account's Balance.

Debit and Credit Rule

If the Normal Balance Side of an Account is the Left Side - Debit Side a Debit increases the balance of the Account. If the Normal Balance Side of an Account is the Right Side - Credit Side a Credit increases the balance of the Account.

Additional Explanation

In other words,

If the **Normal Balance** of an Account is a **Debit (Left Side)**, enter the amount on the **Left Side as a**

Debit to Increase the Account's Balance.

- Assets
- Draws
- Expenses

What does a **Credit** Do ? The opposite of course, enter the amount on the **Right Side as a Credit to Decrease** the Account's Balance.

If the **Normal Balance** of an Account is a **Credit (Right Side)**, enter the amount on the **Right Side as a Credit to Increase** the Account's Balance.

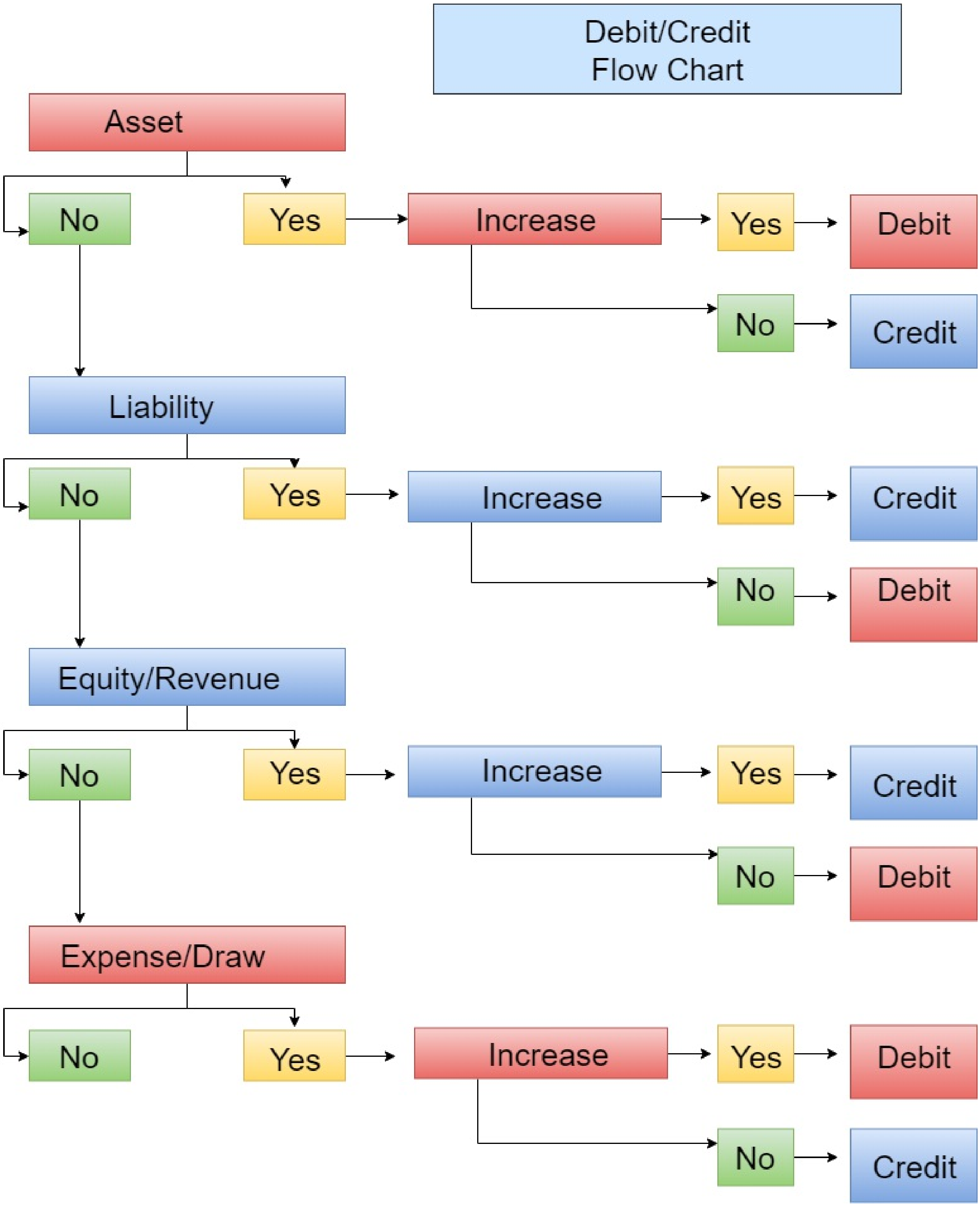
- Liability
- Owner's Equity
- Revenue

What does a **Debit** Do ? The opposite of course, enter the amount on the **Left Side as a Debit to Decrease** the Account's Balance.

Debit and Credit Rules Table

Debit and Credit Table			
Type Of Account	Normal Balance	Increases	Decreases
Assets	Debit-Left Side	Debit-Left Side	Credit-Right Side
Liabilities	Credit-Right Side	Credit-Right Side	Debit-Left Side
Owner's Equity	Credit-Right Side	Credit-Right Side	Debit-Left Side
Revenue	Credit-Right Side	Credit-Right Side	Debit-Left Side
Expense	Debit-Left Side	Debit-Left Side	Credit-Right Side
Draws	Debit-Left Side	Debit-Left Side	Credit-Right Side

Debit Credit Flow Chart



Don't worry if you are initially having trouble remembering when to use a debit or credit. When all else fails !

You can Download

Bean Counter's Debit Credit "Cheat Sheet"

and/or

Eventually, the light bulb turns on and you don't even have to think about when to use a debit or credit. It becomes second nature.

So you know !

There are various symbols that are used to indicate Debits and Credits and whether an account's balance is a Debit or a Credit. Ways and symbols you might run across are:

Dr for Debit and Cr for Credit
+ (Plus Sign) for Debit and – (Minus Sign) for Credit
No Bracket for Debit and < > (Brackets) for Credit
No Parentheses for Debit and ( ) (Parentheses) for Credit

Note : The plus (+) and minus (sign) are often used by accounting and bookkeeping programs to indicate debits and credits. Don't get confused and think that the plus sign means an increase or that the minus sign means a decrease. They **do not** . In this case, they are simply symbols that mean either a debit or a credit.

Stay alert and find out next what you should know about Debits and Credits.

What You Should Know

About Debits and Credits

Debits and Credits are actually based on some simple concepts.

So, let's end this lesson with a quick summary.

An Account has an Increase Side (Column) and a Decrease Side (Column).

The Left Side (Column) of an Account is the Debit Side (Column) and the Right Side (Column) of an Account is the Credit Side (Column).

Debits are simply entries in the left column of an account and Credits are simply entries in the right column of an account.

When you record an entry in the Left Side (Column) of an Account this is called Debiting an Account.

When you record an entry in the Right Side (Column) of an Account this is called Crediting an Account.

Debits do not always represent increases to an account's balance. Nor, do they always represent decreases to an account's balance.

Likewise, Credits do not always represent increases to an account's balance. Nor, do they always represent decreases to an account's balance.

Whether a Debit or Credit to an Account is an Increase or Decrease depends on the Type of Account – Asset – Liability – Owner's Equity – Revenue – Expense – Draw.

A credit to a particular type of account always does the opposite that a debit does. In other words – if a debit increases an account's balance a credit decreases the account's balance or vice versa – if a debit decreases an account's balance a credit increases the account's balance.

All Accounts have a Normal Balance which is either a Debit Balance or a Credit Balance.

Assets, Draws, and Expenses all have Normal Debit Balances.

Liabilities, Owner's Equity (Capital), and Revenue all have Normal Credit Balances.

When using the double entry bookkeeping system, the sum of the debits must equal the sum of the credits for a transaction to be in balance.

Every transaction must have a dollar entry entered on the left side of an account(s) and a dollar entry entered on the right side of an account(s).

When calculating an Account's Balance, Debits are always added together and Credits are always added together; but a Debit and Credit are subtracted from each other.

Just as you have a left and right side of the accounting equation, you also have a left and right side of an account.

Every transaction involves at least one debit and one equal offsetting credit. If a transaction has more than one debit and/or credit, the total of the debits must equal the total of the credits. This is called a compound entry.

The term Debit should not be associated with good or bad.

Likewise the term Credit should not be associated with good or bad.

If we properly use debits and credits to record and summarize our bookkeeping records, our Debits will always equal our Credits and provide some assurance that our records are accurate.

Debits and Credits are crucial concepts to understanding bookkeeping. I hope you've been paying attention and haven't let this lesson go in one ear and out the other.

Up until now, we've been using the Major Types of Accounts (Assets, Liabilities, Owner's Equity, Revenue, Expenses, and Draws) in our discussions and analyses. In our remaining lessons, we'll be using the detail accounts that make up the major types of accounts such as Cash, Accounts Receivable, Accounts Payable, etc. in our discussions and analyses.

Keep in mind the ole sayings "Out Of Confusion Comes Knowledge" and "Practice Makes Perfect" .

Quick Review

Quick Review Of Terms & Concepts

If you thought you we're going to be able to sit back and relax on the beach, I'm sorry to disappoint you. I'm the only one currently entitled to this luxury (I already know bookkeeping but you're getting there).

Let’s reflect a little on what we’ve covered so far. In prior lessons we:

- Discussed the types of business organizations, types of business activities, users of financial information, bookkeeping systems, accounting rules, and the cash and accrual basis of accounting.
- Introduced you to some of the terminology and definitions used in the accounting and bookkeeping language.
- Explained the Accounting Equations, double entry bookkeeping, and how business transactions affect the equation.
- Introduced and explained Debits and Credits and how they affect the Accounting Equation and are used to record business transactions.

If you feel you need a refresher on any of these topics now would be a good time to review any prior lessons before continuing on.

Important Terms & Concepts

Let's get ready for recording transactions in future lessons by reviewing some important terms and concepts.

Account -a separate record for each type of asset, liability, equity, revenue, and expense used to show the beginning balance and to record the increases and decreases for a period and the resulting ending balance at the end of a period. Any detail type of asset, liability, equity, revenue, and expense accounts that our business needs or wants to track have their own separate and individual account.

Major Types or Groups Of Accounts

Assets - Liabilities - Owner's Equity - Revenue - Expense - Draws

A	L	OE			
| Assets	| Liabilities	| Owner's Equity			
		| ____	R	E	D
			Revenue	Expense	Draws

The above diagram is made up of two terms **ALOE** and **RED**. These are the basis for the acronym **ALOE-RED** which helps us remember the major types of accounts. **ALOE**-represents Assets, Liabilities, and Owner's Equity. **RED**-represents Revenues, Expenses, and Draws/Dividends.

Associate these terms with a day at the beach when you get a **RED** sunburn and use **ALOE** (the ointment) to ease the pain.

Detail Accounts

Detail Accounts are the accounts that are actually used to record a business's transactions. Some examples are Cash, Accounts Receivable, Accounts Payable, Sales, Utility Expense, Rent, etc.

Chart Of Accounts

The Chart of Accounts is a codedl listing of all the detail accounts in the General Ledger.

Accounting Equation is also referred to as the **Balance Sheet Equation**.

The equation may be expressed in three forms:

1. Abbreviated or Simple Version:

Property = Property Rights

2. Expanded Version:

Assets = Liabilities + Owner's Equity (Capital)

3. Fully Expanded Version:

Assets = Liabilities + Beginning Owner's Equity (Capital) + Additional Owner Investments + Revenues – Expenses – Draws

Debits and Credits

Rules for Debits and Credits that we will use in the next Lesson were just covered. If you've slept since then, the following procedure is what you use in order to use and apply the Debit and Credit Rules when recording bookkeeping transactions.

Debit Credit Equation = Assets + Expenses + Draws = Liabilities + Beginning Equity + Revenue

How To Use and Apply The Debit and Credit Rules:

(1) Determine the type of account(s) the transactions affect-asset, liability, revenue, or expense account.

(2) Determine the Account's Normal Balance

(3) Determine if the transaction increases or decreases the account's balance.

(4) Apply the debit and credit rules based on the type of account, its normal balance, and whether the balance of the account will increase or decrease.

The **Normal Balance Of An Account** determines whether a Debit or Credit **Increases** an Account's Balance.

Debit and Credit Rule

If the Normal Balance Side of an Account is the Left Side - Debit Side a Debit increases the balance of the Account. If the Normal Balance Side of an Account is the Right Side - Credit Side a Credit increases the balance of the Account.

Additional Explanation

In other words,

If the **Normal Balance** of an Account is a **Debit (Left Side)**, enter the amount on the **Left Side as a Debit to Increase** the Account's Balance.

- Assets
- Draws
- Expenses

What does a **Credit** Do ? The opposite of course, enter the amount on the **Right Side as a Credit to Decrease** the Account's Balance.

If the **Normal Balance** of an Account is a **Credit (Right Side)**, enter the amount on the **Right Side as a Credit to Increase** the Account's Balance.

- Liability
- Owner's Equity
- Revenue

What does a **Debit** Do ? The opposite of course, enter the amount on the **Left Side as a Debit to Decrease** the Account's Balance.

Debit and Credit Rules Table

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Type Of Account	Normal Balance	Increases	Decreases
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Revenue	Credit-Right Side	Credit-Right Side	Debit-Left Side
Expense	Debit-Left Side	Debit-Left Side	Credit-Right Side
Draws	Debit-Left Side	Debit-Left Side	Credit-Right Side

OK, Break Time is over ! Back to the grind and continuing with our next Lesson Sample Business Transactions.

Next Lesson

Debit/Credit Tests

Sample Business Transactions

In this lesson and future lessons we are going to stray away from analyzing and recording transactions using the **"Big Accounts"** and start using the **detail accounts** to record and analyze our business transactions.

Let's take a step in this direction by setting up a simple chart of accounts for ABC Mowing.

Simple Chart Of Accounts For ABC Mowing

Assets

Account Name:Cash
Description:Currency and checks and balance in bank

Account Name:Accounts Receivable
Description:Amounts due from customer's for services rendered

Account Name:Inventory-Office Supplies
Description:On hand supplies of such items as copier & computer paper, pens, pencils and other office supplies

Account Name:Mowing Equipment
Description:Mowers purchased

Liabilities

Account Name:Accounts Payable
Description:Amounts owed suppliers for business purchases and expenses

Account Name:Note Payable-Bank
Description:Mortgages and loans owed to bank

Equity

Account Name:Owner’s Capital
Description:Amounts invested by owner and earned by operations

Account Name:Owner’s Draws
Description:Amounts withdrawn by owner for personal expenses

Revenue

Account Name:Mowing Revenues
Description:Earnings from mowing yards

Expenses

Account Name:Advertising Expense
Description:Expenditures for TV, radio, newspaper, and other promotions.

Account Name:Mulch Expense
Description:Expenditures for mulch used for yard work

These our the **Detail Accounts** that we'll be using to record **ABC Mowing's Transactions** in future Lessons.

Source Documents

The original sources of information that provide documentation (proof) that a transaction has occurred are sales invoices (tickets), invoices from suppliers, contracts, checks written and checks received , promissory notes, and various other types of business documents. These documents provide us with the information needed to record our financial transactions in our bookkeeping records.

Typical Examples of Source Documents:

Invoice-a business document showing the names and addresses of the buyer and the seller; the date and terms of the sale; the description, quantity, unit price, and total price of goods purchased or sold and the method of delivery.

Selling business refers to this document as a Sales Invoice.

Buying business refers to this document as a Supplier Invoice.

Receiving Report-A document originated by the buying business listing the quantities and condition of the goods and/or services received from a supplier.

Sales Order-A documented originated by the seller listing the goods and/or services ordered by a customer and other information such as prices and delivery dates.

Purchase Order-A document originated by the purchaser (buyer) requesting the supplier to ship goods or perform services.

Check Book-Formal record of all checks written, deposits, bank charges, and miscellaneous charges and credits.

Check-A written order directing a bank to pay cash from the account of the writer (drawer) of the check.

Typical Types Of Business Transactions and the Debits and Credits and Accounts Used To Record Them

In a typical business transaction we get something and we give up something.

Sale-Sell goods and/or services

Cash Sale-customer pays at the time of sale

The business gets cash or a check from their customer and gives up a product or service

to their customer.

Accounts Used:

Debit: Cash

Credit: Sales

On Account Sale-business allows the customer time to pay

The business gets a promise to pay from their customer and gives up a product or service

to their customer.

Accounts Used:

Debit: Accounts Receivable

Credit: Sales

Purchase goods and/or services

Cash Purchase-business pays the supplier at the time of purchase

The business gets a product or service from their supplier and gives up cash or a check

to their supplier.

Accounts Used:

Debit: Expense or Inventory Account

Credit: Cash

On Account Purchase-supplier allows the business time to pay

The business gets a product or service from a supplier and gives up a promise to pay to their supplier.

Accounts Used:

Debit: Expense or Inventory Account

Credit: Accounts Payable

Pay Supplier Charge Purchases -pay suppliers for products and/or services that we promised to pay for later (charge).

The business gets the amount of their promise to pay the supplier reduced and gives up cash or a check.

Accounts Used:

Debit: Accounts Payable

Credit: Cash

Receive Customer Charge Payments -receive payments from a customer that promised to pay us later (charge sale).

The business gets cash or a check from their customer and gives up (reduces the amount of) their customer's promise to pay.

Accounts Used:

Debit: Cash

Credit: Accounts Receivable

Borrow Money (Loans) –receive loan from a creditor with payment terms

The business gets cash or equipment and gives up a promise to pay.

Accounts Used:

Debit: Cash or Equipment

Credit: Note Payable

Repay a Loan – business makes payments to creditor

The business gets the amount of their promise to pay reduced and gives up cash or a check.

Accounts Used:

Debit: Note Payable

Credit: Cash

Draw -payments made to owner(s)

The business gets the owner's claim to the business assets reduced and gives up cash or a check.

Accounts Used:

Debit: Owner's Draw

Credit: Cash

Payroll (not covered in this tutorial)

The business gets services from their employees and gives up a check.

Accounts Used:

Debit: Salary & Wages Expense

Credit: Cash

Let's get some practice by analyzing and recording
ABC's Transactions

Recording ABC Transactions

Now, I think we should be ready to revisit our ABC Mowing Company and record the transactions presented in prior lessons in our detailed accounts.

We are going to assume that ABC has beginning balances already recorded in their accounts. These balances are as of December 1, xxxx.

Note: If these balances were as of the beginning of the year the **nominal or temporary accounts** – revenues, expenses, and draws would all have zero balances.

Lastly, we are going to thoroughly review each transaction for December xxxx and show you the hows and whys to properly recording each transaction and present the steps for properly analyzing and recording a transaction.

ABC's Beginning Account Balances as of December 1, xxxx

Assets		Liabilities		Equity	
Cash	$5,500 **Dr**	Accounts Payable	$2,000 **Cr**	Owner's Capital	$7,500 **Cr**
Accounts Receivable	$1,600 **Dr**			Mowing Revenue	$1,000 **Cr**
Mowing Equipment	$2,500 **Dr**			Advertising Expense	$200 **Dr**
Inventory-Office Supplies	$-0-			Mulch Expense	$100 **Dr**
				Owner Draws	$600 **Dr**

Notice I used the symbols **Dr** and **Cr** to abbreviate the Debit and Credit balances in the table of ABC's beginning balances. While this is a common method of representing debits and credits, other symbols that we discussed earlier are also used.

You'd better check me out to see if our books balance before we start recording ABC's transactions. We're going to perform two checks that relate to what we've been learning in prior lessons.

The first check is to see if our **Accounting Equation** balances and the second to make sure that the **debit balances equal the credit balances**.

Equation Check Calculations

Total Assets = Cash + Accounts Receivable + Mowing Equipment

Total Assets = 5,500 + 1,600 + 2,500

Total Assets = 9,600

Total Liabilities is easy because there is only one account (Accounts Payable) with a balance of 2,000.

Total Liabilities = 2,000

Total Equity = Owner's Capital + Revenues – Expenses – Draws

Since we have more than one expense let's summarize them before we use them in our equation.

Total Expenses = Mulch Expense + Advertising

Total Expenses = 100 + 200

Total Expenses = 300

Total Equity = Owner's Capital + Revenues – Expenses – Draws

Total Equity = 7,500 + 1000 – 300- 600

Total Equity = 7,600

Substituting our totals into the Accounting Equation we find that our equation balances.

Assets = Liabilities + Owner's Equity

9,600 = 2,000 + 7,600

Our second check is to see if our debit account balances equal our credit account balances.

Debit Balances	
Cash	5,500
Accounts Receivable	1,600
Mowing Equipment	2,500
Advertising Expense	200
Mulch Expense	100
Owner's Draw	600
Total Debits	10,500
Credit Balances	
Accounts Payable	2,000
Owner's Capital	7,500
Mowing Revenue	1,000
Total Credits	10,500

It looks like we passed muster again. Debit Balances do equal Credit Balances.

Let's revisit that mowing business once again. This time we're going to record our transactions using our detail type of accounts such as Cash, Accounts Receivable, Mowing Equipment, Mowing Revenues, etc. to record our transactions.

We will discuss each transaction and "post" the entry to the appropriate General Ledger Account (T-Account). Keep in mind that each entry will have a debit and a credit.

If you recall, a **T-Account** is a skeleton outline of a formal account which provides the same basic data as a formal ledger account. They are normally used as a teaching aid. In a later lesson we'll be using formal ledger accounts. The following is what the T-Accounts look like.

Notice that Assets, Draws, and Expense Type of Accounts are increased using the Left Side (Column) of the account (debited) and decreased using the Right Side (Column) of the account (credited).

The reverse is true for the Liability, Equity, and Revenue Type of Accounts. These Type Of Accounts are increased using the Right Side (Column) of the account (credited) and decreased using the Left Side (Column) of the account (debited).

Asset Accounts
Account Name

Increase Debit	Decrease Credit
Left Side or Debit Side of Account	Right Side or Credit Side of Account

Liability Accounts
Account Name

Decrease Debit	Increase Credit
Left Side or Debit Side of Account	Right Side or Credit Side of Account

Equity (Capital) Accounts
Account Name

Decrease Debit	Increase Credit
Left Side or Debit Side of Account	Right Side or Credit Side of Account

Revenue Accounts
Account Name

Decrease Debit	Increase Credit
Left Side or Debit Side of Account	Right Side or Credit Side of Account

Expense Accounts
Account Name

Increase Debit	Decrease Credit
Left Side or Debit Side of Account	Right Side or Credit Side of Account

Draw Accounts
Account Name

Increase Debit	Decrease Credit
Left Side or Debit Side of Account	Right Side or Credit Side of Account

Detail Transaction Information

For each transaction for ABC Mowing, we will identify the Source Document, Type Of Transaction, Accounts Affected, and determine and explain the Debits and Credits needed to properly record and post to our General Ledger (T-Accounts).

Entry 1

1. ABC mows a client’s yard and receives a check from the customer for $50 for the service provided.

Source Document:Customer’s Check

Type Of Transaction:Cash Sale

Accounts Affected:Cash Sales

Debits and Credits:

Increase (Left Side) Cash: Debit

Increase (Right Side) Mowing Revenue (Sales): Credit

Explanation Using Our Debit/Credit Rules:

The Asset Account Cash is increased. An increase is recorded by entering the amount in the normal balance side of an account. The normal balance side of cash, which is an asset, is the left (debit) side of the account so we increase cash by entering the amount in the left side as a debit.

The Revenue Account Mowing Revenue (Equity) is also increased. Again, an increase is recorded by entering the amount in the normal balance side of an account. The normal balance side of a revenue account is the right (credit) side of the account so we increase mowing revenue (sales) by entering the amount in the right side as a credit.

Asset Account
Cash

Increase Debit		Decrease Credit
Beg Bal.	5,500	
(1)	50	

Revenue (Equity) Account
Mowing Revenues

Decrease Debit	Increase Credit	
	Beg Bal.	1,000
	(1)	50

Entry 2

2. ABC purchases $100 worth of office supplies and stores them in their storage room. The office supply store gives them an invoice that allows them to pay for them in 15 days (on account).

Source Document:Supplier’s Invoice

Type Of Transaction:On Account Purchase

Accounts Affected:Inventory-Office Supplies Accounts Payable

Debits and Credits:

Increase (Left Side) Inventory-Office Supplies: Debit

Increase (Right Side) Accounts Payable: Credit

Explanation Using Our Debit/Credit Rules:

The Asset Account Inventory-Office Supplies is increased. An increase is recorded by entering the amount in the normal balance side of an account. The normal balance side of inventory-office supplies, which is an asset, is the left (debit) side of the account so we increase inventory-office supplies by entering the amount in the left side as a debit.

The Liability Account Accounts Payable is also increased. Again, we record an increase by entering the amount in the normal balance side of an account. The normal balance side of accounts payable, which is a liability, is the right (credit) side of the account so we increase accounts payable by entering the amount in the right side as a credit.

Asset Account
Inventory-Office Supplies

Increase Debit		Decrease Credit	
(2)	100		

Liability Account
Accounts Payable

Decrease Debit		Increase Credit	
		Beg Bal.	2,000
		(2)	100

Entry 3

3. ABC places an ad in the local newspaper receives the invoice from the supplier and writes a check for $25 to the newspaper.

Source Document:Supplier's Invoice and Company Check

Type Of Transaction:Cash Purchase

Accounts Affected:Advertising Expense (Equity)   Cash

Debits and Credits:

Increase (Left Side) Advertising Expense (Decrease Equity): Debit

Decrease (Right Side) Cash: Credit

Explanation Using Our Debit/Credit Rules:

The Expense Account Advertising Expense is increased. An increase is recorded by entering the amount in the normal balance side of an account. The normal balance side of advertising expense, which is an expense account, is the left (debit) side so we increase advertising expense by entering the amount in the left side as a debit.

The Asset Account Cash is decreased.

We record a decrease by entering the amount in the opposite side of the normal balance side of an account. The normal balance side of cash, which is an asset, is the left (debit) side so we decrease cash by entering the amount in the opposite side which is the right (credit) side of the account as a credit.

Some additional clarification might be useful in order to clarify why an expense is recorded as an increase with a debit. The actual amount of the advertising expense has increased. The business now has spent more for advertising. More expenses are not what a business or an individual wants. Increased personal expenses reduce our personal equity and likewise increased business expenses reduce the owner's equity of a business.

Since an increase in an expense reduces equity it is recorded as an increase using a debit.

Asset Account
Cash

Increase Debit		Decrease Credit	
Beg Bal.	5,500	(3)	25
(1)	50		

Expense (Equity) Account
Advertising Expense

Increase Debit		Decrease Credit	
Beg Bal.	200		
(3)	25		

Entry 4

4. ABC purchases five mowers for $10,000 and finances them with a note from the local bank.

Source Document:Bank Note

Type Of Transaction:Borrow Money

Accounts Affected:Mowing Equipment   Note Payable-Bank

Debits and Credits:

Increase (Left Side) Mowing Equipment: Debit

Increase (Right Side) Note Payable-Bank: Credit

Explanation Using Our Debit/Credit Rules:

The Asset Account Mowing Equipment is increased. An increase is recorded by entering the amount in the normal balance side of an account. The normal balance side of mowing equipment, which is an asset account, is the left (debit) side so we increase mowing equipment by entering the amount in the left side as a debit.

The Liability Account Note Payable-Bank is also increased. Again, an increase is recorded by entering the amount in the normal balance side of an account. The normal balance side of note payable-bank, which is a liability account, is the right (credit) side , so we increase note payable-bank by entering the amount in the right side as a credit.

Asset Account
Mowing Equipment

Increase Debit		Decrease Credit	
Beg Bal.	2,500		
(4)	10,000		

Liability Account
Note Payable-Bank

Decrease Debit		Increase Credit	
		(4)	10,000

Entry 5

5. ABC mows another customer's yard and sends the customer a $75 bill (invoice) for the service they performed. They allow their customer ten (10) days to pay them for this service (on account).

Source Document:Sales Invoice

Type Of Transaction:On Account Sale

Accounts Affected:Accounts Receivable Mowing Revenue (Sales)

Debits and Credits:

Increase (Left Side) Accounts Receivable: Debit

Increase (Right Side) Mowing Revenue (Sales): Credit

Explanation Using Our Debit/Credit Rules:

The Asset Account Accounts Receivable is increased. An increase is recorded by entering the amount in the normal balance side of an account. The normal balance side of accounts receivable, which is an asset, is the left (debit) side of the account so we increase accounts receivable by entering the amount in the left side as a debit.

The Revenue Account Mowing Revenue (Equity) is also increased. Again, an increase is recorded by entering the amount in the normal balance side of an account. The normal balance side of a revenue account is the right (credit) side of the account so we increase mowing revenue (sales) by entering the amount in the right side as a credit.

Asset Account Accounts Receivable			
Increase Debit		Decrease Credit	
Beg Bal.	1,600		
(5)	75		

Revenue (Equity) Account Mowing Revenues			
Decrease Debit		Increase Credit	
		Beg Bal.	1,000
		(1)	50
		(5)	75

Entry 6

6. The owner of ABC needs a little money to pay some personal bills and writes himself a check for $500.

Source Document:Check

Type Of Transaction:Draw

Accounts Affected:Cash   Draw

Debits and Credits:

Increase (left Side)Owner's Draw (Decrease Equity): Debit

Decrease (Right Side) Cash: Credit

Explanation Using Our Debit/Credit Rules:

The Draw Account Owner's Draw is increased. An increase is recorded by entering the amount in the normal balance side of an account. The normal balance side of owner's draw, which is a draw account, is the left (debit) side so we increase owner's draw by entering the amount in the left side as a debit.

The Asset Account Cash is also decreased. We record a decrease by entering the amount in the opposite side of the normal balance side of an account. The normal balance side of cash, which is an asset, is the left (debit) side so we decrease cash by entering the amount in the opposite side which is the right (credit) side of the account as a credit.

Asset Account
Cash

Increase Debit		Decrease Credit	
Beg Bal.	5,500	(3)	25
(1)	50	(6)	500

Draw (Equity) Account
Owner's Draw

Increase Debit		Decrease Credit	
Beg Bal.	600		
(6)	500		

Entry 7

7. ABC pays the office supply company $100 with a check for the office supplies that they charged (promised to pay).

Source Document:Check

Type Of Transaction:Pay Supplier Charge Purchases

Accounts Affected:Cash   Accounts Payable

Debits and Credits:

Decrease (Left Side) Accounts Payable: Debit

Decrease (Right Side) Cash: Credit

Explanation Using Our Debit/Credit Rules:

The Asset Account Cash is decreased. We record a decrease by entering the amount in the opposite side of the normal balance side of an account. The normal balance side of cash, which is an asset, is the left (debit) side so we decrease cash by entering the amount in the opposite side which is the right (credit) side of the account as a credit.

The Liability Account Accounts Payable is also decreased. We record a decrease by entering the amount in the opposite side of the normal balance side of an account. The normal balance side of accounts payable, which is a liability, is the right (credit) side so we decrease accounts payable by entering the amount in the opposite side which is the left (debit) side of the account as a debit.

Asset Account
Cash

Increase Debit		Decrease Credit	
Beg Bal.	5,500	(3)	25
(1)	50	(6)	500
		(7)	100

Liability Account
Accounts Payable

Decrease Debit		Increase Credit	
(7)	100	Beg Bal.	2,000
		(2)	100

Entry 8

8. ABC receives a check from the customer who they billed (invoiced) $75 for services and allowed 10 days to pay.

Source Document:Customer Check

Type Of Transaction:Receive Customer Charge Payments

Accounts Affected:Cash Accounts Receivable

Debits and Credits:

Increase (Left Side) Cash: Debit

Decrease (Right Side) Accounts Receivable: Credit

Explanation Using Our Debit/Credit Rules:

The Asset Account Cash is increased. An increase is recorded by entering the amount in the normal balance side of an account. The normal balance side of cash, which is an asset, is the left (debit) side of the account so we increase cash by entering the amount in the left side as a debit.

Another Asset Account, Accounts Receivable decreased. We record a decrease by entering the amount in the opposite side of the normal balance side of an account. The normal balance side of accounts receivable, which is an asset, is the left (debit) side so we decrease accounts receivable by entering the amount in the opposite side which is the right (credit) side of the account as a credit.

We actually “swapped” one asset accounts receivable for another asset cash.

Asset Account
Cash

Increase Debit		Decrease Credit	
Beg Bal.	5,500	(3)	25
(1)	50	(6)	500
(8)	75	(7)	100

Asset Account
Accounts Receivable

Increase Debit		Decrease Credit	
Beg Bal.	1,600	(8)	75
(5)	75		

Entry 9

9. ABC purchased some mulch for $60 and received an invoice from their supplier who allows them 15 days to pay. The mulch was used on a customer’s yard.

Source Document:Supplier's Invoice

Type Of Transaction: Purchase on Account

Accounts Affected:Mulch Expense   Accounts Payable

Debits and Credits:

Increase (Left Side) Mulch Expense (Decrease Equity): Debit

Increase (Right Side) Accounts Payable: Credit

Explanation Using Our Debit/Credit Rules:

The Expense Account Mulch Expense is increased. An increase is recorded by entering the amount in the normal balance side of an account. The normal balance side of mulch expense, which is an expense account, is the left (debit) side so we increase mulch expense by entering the amount in the left side as a debit.

The amount owed to a supplier also increased.

The Liability Account Accounts Payable is increased. An increase is recorded by entering the amount in the normal balance side of an account. The normal balance side of accounts payable, which is a liability, is the right (credit) side of the account so we increase accounts payable by entering the amount in the right side as a credit.

Liability Account
Accounts Payable

Decrease Debit		Increase Credit	
(7)	100	Beg Bal.	2,000
		(2)	100
		(9)	60

Expense (Equity) Account
Mulch Expense

Increase Debit		Decrease Credit	
Beg Bal.	100		
(9)	60		

Entry 10

10. ABC bills (prepares an invoice) the customer $80 for the mulch and mowing his yard and receives a check for $80 from the customer.

Source Document:Sales Invoice and Customer Check

Type Of Transaction:Cash Sale

Accounts Affected:Cash   Mowing Revenue (Sales)

Debits and Credits:

Increase (Left Side) Cash: Debit

Increase (Right Side) Mowing Revenue (Equity): Credit

Explanation Using Our Debit/Credit Rules:

The Asset Account Cash is increased. An increase is recorded by entering the amount in the normal balance side of an account. The normal balance side of cash, which is an asset, is the left (debit) side of the account so we increase cash by entering the amount in the left side as a debit.

The Revenue Account Mowing Revenue (Equity) is also increased. Again, an increase is recorded by entering the amount in the normal balance side of an account. The normal balance side of a revenue account is the right (credit) side of the account so we increase mowing revenue (sales) by entering the amount in the right side as a credit.

Asset Account
Cash

Increase Debit		Decrease Credit	
Beg Bal.	5,500	(3)	25
(1)	50	(6)	500
(8)	75	(7)	100
(10)	80		

Revenue (Equity) Account
Mowing Revenue

Decrease Debit		Increase Credit	
		Beg Bal.	1,000
		(1)	50
		(5)	75
		(10)	80

ABC’s Calculated Ending Account Balances After Posting

Me, being the nice guy that I am, calculated the ending account balances for you.

Assets		Liabilities		Equity	
Cash	5,080 **Dr**	Accounts Payable	2,060 **Cr**	Owner's Capital	7,500 **Cr**
Accounts Receivable	1,600 **Dr**	Note Payable-Bank	10,000 **Cr**	Mowing Revenue	1,205 **Cr**
Mowing Equipment	12,500 **Dr**			Advertising Expense	225 **Dr**
Inventory-Office Supplies	100 **Dr**			Mulch Expense	160 **Dr**

				Owner Draws	1,100 **Dr**

Let's perform our checks on our ending balances after posting.

The first check is to see if our Accounting Equation balances and the second to make sure that the debit balances equal the credit balances.

Equation Check Calculations

Total Assets = Cash + Accounts Receivable + Mowing Equipment +Office Supplies

Total Assets = 5,080 + 1,600 + 12,500 + 100

Total Assets = 19,280

Total Liabilities = Accounts Payable + Notes Payable

Total Liabilities = 2,060 + 10,000

Total Liabilities = 12,060

Total Equity = Owner's Capital + Revenues – Expenses – Draws

Since we have more than one expense let's summarize them before we use them in our equation.

Total Expenses = Mulch Expense + Advertising

Total Expenses = 160 + 225

Total Expenses = 385

Total Equity = Owner's Capital + Revenues – Expenses – Draws

Total Equity = 7,500 + 1205 – 385- 1100

Total Equity = 7,220

Substituting our totals into the Accounting Equation we find that our equation balances.

Assets = Liabilities + Owner's Equity

19,280 = 12,060   + 7,220

Our second check is to see if our debit account balances equal our credit account balances.

Let's Total Our Debit Balances

Debit Balance Accounts	
Cash	5,080
Accounts Receivable	1,600
Mowing Equipment	12,500
Inventory-Office Supplies	100
Advertising Expense	225
Mulch Expense	160
Owner's Draw	1,100
Total Debits	20,765

Now, we'll Total Our Credit Balances

Credit Balance Accounts	
Accounts Payable	2,060
Note Payable-Bank	10,000
Owner's Capital	7,500
Mowing Revenue	1,205
Total Credits	20,765

Looks like everything is still in balance after we posted our transactions.

Assets = Liabilities + Owner’s Equity and our Debit Balance Accounts = our Credit Balance Accounts.

That wasn't too bad was it ? Get a grip on yourself. We still have more lessons to complete. After the Videos and Tests let's tackle the next lesson that covers the General Ledger and Journals.

General Ledger

and Chart Of Accounts

In a prior lesson, we used T-Accounts to record the transactions for ABC, the lawn mowing guys.

What you didn't know at the time is that we were actually recording transactions in **General Ledger Accounts**.

A General Ledger is just a formal set of T-Accounts. Each account that we want to track and keep up with has a separate page or pages maintained in a record book called the General Ledger.

The book is organized into major sections just like the Accounting Equation that we studied in previous lessons. **Do you have any idea what these sections might be ?**

Come on this question is not that hard. The general ledger's major sections are Assets, Liabilities, Owner's Equity, Revenues, Expenses, and Draws.

For each item (account) in our General Ledger, we record the increases and decreases for a period (usually a month) and calculate its ending balance. The ending balance of the account is easily determined by adding the increases and subtracting the decreases from the account's beginning period balance.

Ending Account Balance = Beginning Balance + Increases – Decreases

If you noticed in my above equation I used the terms increases and decreases. If you also recall in our discussion about debits, I tried to stress the fact that when applied to bookkeeping these terms need to be **associated with the types of accounts** .

We also should know by now that the type of accounts have a normal balance that is either a debit or credit balance. So actually the above equation is stated in two ways. The equation is stated one way for debit balance accounts, and another way for credit balance accounts.

Using our bookkeeping terms debits and credits, we come up with the following equations:

Debit Balance Accounts Equation

Ending Account Balance for Normal Debit Balance Accounts = Beginning Balance + Debits(Increases) – Credits(Decreases)

Credit Balance Accounts Equation

Ending Account Balance for Normal Credit Balance Accounts = Beginning Balance + Credits(Increases) – Debits(Decreases)

Simply stated a **General Ledger** is just a book containing the **summarized** financial transactions and balances of the **accounts** for all of a business's assets, liabilities, equity, revenue, and expense accounts.

One other record that goes hand in hand with the general ledger and that we've touched on before and used in a prior lesson is **The Chart Of Accounts** .

Remember The Chart Of Accounts is simply a listing of all the accounts in the general ledger that contains the account's name, a brief description of the account, and usually an account number assigned to aid in recording and tracking transactions.

It's chief purpose is to serve as an aid (reference) for looking up accounts and their associated account numbers.

For this lesson, we expanded our chart of accounts by adding account numbers and grouped the numbers into ranges that represent the major type of accounts.

Chart Of Accounts For ABC Mowing

Note: The charts of accounts used in this tutorial were purposely kept simple and used to illustrate what the chart of accounts is and how it's used. For those of you that are curious, I've provided a detailed list of the accounts you might encounter in the "real" world. Often a numbering system is set up with a range of numbers for assets, liabilities, equity, revenue, and expense accounts.

ABC Mowing Chart Of Accounts **Assets** have a range from 100-199 ; **Liabilities** a range from 200-299; **Equity** a range from 300-399; **Revenues** a range from 400-499; and **Expenses** a range from 500-699.

Chart Of Accounts ABC Mowing

Assets (100-199) Account Name:Cash Account Number:100 Description:Currency , checks, and bank balance	**Equity (300-399)** Account Name:Owner's Capital Account Number:300 Description:Amounts invested by owner and earned by operations
Account Name:Accounts Receivable Account Number:110 Description:Amounts due from customers for services rendered	Account Name:Owner's Draws Account Number:310 Description:Amounts withdrawn by owner for personal expenses
Account Name:Inventory-Office Supplies Account Number:115 Description:On hand supplies of such items as copier & computer paper, pens, and other office supplies	**Revenue (400-499)** Account Name:Mowing Revenues Account Number:400 Description:Earnings from mowing and landscaping
Account Name:Mowing Equipment Account Number:150 Description:Mowers purchased	**Expenses (500-699)** Account Name:Advertising Expense Account Number:510 Description:Expenditures for TV, radio, newspaper, and other promotions
Liabilities (200-299) Account Name:Accounts Payable Account Number:200 Description:Amounts owed suppliers for business purchases and expenses	Account Name:Mulch Expense Account Number:520 Description:Expenditures for mulch used for yard work
Account Name:Note Payable-Bank Account Number:210 Description:Mortgages and loans owed to bank	

Of course most businesses have many more than our eleven accounts we used for our sample ABC business. Can you think of some other accounts that we might need and want ? How about telephone, utilities, professional fees (that's me), salaries & wages, equipment rental, building rental, maintenance & repairs, contract labor, office equipment just to name a few.

Sample Balance Sheet and Income Statement Detail Accounts

Balance Sheet Accounts-PDF

Income Statement Accounts-PDF

Now, let's take a look at what a
Formal Journal and General Ledger Account look like.

General Ledger Journals

General Ledger & Journals

What Information does a General Ledger and General Journal contain ?

Let's take a look at a sample record for each to find out exactly what financial information they provide.

General Ledger

- Name of Account and Account Number
- Date of Posting
- Description-additional notes about the entry if needed
- Posting Reference-journals name (abbreviation) , page, and entry reference
- Amounts of the debits or credits transferred (posted) from the General Journal
- Current Balance of the Account

Sample of a General Ledger Page

The **Posting Reference GJ-1-1** refers to:

GJ-General Journal

1-Page 1

1-Entry Number 1

Account Name:Cash				Account Number:100	
Date	Description	Post Ref	Debit Amount	Credit Amount	Balance
Jan 1,xxxx	Beginning Balance				5000
Jan 5,xxxx		GJ-1-1		1000	4000

Jan 8,xxxx		GJ-1-2	200		4200
Jan 10,xxxx		GJ-1-3		400	3800

Notice that the account has an amount column for debits (left side or first column) and an amount column for credits (right side or second column).

General Journal

Journals are preliminary records where business transactions are first entered into the accounting system. The journal is commonly referred to as the book of original entry.

Specialized Journals-are journals used to initially record special types of transactions such as sales, cash disbursements, and cash receipts in their own journal.

The end result of double entry bookkeeping is having an up to date , in balance, and properly

posted Ledger. In our prior lessons we recorded all our debits and credits (transactions) directly in the General Ledger. This would work for a small business that had very few transactions

but would become unwieldy for most businesses with any volume of activity. By its very definition the General Ledger is supposed to be a summary record of a business's

financial transactions.

It logically follows that since we only want summary amounts in our Ledger we need to record

our detail entries some place else first. What record(s) do we use to do this ? You're right ! Journals are our preliminary records. All our transactions are first entered in a preliminary record called a journal or book of original entry. This process is called journalizing.

After our business transactions have been entered in our journal(s), they are then periodically (usually monthly) summarized and totaled and then transferred (posted) to the General Ledger as summary entries.

What type of information is included in the Journal Record ?

- Entry Number
- Date of each transaction
- Names and/or the account numbers of the accounts to be debited or credited
- Amounts of the debits and credits
- Posting Reference-Account Number in the General Ledger
- Explanation or description of the entry

The journals contain all the chronological (by date) information necessary to record debit and credit amounts in the accounts of the General Ledger.

Sample Of A General Journal Page

General Journal			Page 1		
Entry No	Date	Account Name	Post Ref.	Debit	Credit
GJ-1-1	Jan 5,xxxx	Supplies	502	1000	
		Cash	100		1000
Record Supplies Expense					
GJ-1-2	Jan 8,xxxx	Cash	100	200	
		Sales	300		200
Record Cash Sale					
GJ-1-3	Jan 10,xxxx	Advertising Expense	500	400	
		Cash	100		400
Record Advertising Expense					
GJ-1-4	Jan 20,xxxx	Utilities		650	
		Cash			650
Record Utilities Expense					

Do you notice anything odd about any of our entries in our General Journal ?

Look at entry number 4 (GJ-1-4). It doesn't have a posting reference. Why not ? The answer is simple. Entry Number 4 has not yet been posted to the General Ledger. This is our way of keeping up with what entries have and have not been posted to the General Ledger.

Let's continue by taking a look at **ABC Mowing's Balances**.

The Balances in our Table are the Beginning Balances in **ABC's General Ledger Accounts** presented below.

ABC's Beginning Account Balances as of December 1,xxxx					
Assets		Liabilities		Equity	
Cash	5,500	Accounts Payable	(2,000)	Owner's Capital	(7,500)
Accounts Receivable	1,600			Mowing Revenues	(1,000)

Mowing Equipment	2,500		Advertising Expense	200
			Mulch Expense	100
			Owner Draws	600

Note: Credit Balances are indicated using parentheses ()

ABC Transactions for December xxxx

1. December 2, xxxx ABC mows a client's yard and receives a check # 484 from the customer for $50 for the service provided.

Journal Entry 1 GJ-1-1

2. December 4, xxxx ABC purchases $100 worth of office supplies for inventory and stores them in their storage room. The office supply store gives them an invoice # 983 that allows them to pay for them in 15 days (on account).

Journal Entry 2 GJ-1-2

3. December 8, xxxx ABC places an ad in the local newspaper receives the invoice from the supplier # 555 and writes a check # 900 for $25 to the newspaper.

Journal Entry 3 GJ 1-3

4. December 10, xxxx ABC purchases five mowers for $10,000 and finances them with a note from the local bank.

Journal Entry 4 GJ 1-4

5. December 15, xxxx ABC mows another customer's yard and sends the customer a bill (invoice # 1000) for $75 for the service they performed. They allow their customer 10 days to pay them for this service (on account).

Journal Entry 5 GJ 1-5

6. December 20, xxxx the owner of ABC needs a little money to pay some personal bills and writes himself a check # 901 for $500.

Journal Entry 6 GJ 1-6

7. December 22, xxxx ABC pays the office supply company $100 with a check # 902 for the office supplies that they charged (promised to pay).

Journal Entry 7 GJ 1-7

8. December 27, xxxx ABC receives a check # 55 from the customer who they billed (invoiced) $75 for services and allowed 10 days to pay.

Journal Entry 8 GJ 1-8

9. December 29, xxxx ABC purchased some mulch for $60 and received an invoice # 777 from their supplier who allows them 15 days to pay. The mulch was used on a customer's yard.

Journal Entry 9 GJ 1-9

10. December 31, xxxx ABC bills (prepares an invoice # 1001) the customer $80 for the mulch and mowing his yard and receives a check for $80 from the customer.

Journal Entry 10 GJ 1-10

ABC's General Journal

General Journal			Page 1		
Entry Number	Date	Account Name	Post Ref.	Debit	Credit
GJ-1-1	Dec 2,xxxx	Cash	100	50	
		Mowing Revenue	400		50
Record Customer Check # 484 and revenue from mowing job					
GJ-1-2	Dec 4,xxxx	Inventory-Office Supplies	115	100	
		Accounts Payable	200		100
Record Invoice # 983 for office supplies purchased on account					
GJ-1-3	Dec 8,xxxx	Advertising Expense	510	25	
		Cash	100		25

Record Check # 900 for advertising services					
GJ-1-4	Dec 10,xxxx	Mowing Equipment	150	10000	
		Note Payable-Bank	210		10000
Record purchase of mowing equipment financed by bank note					
GJ-1-5	Dec 15,xxxx	Accounts Receivable	110	75	
		Mowing Revenue	400		75
Record Invoice # 1000 on account to customer for revenue earned mowing yard					
GJ-1-6	Dec 20,xxxx	Owner's Draw	310	500	
		Cash	100		500
Record owner's draw Check # 901					
GJ-1-7	Dec 22,xxxx	Accounts Payable	200	100	
		Cash	100		100
Record Check #902 paid to supplier for office supplies charged on account (Invoice # 983)					
GJ-1-8	Dec 27,xxxx	Cash	100	75	
		Accounts Receivable	110		75
Record Customer's Check # 55 received from customer on account					
GJ--1-9	Dec 29,xxxx	Mulch Expense	520	60	
		Accounts Payable	200		60
Record Invoice # 777 with credit terms for purchase of mulch					
GJ-1-10	Dec 31,xxxx	Cash	100	80	
		Mowing Revenue	400		80
Record Check # 555 received from customer paying our Invoice # 1001 for mowing services					

ABC's General Ledger

Account Name: Cash			Account Number: 100		
Date	Description	Post Ref.	Debit	Credit	Balance
Dec 1	Beg Bal.				5500
Dec 2		GJ-1-1	50		5550
Dec 8		GJ-1-3		25	5525
Dec 20		GJ-1-6		500	5025
Dec 22		GJ-1-7		100	4925
Dec 27		GJ-1-8	75		5000
Dec 31		GJ-1-10	80		5080

Account Name: Accounts Receivable			Account Number: 110		
Date	Description	Post Ref.	Debit	Credit	Balance
Dec 1	Beg Bal.				1600
Dec 15		GJ-1-5	75		1675
Dec 27		GJ-1-8		75	1600

Account Name: Inventory-Office Supplies			Account Number: 115		
Date	Description	Post Ref.	Debit	Credit	Balance
Dec 1	Beg Bal.				0
Dec 4		GJ-1-2	100		100

Account Name: Mowing Equipment			Account Number: 150		
Date	Description	Post Ref.	Debit	Credit	Balance
Dec 1	Beg Bal.				2500
Dec 10		GJ-1-4	10000		12500

Account Name: Accounts Payable			Account Number: 200		
Date	Description	Post Ref.	Debit	Credit	Balance
Dec 1	Beg Bal.				(2000)
Dec 4		GJ-1-2		100	(2100)
Dec 22		GJ-1-7	100		(2000)
Dec 29		GJ-1-9		60	(2060)

Account Name: Note Payable-Bank			Account Number: 210		
Date	Description	Post Ref.	Debit	Credit	Balance
Dec 1	Beg Bal.				0
Dec 10		GJ-1-4		10000	(10000)

Account Name: Owner's Capital			Account Number: 300		
Date	Description	Post Ref.	Debit	Credit	Balance
Dec 1	Beg Bal.				(7500)

Account Name: Owner's Draws			Account Number: 310		
Date	Description	Post Ref.	Debit	Credit	Balance
Dec 1	Beg Bal.				600
Dec 20		GJ-1-6	500		1100

Account Name: Mowing Revenue			Account Number: 400		
Date	Description	Post Ref.	Debit	Credit	Balance
Dec 1	Beg Bal.				(1000)
Dec 2		GJ-1-1		50	(1050)
Dec 15				75	(1125)
Dec 31				80	(1205)

Account Name: Advertising Expense			Account Number: 510		
Date	Description	Post Ref.	Debit	Credit	Balance
Dec 1	Beg Bal.				200
Dec 8		GJ-1-3	25		225

Account Name: Mulch Expense			Account Number: 520		
Date	Description	Post Ref.	Debit	Credit	Balance
Dec 1	Beg Bal.				100
Dec 29		GJ-1-9	60		160

So you know !

There are various symbols that are used to indicate Debits and Credits and whether an account's balance is a Debit or a Credit. Ways and symbols you might run across are:

Dr for Debit and Cr for Credit
+ (Plus Sign) for Debit and – (Minus Sign) for Credit
No Bracket for Debit and < > (Brackets) for Credit
No Parentheses for Debit and ( ) (Parentheses) for Credit

Note : The plus (+) and minus (sign) are often used by accounting and bookkeeping programs to indicate debits and credits. Don't get confused and think that the plus sign means an increase or that the minus sign means a decrease. They **do not** . In this case, they are simply symbols that mean either a debit or a credit.

In this **Lesson**, we illustrated the recording of ABC's transactions in the **General Journal** and the posting -transferring the balances to the the **General Ledger Accounts**.

You have now been introduced to some of bookkeeping and accounting's formal records, namely the General Ledger and General Journal. You could get by with just these two records, but if your business like most has many transactions instead of the few that ABC had you'd be spending a heck of a lot of time recording and posting.

In this course the only Journal we'll use is the **General Journal**.

While you could record all your transactions just using this journal, bookkeeping has a better solution.

What's the solution to streamlining the recording and posting processes.

Special Journals are the solution.

Instead of using just one journal to record all our business transactions we use many. Although this tutorial is not going to discuss the Special Journals in detail, I wanted to make you aware of them and the purpose they serve and the types of transactions recorded using them.

Some **Special Journals** a business will normally have are:

- Cash Receipts Journal
- Cash Disbursements Journal (Check Register)
- Payroll Journal
- Sales Journal
- Purchase Journal
- General Journal

All these journals are designed to record special types of business transactions and post the totals accumulated in these journals to the General Ledger periodically (usually once a month) using a manual system.

For a quick peak at Special Journals

Sorry, no Lesson can be tossed aside so let's learn about
the Trial Balance

Posting Trial Balance

Trial Balance

After transactions have been recorded in the Journals, they are then transferred (posted) to the General Ledger Accounts. After transactions have been posted to the General Ledger, a Trial Balance is prepared.

We used a Trial Balance in an earlier lesson to check our postings. I just didn't tell you at the time. Let's review the formal definition. A **Trial Balance** is a listing of all the accounts appearing in the General Ledger with the dollar amounts of the debit or credit balance of each. It is used to make sure the books are "in balance" - total debits equal total credits.

A Trial Balance is just a **Worksheet** that bookkeepers and accountants prepare from the **General Ledger** to check that the books (General Ledger) are in balance.

Debit Account Balances = **Credit Account Balances**

Let's take a look at ABC's Trial Balance.

ABC Mowing Trial Balance Worksheet		
Account	Debit Balances	Credit Balances
Asset Accounts	5080	
Cash	5080	
Accounts Receivable	1600	
Inventory-Office Supplies	100	
Mowing Equipment	12500	

Liability Accounts		
Accounts Payable		2060
Note Payable-Bank		10000
Equity Accounts		
Owner's Capital		7500
Owner Draws	1100	
Revenue Accounts		
Mowing Revenue		1205
Expense Accounts		
Mulch Expense	160	
Advertising Expense	225	
Totals	20765	20765

As you can see, the **Debit Balance** Accounts equal the **Credit Balance** Accounts.

Normal Balances for the Types of Accounts

Just to keep you on your toes - do you recall what type of accounts normally have a debit or credit balance ?

- Assets, Expenses, and Draws normally have Debit Balances.

- Liabilities, Owner's Capital, and Revenue accounts normally have Credit Balances.

Need proof ?
Refer back to our preceding Trial Balance for ABC. The Trial Balance has a column for Debit Balance Accounts and a column for Credit Balance Accounts.

Sure enough, our Assets, Owner's Draws, and Expense Type of Accounts are listed in the Debit Balance Column. Likewise, our Liability, Owner's Capital, and Revenue Type of Accounts are listed in the Credit Balance Column.

How do you initially determine that an Account has a Debit or Credit Balance ? This is simply a matter of determining if the Account has more Debit Amounts Posted or More Credit Amounts Posted. If More Debits Than Credits have been posted to the Account, the Account will have a **Debit Balance**. Likewise, if More Credits Than Debits have been posted to the Account, the Account will have a **Credit Balance**.

We'll use **ABC's Trial** Balance later to prepare our **Formal Financial Statements**.

Before we move on to the next lesson, since they say that a picture’s worth a thousand words, let’s use a picture to illustrate the flow of information (business transactions) into our bookkeeping records.

You're right **Financial Statements** have not yet been discussed; but, guess what's coming next ?

Bookkeeping's Flow Of Information

Source Documents Provide the initial data about business transactions

Journals Use the information from the Source Documents to create a chronological listing of all business transactions and detailed information about each transaction

General Ledger Uses the information transferred from the Journal(s) to summarize the data into individual accounts

Trial Balance Uses the information from the General Ledger to summarize and check the data to use for preparing Financial Statements
Financial Statements Uses the summarized data contained in the Trial Balance to prepare the business's Financial Reports

After the Videos and Tests get ready to see how you can determine if a business is Sick or Well with Financial Statements

Formal Financial Statements

The objective of this lesson is not so much a how to do it; but, to inform, introduce, and make you aware of the basic financial statements.

Let's start this lesson by reviewing a few definitions.

Financial Statements are summary accounting reports prepared periodically to inform the owner, creditors, and other interested parties as to the financial condition and operating results of the business.

The four basic financial statements or reports are:

Balance Sheet -The financial statement which shows the amount and nature of business's assets, liabilities, and owner's equity as of a specific point in time. It is also known as a Statement Of Financial Position or a Statement Of Financial Condition.

Income Statement -The financial statement that summarizes revenues and expenses for a specific period of time, usually a month or a year. This statement is also called a Profit and Loss Statement or an Operating Statement.

Capital Statement -The financial report that summarizes all the changes in owner's equity that occurred during a specific period.

Cash Flow Statement -The financial statement that reports the sources and uses of cash for a specific period of time, normally a year.

Order Of Preparation

Because some of the statements use information from other statements, the statements are prepared in the following order:

1. Income Statement

2. Capital Statement

Uses Information from the Income Statement

3. Balance Sheet

Uses Information from the Capital Statement

4. Cash Flow Statement

Uses Information from the Balance Sheet

Let's revisit the Trial Balance and how it's used

to prepare the Financial Statements

Hopefully, it balances a lot better than our guy on the highwire.

Trial Balance Worksheet

A Trial Balance/Worksheet that we discussed earlier is prepared from the General Ledger. The balances are taken from the General Ledger and listed in this Trial Balance Worksheet in the order of the accounting equation.

Asset balances are listed first; followed by Liabilities; and then Owner's Equity ("Ma Capital"); and finally her "kids" Revenues and Expenses.

Once you have a Trial Balance it's simply a matter of transferring the amounts from the Trial Balance to use to prepare the Balance Sheet, Income Statement, and Capital Financial Statements. Add in the prior year's balance sheet and you have the information needed for preparing the Cash Flow Statement.

ABC Trial Balance

ABC Mowing			
Trial Balance Year End			
Account	Debit Balances	Credit Balances	Account Type
Asset Accounts			
Cash	5080		Balance Sheet
Accounts Receivable	1600		Balance Sheet
Inventory-Office Supplies	100		Balance Sheet

Mowing Equipment	12500		Balance Sheet
Liability Accounts			
Accounts Payable		2060	Balance Sheet
Note Payable-Bank		10000	Balance Sheet
Equity Accounts			
Owner's Capital		7500	Balance Sheet
Owner's Draws	1100		Balance Sheet
Revenue Accounts			
Mowing Revenue		1205	Income Statement
Expense Accounts			
Mulch Expense	160		Income Statement
Advertising Expense	225		Income Statement
Totals	20765	20765	

It should be apparent that by having the information from the General Ledger and the Trial Balance one can readily prepare the Balance Sheet, Income Statement, and Capital financial statements.

The Trial Balance/Worksheet normally contains additional columns for adjusting and closing entries.

Briefly, closing entries transfer (close) the balances in the General Ledger's individual revenue, expense, and drawing account(s) to the owner's capital account at the end of a period (usually year end) which results in the same General Ledger Capital Account ending balance as contained in the Capital Statement. This Ending Capital balance becomes the new Beginning Capital Balance for the new year.

All the revenues, expense, and drawing account balances are reset to zero so that their balances will only represent transaction amounts (increases and decreases to owner's equity) in the new year.

The Statement that determines whether a business
had a Profit or a Loss - Income Statement

Income Statement

The Income Statement is a formal financial statement that summarizes a company's operations (revenues and expenses) for a specific period of time usually a month or a year.

A fiscal year is the period used for calculating annual (yearly) income statements.

While a large number of businesses use the calendar year (January-December) as their fiscal year, a business can elect to use any other twelve month period such as June-May their fiscal year.

The categories and format(s) of the Income Statement follow the rules known as Generally Accepted Accounting Principles (GAAP) and contain specific revenue and expense categories.

The following types of accounts are used to prepare the Income Statement.

Revenue (Also Called Income)

Formal Definition:The gross increase in owner’s equity resulting from the operations and other activities of the business.

Informal Definition:Amounts a business earns by selling services and products. Amounts billed to customers for services and/or products.

Expense (Also Called Cost)

Formal Definition:Decrease in owner’s equity resulting from the cost of goods, fixed assets, and services and supplies consumed in the operations of a business.

Informal Definition:The costs of doing business. The stuff we used and had to pay for or charge to run our business.

Additional Explanation:

Some examples of business expenses are office supplies, salaries & wages, advertising, building rental, and utilities.

Hopefully a business earns a profit called net income (revenues are larger than expenses). If however, expenses are larger than revenues a net loss results.

The major sections of an income statement are the heading, the revenue section, the expense section, and the final calculation of a profit or loss. The heading should contain the name of the company, the title of the statement, and the period covered by the statement.

An Income Statement is just a formal summary of “Mom Capital’s “Kids” Revenue and Expense.

The **Income Statement for ABC Mowing** is presented below.

ABC Mowing		
Income Statement		
For The Period Ending December 31,xxxx		
Revenue from operations		$1,205
Expenses		
Advertising Expense	$225	
Mulch Expense	160	
Total Expenses		$385
Net Income		$820

Note: In the real world an income statement would have many more expense categories than the two types illustrated in our simple example . Some additional expenses that would normally be included are:

- Office Supplies Used
- Telephone

- Building/Office Rent
- Utilities
- Depreciation Expense
- Maintenance and Repairs
- Interest Expense
- Memberships
- Donations
- Bank Fees and Charges
- Salaries & Wages
- Employment Taxes
- Equipment Rental
- Contract Labor
- Professional Fees
- Travel
- Entertainment
- Any other type that your business incurs

Our Income Statement or what is sometimes also referred to as a Profit and Loss Statement was prepared for a service type of business and is in the format of what is called a

Single Step Income Statement.

A single step income statement is the income statement format where all the revenues and gains are grouped together and totaled and all the expenses are grouped together and totaled. Net Income is then calculated by subtracting the total expenses from the total revenues.

Below is a sample **Single Step Income Statement** with additional expenses listed.

Example Company	
Income Statement	
For Period Ending December 31,xxxx	
Revenues & Gains	
Service Revenues	$300,000
Interest Income	5,000
Gain on asset sales	2,000
Total revenues & gains	$307,000
Expenses & Losses	
Salaries & wages	$100,000
Payroll taxes	10,000

Office supplies	2,000
Maintenance & repairs	4,000
Vehicle expenses	5,000
Advertising expenses	7,000
Telephone & internet	3,000
Insurance expense	10,000
Professional fees	5,000
Building rental	20,000
Depreciation expense	5,000
Utilities	6,000
Travel & entertainment	4,000
Taxes	15,000
Total expenses	$196,000
Net income	$111,000

Businesses that are retailers, wholesalers, or manufacturers that sell products have a special section included in their income statement called Cost Of Goods Sold. This section computes the Cost Of The Goods Sold that were either purchased and sold or manufactured and sold.

In retailing and wholesaling, computing the cost of goods sold during the accounting period involves beginning and ending inventories. In manufacturing it involves finished-goods inventories, raw materials inventories and goods-in-process inventories.

These types of businesses would normally use an alternative to the single-step income statement format called the **multiple-step income statement**, because it uses multiple subtractions in computing the net income shown on the bottom line.

The multiple-step profit and loss statement segregates the operating revenues and operating expenses from the nonoperating revenues, nonoperating expenses, gains, and losses. The multiple-step income statement also shows the gross profit (net sales minus the cost of goods sold).

Sample Multi-Step Income Statement

Example Company
Income Statement

For Period Ending December 31,xxxx	
Revenues & Gains	
Service Revenues	$300,000
Interest Income	5,000
Gain on asset sales	2,000
Total revenues & gains	$307,000
Cost Of Goods Sold	150,000
Gross Profit	$157,000
Operating Expenses	
Salaries & wages	$40,000
Payroll taxes	5,000
Office supplies	2,000
Maintenance & repairs	4,000
Vehicle expenses	5,000
Advertising expenses	7,000
Telephone & internet	3,000
Insurance expense	10,000
Professional fees	5,000
Building rental	10,000
Depreciation expense	5,000
Utilities	6,000
Travel & entertainment	4,000
Taxes	5,000
Total operating expenses	$111,000
Operating Income	$46,000
Non operating & other	
Interest revenue	2,000
Gains	5,000
Interest Expense	(4,000)
Losses	(1,000)

Total non operating	$2,000
Net income	$48,000

Sample Income Statement Accounts PDF

What caused the owner's claim to the assets to increase or decrease ?

The reasons are provided by the Capital Statement

Capital Statements

The Capital Statement

The capital statement serves as the bridge between the income statement and balance sheet.

It uses the net income/loss from the income statement in addition to the owner's investments and withdrawal to determine the Owner's Ending Capital balance shown on the balance sheet.

Let's illustrate this statement with a simple equation.

Ending Owner's Equity = Beginning Equity + Additional Capital Contributed + Profit or – Loss – Draws

ABC Mowing		
Capital Statement		
For The Period Ending December 31, xxxx		
Beginning of Period Capital		$7,500
Capital Contributed	0	
Net Income	820	
Less:Owner Withdrawals	1,100	
Decrease In Capital		280
End of Period Capital		$7,220

How The Balance Sheet, Income Statement, and Capital Statement Are Related.

If you compare the owner's equity (owner's claim to assets) for two year end balance sheets, the difference (increase or decrease) is explained by the Income Statement and Capital Statement. Remember, revenues increase equity; capital contributed to the business increases equity; expenses decrease equity; and owner's draws decrease equity.

Onward to the Balance Sheet- a picture of the financial condition of a businees at a specific date.

Balance Sheet

A Balance Sheet is simply a picture of a business at a specific point in time, usually the end of the month or year. By analyzing and reviewing this financial statement the current financial "health" of a business can be determined.

The balance sheet is derived from our accounting equation and is a formal representation of our equation

Assets = Liabilities + Owner's Equity.

If you recall, in an earlier lesson we learned that this equation is also called the **Balance Sheet Equation**.

The categories and format of the Balance Sheet are based on what are called Generally Accepted Accounting Principles (GAAP). These principles are the rules established so that every business prepares their financial statements the same way.

What makes up a **Balance Sheet** ?

Assets

Formal Definition:The properties used in the operation or investment activities of a business.

Informal Definition:All the good stuff a business has (anything with value). The goodies.

Additional Explanation:

The good stuff includes tangible and intangible stuff. Tangible stuff you can physically see and touch such as vehicles, equipment and buildings. Intangible stuff is like pieces of paper (sales invoices) representing loans to your customers where they promise to pay you later for your services or product. Examples of assets that many individuals have are cars, houses, boats, furniture, TV's, and appliances.

Some examples of business type assets are cash, accounts receivable, notes receivable, inventory, land, and equipment.

Assets are listed based on how quickly they can be converted into cash which is called liquidity. In other words, they're ranked. The asset most easily converted into cash is listed first followed by the next easiest and so on. Of course since cash is already cash it's the first asset listed.

Liabilities

Formal Definition:Claims by creditors to the property (assets) of a business until they are paid.

Informal Definition:Other's claims to the business's stuff. Amounts the business owes to others.

Additional Explanation:

Usually one of a business's biggest liabilities (hopefully they are not past due) is to suppliers where they have bought goods and services and charged them. This is similar to us going out and buying a TV and charging it on our credit card. Our credit card bill is a liability. Another good personal example is a home mortgage. Very few people actually own their own home. The bank has a claim against the home which is called a mortgage. This mortgage is another example of a personal liability. Some examples of business liabilities are accounts payable, notes payable, and mortgages payable.

Liabilities are listed in the order of how soon they have to be paid. In other words, the liabilities that need to be paid first are also listed first.

Owner's Equity (Capital)

Formal Definition:The owner's rights to the property (assets) of the business; also called proprietorship and net worth.

Informal Definition:What the business owes the owner. The good stuff left for the owner assuming all liabilities (amounts owed) have been paid.

Additional Explanation:

Owner's Equity represents the owner's claim to the good stuff (assets). Most people are familiar

with the term equity because it is so often used with lenders wanting to loan individuals money based on their home equity. Home equity can be thought of as the amount of money an owner would receive if he/she sold their house and paid off any mortgage (loan) on the property.

Owner's equity (or net worth or capital) is increased by money or property contributed and any profits earned and decreased by owner withdrawals and losses.

All Balance Sheets contain the same categories of assets, liabilities, and owner's equity.

If you look below at our Balance Sheet for ABC Mowing you can readily see that there are three main sections, assets, liabilities, and owner's equity just like the accounting equation.

The major sections of a balance sheet are the heading, the assets,the liabilities, and the owner’s equity. The heading contains the name of the company, the title of the statement, and the date of the statement.

ABC Mowing			
Balance Sheet			
As Of December 31,xxxx			
Assets		Liabilities	
Cash	$5,080	Accounts Payable	$2,060
Accounts Receivable	1,600	Notes Payable	10,000
Office Supplies	100		
Mowing Equipment	12,500	Total Liabilities	$12,060
		Owner's Equity	
		ABC Capital	7,220
Total Assets	$19,280	Total Liabilities & Equity	$19,280

This layout is called the **Account Form**. In this form the major categories are presented side by side.

Another layout sometimes used is called the **Report Form**. In this form the major categories are stacked on top of each other.

An example of the Report Form follows.

ABC Mowing		
Balance Sheet		
As Of December 31,xxxx		
Assets		
Cash	$5,080	
Accounts Receivable	1,600	
Office Supplies	100	

Mowing Equipment	12,500	
Total Assets		$19,280
Liabilities		
Accounts Payable	$2,060	
Note Payable-Bank	10,000	
Total Liabilities		$12,060
Owner's Equity		
ABC Capital		$7,220
Total Liabilities & Equity		$19,280

The Balance Sheets presented for our mowing guys above is a simple representation of a Balance Sheet. Normally, a business prepares what is called a Classified Balance Sheet with many categories.

A Classified Balance for our mowing guys is presented below.

ABC Mowing			
Classified Balance Sheet			
As Of December 31,xxxx			
Assets		Liabilities	
Current Assets		Current Liabilities	
Cash	$5,080	Accounts Payable	$2,060
Accounts Receivable	1,600	Note Payable-Current Portion	2,500
Office Supplies	100	Total Current Liabilities	4,560
Total Current assets	$6,780		
Fixed Assets		Long Term Liabilities	
Mowing Equipment	$12,500	Note Payable-Lomg Term	$7,500
Total Fixed Assets	$12,500	Total Long Term Liabilities	$7,500
		Owner's Equity	
		ABC Capital	$7,220
Total Assets	$19,280	Total Liabilities & Equity	$19,280

What’s the difference ? We’ve included categories; namely, Currents Assets, Fixed Assets, Current Liabilities, and Long Term Liabilities.

So you know. The most common **Categories or Classifications** used within a Classified Balance Sheet are:

Asset Categories

Current Assets

The following are categorized or classified as Current Assets in a Classified Balance Sheet:

In general, any asset is classified as a current asset when there is a reasonable expectation that the asset will be consumed within the next year, or within the operating cycle of the business.

Current assets are presented in the order of liquidity, i.e., cash, temporary investments, accounts receivable, inventory, supplies, prepaid insurance.

Cash: All liquid, short-term investments that are easily convertible into cash and available for current operations.

Marketable securities: All securities that are held for trading.

Accounts Receivable: All trade receivables, as well as all other types of receivables that should be collected within one year.

Inventory: All raw materials, work in process, and finished goods items, less an obsolescence reserve.

Supplies: Consumable items such as office supplies or factory supplies that are stocked for recurring use.

Prepaid expenses: Any prepayment that is expected to be used within one year such as prepaid rent or insurance.

Long Term Assets

Long Term Investments

Long-term investments are the company’s investments, including stocks, bonds, real estate and cash, that it intends to hold for more than a year.

Fixed Assets (or Property, Plant, and Equipment)

Included are land, buildings, leasehold improvements, equipment, furniture, fixtures, delivery trucks, and automobiles that are owned by the company.

Intangible Assets

Some examples of intangible assets include copyrights, patents, goodwill, trade names, trademarks, and mail lists.

Other Assets

Any other asset not included in another category.

Liability Categories

Current Liabilities

The following are categorized or classified as Current Liabilities in a Classified Balance Sheet:

In general, a liability is classified as current when there is a reasonable expectation that the liability will come due within the next year, or within the operating cycle of the business.

Notes Payable-Short Term Portion: Promissory notes where the borrower borrows a specific amount of money from a lender and promises to pay it back with interest over a predetermined time period. Portion of the notes due within a year of the balance sheet date.

Accounts Payables: All trade payables related to the purchase of goods or services from suppliers.

Accrued expenses: Expenses incurred by the business, for which no supplier invoice has yet been received.

Short-term debt: Loans for which payment is due within the next year.

Unearned revenue: Advance payments from customers that have not yet been earned by the company.

Long-term Liabilities

A long-term liability is an obligation that is due for payment one year or more later than the date of the balance sheet.

Equity Categories

Owner’s Equity

Residual Amounts owed owner(s) as a result of owner investments, owner withdrawals, and profits earned.

As I have often said, a picture's worth a thousand words.

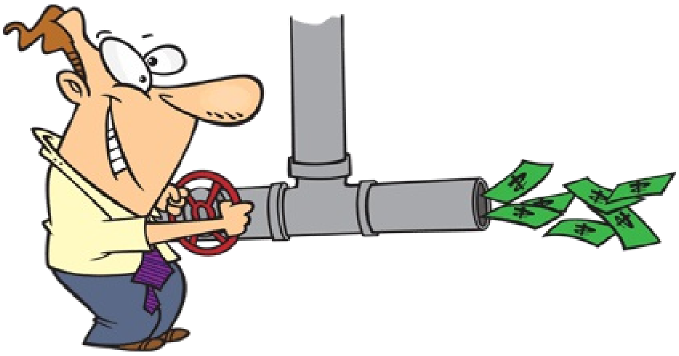
Sample Company			
Classified Balance Sheet			
As Of December 31,xxxx			
Assets		Liabilities	
Current Assets		Current Liabilities	
Cash	$15,500	Notes payable	$20,000
Petty cash	100	Accounts payable	45,000
Temporary investments	5,000	Wages payable	9,500
Accounts receivable-net	35,500	Interest payable	1,000
Inventory	30,000	Taxes payable	6,000
Supplies	2,500	Total current liabilities	$81,500
Prepaid insurance	1,500		
Total current assets	$90,100	Long term liabilities	
		Notes payable	$200,000
Investments	$5,000		
		Total liabilities	$281,500
Property,plant,& equipment			
Land	$30,000		
Land improvements	2,500	Owner's equity	
Buildings	150,000	Owner's Capital	$204,100
Equipment	200,000		
Vehicles	20,000		
Less:Accumulated depreciation	(50,000)		
Property,plant,&equipment-net	$352,500		
Intangible assets			
Goodwill	$10,000		
Trademarks	25,000		
Total intangible assets	$35,000		
Other assets	$3,000		
		Total liabilities &	

Total assets	$485,600	equity	$485,600

Sample Balance Sheet Accounts PDF

What caused our cash balances to increase or decrease ?

The Cash Flow Statement provides the answers.



Cash Flow Statement

Cash

The last financial statement, the **Cash Flow Statement** is prepared to report all the changes in cash that occurred over a period of time usually a month or year.

The major sections of the statement are the heading, a section for reporting the increases in cash (resources provided by), a section for reporting the decreases in cash (resources applied to), and a summary of the change in cash (increase/decrease) for the period.

If the business was in operation in the previous year, the prior year balance sheet along with the current year balance sheet and current year income statement is needed in order to prepare the statement. Additional analysis of some of the accounts may also be needed.

Our example assumes that ABC Mowing's prior year balance sheet is as follows:

ABC Mowing		
Balance Sheet		
As Of December 31,xxxx Prior Year		
Assets		
Cash	$6,400	
Accounts Receivable	600	
Mowing Equipment	2,500	
Total Assets		$9,500
Liabilities		

Accounts Payable	$2,000	
Total Liabilities		$2,000
Owner's Equity		
ABC Capital		$7,500
Total Liabilities & Equity		$,9500

Using the above prior year balance sheet along with the current year balance sheet and income statement we prepared the following Statement Of Changes in Cash:

Summary of how to prepare the statement:

The first step is determining the cash provided or used by operations and begins with the operating income for the period.

Adjustments are made to the income for revenue or expenses items that did not provide or use cash.

Additional adjustments are made for all current and noncurrent accounts and are recorded as addition or subtractions depending upon their effect on cash based on their beginning of the year and end of the year balances.

ABC Mowing				
Cash Flow Statement				
For the Period Ending December 31,xxxx				
Sources Of Cash				
Financing from bank loan	$10,000			
Total Sources				$10,000
Uses Of Cash				
Income from Operations	820			
Add:				
Increase in Accounts Payable	60	880		

Deduct:				
Increase in Supplies Inventory	100			
Increase in Accounts Receivable	1,000	1,100		
Cash Used by Operations			220	
Payment of Owner's Draws			1,100	
Purchase of Equipment			10,000	
Total Uses				11,320
Decrease in Cash				$1,320
Change in Cash Balances				
Cash Balances December 31,xxxx (Current Year)				$5,080
Cash Balances December 31,xxxx (Prior Year)				6,400
Decrease In Cash				$1,320

Additional facts and information about the business

is disclosed in the Notes to the Financial Statements

Notes To Financials

Notes To Financial Statements

Notes to the financial statements are an integral part of the statements and are required by Generally Accepted Accounting Principles. Notes to financial statements,sometimes referred to as footnotes, are used to provide additional information about a business's financial condition and methods used at arriving at the amounts presented in the financial statements.

These notes contain important information about such things as the accounting methods used for recording and reporting transactions, any pending lawsuits or regulations that may affect the business, and other information that should be disclosed in order to properly analyze and evaluate the financial condition of the business.

The Good News

While these financial statements were prepared from just a very few transactions, my goal was to introduce you to what formal financial statements are needed and what's involved in preparing them even though the bookkeeper may or may not be required or responsible for preparing them. Many businesses have their accountant or CPA (Certified Public Accountant) prepare or review their financial statements.

Another plus, nowadays, good accounting or bookkeeping software will automatically generate these statements. While this is great, we still need to be aware of that ole saying "GIGO – Garbage In Garbage Out".

Are we there yet ?

Analyzing Financial Performance

While preparing financial statements is critical to the success of a business, it's only half the battle. In order for a business to fully benefit the financial information needs to be analyzed and compared. A few tools used are comparing past performance with current performance and comparing how the business stacks up against its competitors or similar businesses.

While the Financial Statements presented in this lesson are simplified versions of the "real" world and were compiled from only a few financial transactions, the concepts and methods used are the same as you would use for a business with a multitude of transactions.

So you know – things do change !

The Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) are continually working on projects and changes to the financial statement presentations as well as the accounting rules may result.

Now's not the time to give up. You've made it this far and have only one lesson left to complete the course.

Yes, if you need one, you can take a break before moving on to our Final Review after the Videos and Testing.

Final Review

Final Review

Remember me ? Yeah, it's me Dave. It's not often that I get my picture in a publication twice but when you're the publisher you have a lot of leeway. I started out with you so I guess it's only fitting and proper that I also end with you.

Of course businesses have many more than the ten simple transactions that I used in my example of ABC Mowing. Probably 80% of a bookkeeper's time is spent recording and summarizing a business's financial transactions. I intentionally limited the transactions used in my prior lessons in order to focus on the broad concepts. My purpose (which I hope I accomplished) was to prepare you with a strong foundation that you can continue to build on.

What We Covered

Let's Review the path that got us here.

The **Introduction** discussed the types of business organizations, types of business activities, users of financial information, bookkeeping systems, accounting rules, and the cash and accrual basis of accounting.

Highlights:

Bookkeeping

The process of recording and classifying business financial transactions (activities). In simple language-maintaining the records of the financial activities of a business or an individual. Bookkeeping's objective is simply to record and summarize financial transactions into a usable form that provides financial information about a business or an individual.

Types Of Business Organization

One of the first decisions that a person(s) needs to make is how the company should be structured. The four basic legal forms of ownership for small businesses are a Sole Proprietorship, Partnership, Corporation, and Limited Liability Company. There are advantages and disadvantages as well as income tax ramifications associated with each type of organization. We aren't going to delve in to this area but a brief description of the different types of organization and what they are is needed.

Sole Proprietorship

Most small business start out as sole proprietorships. These firms are owned by one person who is normally active in running and managing the business.

Partnership

A partnership is two or more people who share the ownership of a single business. In order to avoid misunderstandings about how profits/losses are shared , who's responsible for what, and other management, ownership, and operating decisions the partners normally have a formal legal partnership agreement.

Corporation

A corporation is an organization that is made up of many owners who normally are not active in the decision making and operations of the business. These owners are called shareholders. Their ownership interest is represented by certificates of ownership (stock) issued by the corporation.

Limited Liability Company (LLC)

The LLC is a relatively new type of business structure that combines the benefits of a partnership and corporation.

Types Of Bookkeeping Systems

Single Entry

With the single-entry system, you record a daily and a monthly summary of business income, and a monthly summary of business expenses. Single-entry is not a complete accounting system, but it shows income and expenses in sufficient detail for tax purposes. This system focuses on the business' profit and loss statement and not on its balance sheet. The single entry system is an "informal" record keeping system. While the single entry system may be acceptable for tax purposes, it does not provide a business with all the financial information needed to adequately report the financial affairs of a

business.

Double Entry System

The double-entry system has built-in checks and balances and is more accurate than single-entry system. The double-entry system is self-balancing. Since all business transactions consist of an exchange of one thing for another, double-entry bookkeeping is used to show this two-fold effect. This system is a complete accounting system and focuses on the income statement and balance sheet.

Cash Basis/Accrual Basis of Accounting

Another decision faced by a new business is what accounting/bookkeeping method they are going to use to track their revenue and expenses. If inventories are a major part of the business, the decision is made for the business owner by the Internal Revenue Service (IRS) and the business is required to use the accrual method of accounting.

The **Cash Basis** recognizes revenues (earnings) in the period the cash is received and expenses in the period when the cash payments are made. The **Accrual Basis** records income in the period earned and all expenses in the period incurred.

Rules

Just like we have rules in sports to tell us how to play the game, we also have rules for accounting and bookkeeping.

The following are some of the **Rules** used to "play" the Accounting "Game":

Accrual Concept

Revenue Realization Concept

Matching Concept

Accounting Period Concept

Money Measurement Concept

Business Entity Concept

Going Concern Concept

Cost Concept

Conservatism Concept

Consistency Concept

Comparable

Materiality Concept

Cost-Benefit Convention

Industry Practices Convention

Lesson 1 **The Bookkeeping Language** introduced you to some of the terminology and definitions used in the accounting and bookkeeping language.

Highlights:

Major Type of Accounts:

ALOE-RED

<table>
<tr><td>A</td><td>L</td><td>OE</td><td colspan="3" rowspan="2"></td></tr>
<tr><td>|
Assets</td><td>|
Liabilities</td><td>|
Owner's Equity</td></tr>
<tr><td colspan="3" rowspan="2">| ____</td><td>R</td><td>E</td><td>D</td></tr>
<tr><td>Revenue</td><td>Expense</td><td>Draws</td></tr>
</table>

The above diagram is made up of two terms **ALOE** and **RED**. These are the basis for the acronym **ALOE-RED** which helps us remember the major types of accounts. **ALOE**-represents Assets, Liabilities, and Owner's Equity. **RED**-represents Revenues, Expenses, and Draws/Dividends.

Associate these terms with a day at the beach when you get a **RED** sunburn and use **ALOE** (the ointment) to ease the pain.

Assets

Formal Definition:The properties used in the operation or investment activities of a business.

Informal Definition:All the good stuff a business has (anything with value). The goodies.

Additional Explanation: The good stuff includes tangible and intangible stuff. Tangible stuff you can physical see and touch such as vehicles, equipment and buildings. Intangible stuff is like pieces of paper (sales invoices) representing loans to your customers where they promise to pay you later for your services or product. Examples of assets that many individuals have are cars, houses, boats, furniture, TV's, and appliances. Some examples of business type assets are cash, accounts receivable, notes receivable, inventory, land, and equipment.

Liabilities

Formal Definition:Claims by creditors to the property (assets) of a business until they are paid.

Informal Definition:Other's claims to the business's good stuff. Amounts the business owes to others.

Additional Explanation: Usually one of a business's biggest liabilities (hopefully they are not past due) is to suppliers where a business has bought goods and services and charged them. This is similar to us going out and buying a TV and charging it on our credit card. Our credit card bill is a liability. Another good personal example is a home mortgage. Very few people actually own their own home. The bank has a claim against the home which is called a mortgage. This mortgage is another example of a personal liability. Some examples of business liabilities are accounts payable, notes payable, and mortgages payable.

Owner's Equity also called Owner's Capital

Comment:Both terms may be used interchangeably. In my tutorial lessons, I may refer to both terms or just use one or the other.

Formal Definition:The owner's rights to the property (assets) of the business; also called proprietorship and net worth.

Informal Definition:What the business owes the owner. The good stuff left for the owner assuming all liabilities (amounts owed) have been paid.

Additional Explanation:Owner's Equity (Capital) represents the owner's claim to the good stuff (assets). Most people are familiar with the term equity because it is so often used with lenders wanting to loan individuals money based on their home equity. Home equity can be thought of as the amount of money an owner would receive if he/she sold their house and paid off any mortgage (loan) on the property.

Revenue (Income), Expenses, Investment, and Draws

Revenues, expenses, investment, and draws are sub categories of owner's equity (capital). Think of owner's equity as a mom named Capital with four children to keep up with.

The kids are named Revenue, Expense, Investment, and Draws and each kid has one job that they are responsible for in order to earn their allowance.

Kid Revenue is responsible for keeping track of increases in owner's equity (Ma Capital) resulting from business operations.

Kid Expense is responsible for keeping track of decreases in owner's equity (Ma Capital) resulting from business operations.

Kid Draws has the job of keeping up with decreases in owner's equity (Ma Capital) resulting from owner withdrawals for living expenses and other personal expenses.

Kid Investment has the job of keeping up with increases in owner's equity (Ma Capital) resulting from additional amounts invested in the business.

Revenue also called Income

Formal Definition:The gross increase in owner's equity (capital) resulting from the operations and other activities of the business.

Informal Definition:Amounts a business earns by selling services and products. Amounts billed to customers for services and/or products.

Additional Explanation:Individuals can best relate by thinking of revenue as their earnings/wages they receive from their job. Most business revenue results from selling their products and/or services.

Expense also called Cost

Formal Definition:Decrease in owner's equity (capital) resulting from the cost of goods, fixed assets, and services and supplies consumed in the operations of a business.

Informal Definition:The costs of doing business. The stuff we used and had to pay for or charge to run our business.

Additional Explanation:Some examples of personal expenses that most individuals are familiar with are utilities, phone, clothing, food, gasoline, and repairs. Some examples of business expenses are office supplies, salaries & wages, advertising, building rental, and utilities.

Owner's Investments

Formal Definition: Increase in owner's equity (capital) resulting from additional investments of cash and/or other property made by the owner.

Informal definition: Additional amounts, either cash or other property, that the owner puts in his

business.

Additional Explanation:Although these amounts can be kept up with as a separate item, they are usually recorded directly in the Owner's Capital Account. In other words, immediately put into Ma Equity's purse.

Owner's Drawing

Formal Definition: Decrease in owner's equity (capital) resulting from withdrawals made by the owner.

Informal definition: Amounts the owner withdraws from his business for living and personal expenses.

Additional Explanation:The owner of a sole proprietorship does not normally receive a "formal" pay check from the business, but just like most of the rest of us needs money to pay for his house, car, utilities, and groceries. An owner's draw is used in order for the owner to receive money or other "goodies" from his business to take care of his personal bills.

Lesson 2 the **Accounting Equation**

Abbreviated version

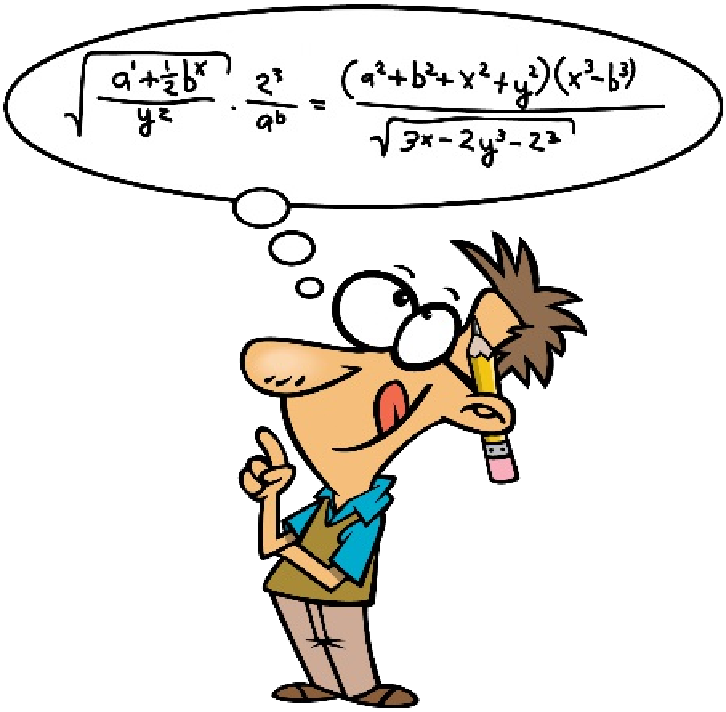
PROPERTY=PROPERTY RIGHTS

or the **Expanded version**

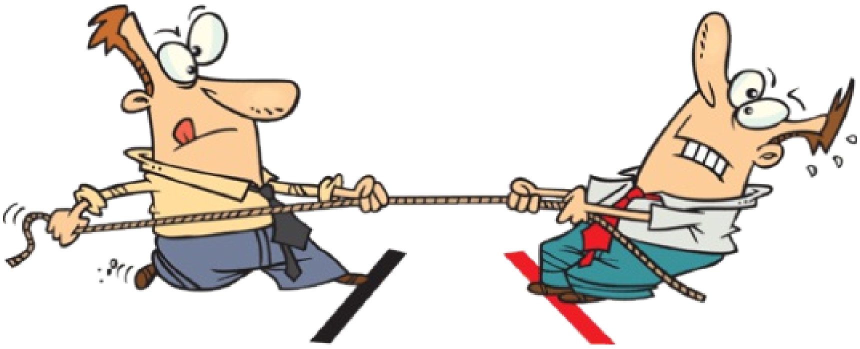
ASSETS=LIABILITIES + OWNER'S EQUITY

and lastly the **Fully expanded version**

ASSETS = LIABILITIES + BEGINNING OWNER'S EQUITY + ADDITIONAL OWNER INVESTMENTS + REVENUE - EXPENSES - DRAWS



Lesson 3 **Debits and Credits** introduced and explained Debits and Credits and how they affect the Accounting Equation(s) and are used to record business transactions.



Highlights:

For Every Debit There Is A Credit

Debit- an entry (amount) entered on the left side (column) of a journal or general ledger account that increases an asset, draw or an expense or an entry that decreases a liability, owner's equity (capital) or revenue.

Credit - an entry (amount) entered on the right side (column) of a journal or general ledger account that increases a liability, owner's equity (capital) or revenue, or an entry that decreases an asset, draw, or an expense.

Debit and Credit Equation

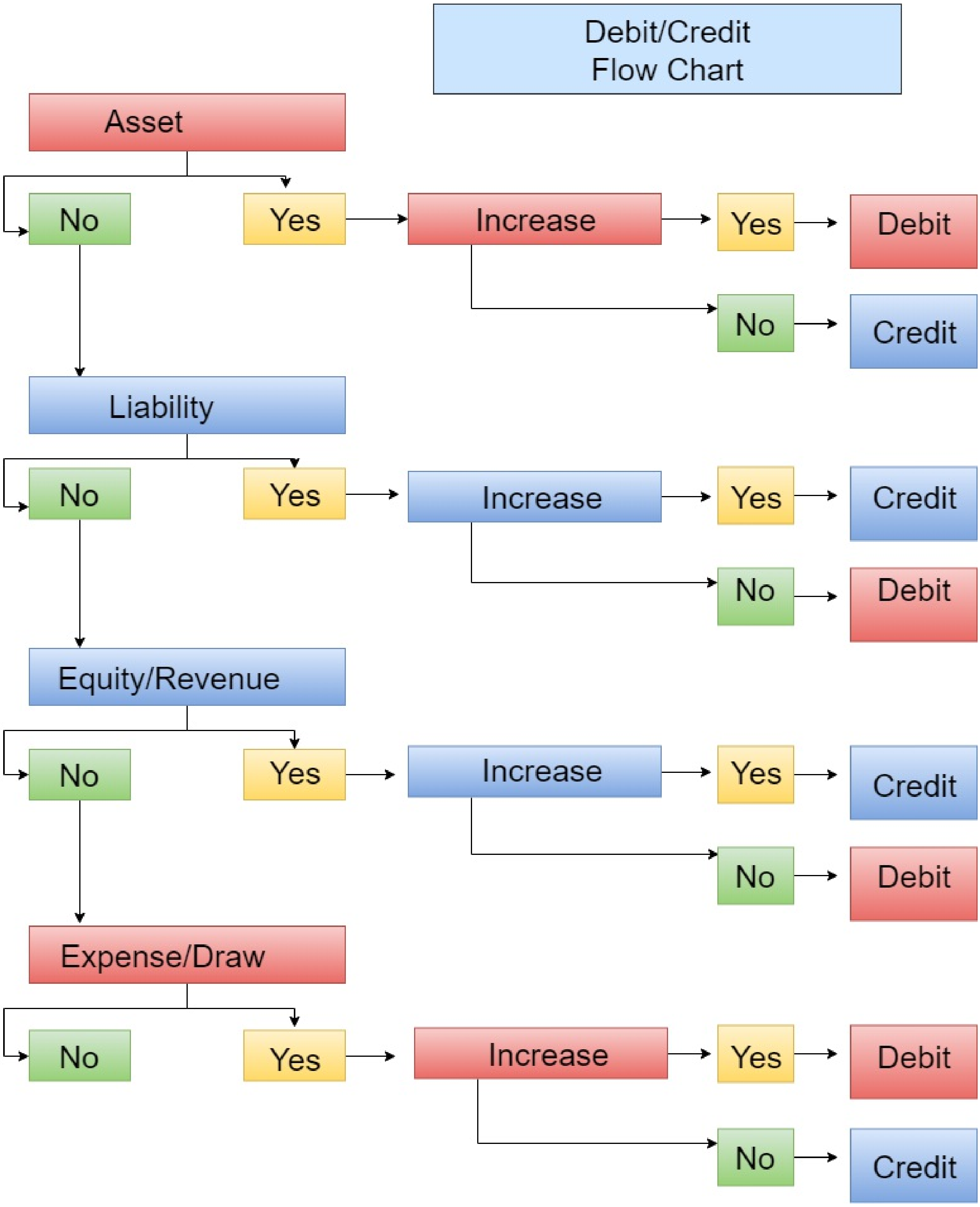
Assets + Draws + Expenses = Liabilities + Owner's Equity + Revenue

Normal Debit Balance Accounts = Normal Credit Balance Accounts

Debit and Credit Rules Table

Debit and Credit Table			
Type Of Account	Normal Balance	Increases	Decreases
Assets	Debit-Left Side	Debit-Left Side	Credit-Right Side
Liabilities	Credit-Right Side	Credit-Right Side	Debit-Left Side
Owner's Equity	Credit-Right Side	Credit-Right Side	Debit-Left Side
Revenue	Credit-Right Side	Credit-Right Side	Debit-Left Side
Expense	Debit-Left Side	Debit-Left Side	Credit-Right Side
Draws	Debit-Left Side	Debit-Left Side	Credit-Right Side

Debit & Credit Flow Chart



explained and used examples to illustrate how business transactions are properly analyzed, recorded, and summarized.

Highlights:

We analyzed transactions and identified the Source Document, Type Of Transaction, Accounts Affected, and determined and explained the Debits and Credits needed to properly record and post to our General Ledger Accounts.

The **Source Documents** that provide documentation (proof) that a transaction has occurred are sales invoices (tickets), invoices from suppliers, contracts, checks written and checks received , promissory notes, and various other types of business documents. These documents provide us with the information needed to record our financial transactions in our bookkeeping records.

Our **Chart Of Accounts** was used to determine what **accounts** to use for recording the transactions. If you recall, a Chart Of Accounts is simply a coded listing of all the accounts in the **General Ledger**.

An **Account**, if you recall is a separate record for each type of asset, liability, equity, revenue, and expense used to show the beginning balance and record the increases and decreases for a period and the resulting ending balance at the end of a period.

All transactions have at least one **debit** and one **credit**.

Lesson 5 **The General Ledger and Journals**

explained what General Ledger and Journals are, how they're used, and what bookkeeping purposes they serve.

Highlights:

A **General Ledger** is just a book containing the summarized financial transactions and balances of the accounts for all of a business's assets, liabilities, equity, revenue, and expense accounts.

Journals are preliminary records where business transactions are first entered into the accounting system. The journal is commonly referred to as the book of original entry. **Specialized Journals**- are journals used to initially record special types of transactions such as sales, cash disbursements, and cash receipts in their own journal.

Lesson 6 **Financial Statements** explained what financial statements are, how they're created, and how they're used.

Highlights:

Financial Statements are summary accounting reports prepared periodically to inform the owner, creditors, and other interested parties as to the financial condition and operating results of the business. The four basic financial statements are:

Balance Sheet-The financial statement which shows the amount and nature of business assets, liabilities, and owner's equity as of a specific point in time. It is also known as a Statement Of Financial Position or a Statement Of Financial Condition.

Income Statement-The financial statement that summarizes revenues and expenses for a specific period of time, usually a month or a year. This statement is also called a Profit and Loss Statement or an Operating Statement.

Capital Statement-The financial report that summarizes all the changes in owner's equity that occurred during a specific period.

Statement of Changes in Cash-The financial statement that reports the sources and uses of cash for a specific period of time, normally a year.

Believe It Or Not

I know you probably got tired of ABC Mowing; but, using only our 10 sample transactions, we've covered the Basics Of Bookkeeping. Of course, in the real world, a business will have many more transactions that need to be analyzed and recorded; but, you apply the same methods and concepts that we learned and used in this Tutorial.

Congratulations

My congratulations to all you Yogi Bears (Smarter Than The Average Bear) For those of you too young to remember, Yogi Bear is a cartoon character created by William Hanna and Joseph Barbara who always claimed to be smarter than the average bear. Hopefully, if I did my job, when it comes to bookkeeping, you can now claim to be smarter than the average bear. No I didn't say you're ready for the CPA exam yet !


CERTIFICATE

Appendix

Learning Aids

Bean Counter Tutorial
Terms & Definitions
Tutorial Glossary

Addiitional Accounting & Bookkeeping
Terms & Definitions
Glossary

Debits & Credits Cheat Sheets
Help on determining when to Debit or Credit
Dr/Cr Cheat Sheet
Diagram
Debit/Credit Flow Chart

Special Journals
What Journal To Use
Flow Chart/Diagram
Special Journals

ALOE-RED
Acronymn - Easy Way of Remembering the Types Of Accounts

Major Types Of Accounts & Relationships
Diagram
Types Of Accounts

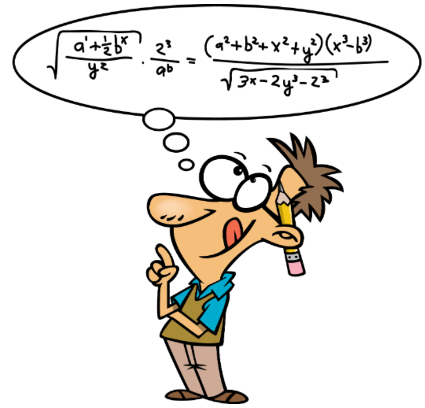
Basic Accounting Financial Statements Equations
Diagram
Accounting Equation

Sample Balance Sheet Accounts
Descriptions & Definitions
Balance Sheet Accounts

Sample Income Statement Accounts
Descriptions & Definitions

Income Statement Accounts

Basic Accounting Financial Statement Equations



Balance Sheet

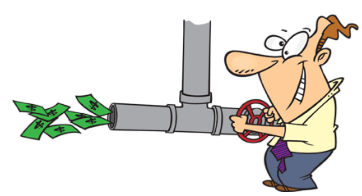
Assets = Liabilities + Owner's Equity

Income Statement

Revenue - Costs/Expense = Profit/Loss

Cash Flow Statement

Ending Cash = Beginning Cash + Cash In - Cash Out



Types Of Accounts

A — **Assets**

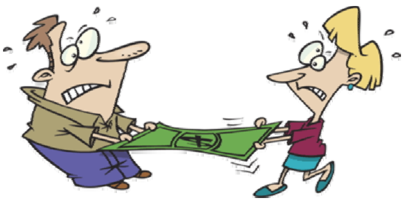
L — **Liabilities**

OE — **Owner's Equity**

- **R** — **Revenue**
- **E** — **Expense**
- **D** — **Draws/Dividends**

The above diagram is made up of two terms ALOE and RED. These are the basis for the acronym-ALOE-RED which helps us remember the types of accounts. ALOE-represents Assets, Liabilities, and Owner's Equity. RED-represents Revenues, Expenses, and Draws/Dividends.

Associate these terms with a day at the beach when you get a RED sunburn and use ALOE (the ointment) to ease the pain.



Balance Sheet Accounts

The Chart of Accounts is normally arranged or grouped by the Major Types of Accounts. The Balance Sheet Accounts (Assets, Liabilities, & Equity) are presented first, followed by the Income Statement Accounts (Revenues & Expenses).

Here we're going to discuss the Balance Sheet Portion of the Chart Of Accounts and how it's organized.

While most balance sheet accounts that need to be set up are common to all businesses, some depend on the type of business. Inventory accounts are needed for those businesses that produce and sell goods or "inventoriable" services as well as those that just buy and resell the goods.

The Assets, Liabilities, and Equity are presented in separate sections of a Balance Sheet in order that important relationships and subtotals and totals can be presented.

Note: This USA Order may vary depending on your country.

- ## Assets
  Formal Definition:The properties used in the operation or investment activities of a business.

  Informal Definition:All the good stuff a business has (anything with value). The goodies.

  Additional Explanation: The good stuff includes tangible and intangible stuff. Tangible stuff you can physical see and touch such as vehicles, equipment and buildings. Intangible stuff is like pieces of paper (sales invoices) representing loans to your customers where they promise to pay you later for your services or product.

  Assets are generally assigned to sub-categories or sub-groups. Similar types of assets are grouped together. The groups are based on the asset's purpose or use and liquidity (availability of the asset for paying debts).

  The order that the Assets are presented are based on the following guidelines:
  1. List the Items that are cash.
  2. List the Items that are held primarily for converting into cash and list them in the order of their expected conversion into cash (beginning with the fastest and moving toward the slowest).
  3. List the Items used in operations that could be converted into cash listed in the order of their expected conversion into cash (beginning with the fastest and moving toward the slowest).
  4. List the Items whose cost provide future benefits or can not be converted into cash.

  - ### Current Assets
    Current Assets include Cash and Assets that will be converted into cash or consumed in a relatively short period of time, usually within a year or the business's operating cycle. Prepaid Expenses and Supplies (already paid for or a liability incurred) are included because they will normally be used or consumed within the operating cycle.

    - Cash and Cash Equivalents
      Anything accepted by a bank for deposit is considered as Cash or Cash Equivalents. Cash in the form of coins and currency, undeposited checks, money orders, deposits in banks are examples. The cash must be available for immediate use and not restricted in any manner.
      - Cash On Hand
        - Cash Register Drawer(s) Funds
        - Undeposited Cash
      - Petty Cash
      - Bank Checking Accounts
        - General
        - Payroll

        - Savings Accounts
        - Money Market Accounts

- Short-Term Investments
  Short-Term Investments include readily marketable securities that can easily be sold and converted back into cash. These type of investments normally result from a business in the lucky position of having excess cash available. The invested should be temporary in nature and not made to exercise control over another business or satisfy any other requirements and/or agreements. Reported at current market value by using an allowance for unrealized market gains and losses.

    - Certificates of Deposit
    - Stocks
    - Bonds
    - Other Short Term Investments
    - Valuation Allowance for Market Value Fluctuations

- Receivables
  Included in this category are Accounts Receivable (open account customer balances resulting from sales) and customer Notes (principal and interest resulting from sales) that are formalized agreements and evidenced in writing. Short term temporary loans and advances are also included. An allowance for estimated uncollectible amounts is also provided.

    - Accounts Receivable
      This account will normally have a sub ledger that contains a record for each customer or client.
    - Allowance For Bad Debts (Contra Account)
      Used to record customer accounts that may not be collected.
    - Trade Notes Receivable - Current principal portion
    - Interest Receivable
    - Other Receivables
        - Short Term Owner Loans and Advances
        - Short Term Employee Loans & Advances
        - Short Term Travel and Expense Advances

- Inventory
  The accounts set up in the inventory section depend on the type of business. Is the business a service, retailer, wholesaler or manufacturer ? For retailers and wholesalers an inventory sub ledger is usually maintained to keep track of each individual product. Manufacturing types of businesses usually and Service types of businesses occasionally maintain sub legers for projects, jobs, and processes.

    - Manufacturer
        - Raw Materials
        - Manufacturing Supplies
        - Work In Process
            - Direct Labor
            - Direct Material
            - Manufacturing Costs
                - Direct Labor
                - Direct Material
                - Manufacturing Overhead - Actual
                    - Indirect Labor
                    - Supervision Salaries
                    - Fringe Benefits
                    - Manufacturing Supplies
                    - Small Parts

                - Perishable Tools
                - Utilities
                - Depreciation
                - Rent
                - Leases
                - Repairs & Maintenance
                - Insurance
                - Property Taxes
            - Overhead Costs Applied
        - Finished Goods

    - Retailer or Wholesaler
        - Merchandise Inventory
        - Store Supplies

    - Service
        - Work In Process - Projects / Jobs
        - Completed / Unbilled Projects / Jobs

    - Common To All
        - Office Supplies

- Prepaid Expenses
  Prepaid Expenses are assets created by the early payment of cash or assuming a liability. They expire and are charged to expenses based on the passage of time, usage, or other factors. All Prepaid Expenses could be recorded in a single account or separate accounts could be used for each different type.

    - Prepaid Insurance
    - Prepaid Rent
    - Prepaid Advertising
    - Prepaid Interest
    - Other Prepaid Expenses

- Other Current Assets
  This category includes other current assets that do not neatly fit into any of the other categories. The amounts must be deemed collectible in a relatively short period of time (operating cycle).

    - Notes Receivable - Current principal portion of Long-term Notes
    - Other Current Assets

Long-Term Investments

Investments that are intended to be held and not converted into cash for an extended period of time (longer than the operating cycle). Reported at current market value by using an allowance for unrealized market gains and losses.

- Stocks
- Bonds
- Other Long Term Investments
- Valuation Allowance for Market Value Fluctuations

Property, Plant, and Equipment

Assets of a durable nature that are used to provide current and future economic benefits to the business.

These accounts will normally have a sub ledger that contains a record for each parcel of land, building, or piece of machinery and equipment along with depreciation calculations and amounts.

- Land
- Buildings
- Accumulated Depreciation - Buildings (Contra Account)
- Building Improvements
- Accumulated Depreciation - Building Improvements (Contra Account)
- Machinery and Equipment
- Accumulated Depreciation - Machinery and Equipment (Contra Account)
- Office Equipment
- Accumulated Depreciation - Office Equipment (Contra Account)
- Computer Equipment
- Accumulated Depreciation - Computer Equipment (Contra Account)
- Vehicles
- Accumulated Depreciation - Vehicles (Contra Account)
- Furniture and Fixtures
- Accumulated Depreciation - Furniture and Fixtures (Contra Account)
- Leasehold Improvements
- Accumulated Amortization - Leasehold Improvements (Contra Account)
- Computer Software
- Accumulated Amortization - Computer Software (Contra Account)
- Other Property, Plant, or Equipment
- Accumulated Depreciation - Other Property, Plant, or Equipment

Other Noncurrent Assets

All assets that are noncurrent and that do not fit neatly into any of the other categories.

- Long Term Owner Loans & Advances
- Long Term Employee Loans & Advances
- Notes Receivable - Long-term principal portion of Long-term Notes
- Security Deposits
- Intangible Assets
  - Patents
  - Organization Costs
  - Goodwill
  - Accumulated Amortization (Contra Account)

Liabilities

Formal Definition:Claims by creditors to the property (assets) of a business until they are paid.

Informal Definition:Other's claims to the business's stuff. Amounts the business owes to others.

Additional Explanation: Usually one of a business's biggest liabilities (hopefully they are not past due) is to suppliers where they have bought goods and services and charged them.

Liabilities are listed in the order of their expected payment date (maturity). In other words, how soon they must be repaid. Liability accounts are separated into current (short-term) liabilities and long-term liabilities. Short-Term Liabilities generally are debts that must be repaid within 1 year from the date of the balance sheet. Long-Term Liabilities are debts that must be paid more than 1 year from the date of the balance sheet.

Current Liabilities

Current liabilities are the portion of obligations (amounts owed) due to be paid within the current operating cycle (normally a year) and that normally require the use of existing current assets to satisfy the debt.

- Short Term Notes (Demand Notes)
- Accounts Payable Trade
  A sub ledger is normally maintained in order to keep up with and track amounts owed to individual suppliers.
- Accounts Payable Other
- Payroll Liabilities
  - Accrued Salaries and Wages Payable
  - Employee Payroll Withholdings (Deductions)
    - Employee U.S. Federal Income Tax Withheld
    - Employee State Income Tax Withheld
    - Employee Local Income Tax Withheld
    - Employee FICA Withheld
    - Employee Medicare Withheld
    - Employee Garnishments Withheld
    - Employee Benefits
      - Employee Insurance Deduction Withheld
      - 401 K Deduction Withheld
      - IRA Deduction Withheld
    - Other Payroll Withholdings
  - Employer Provided Benefits
    - Mandatory
      - Employer FICA Contribution Payable
      - Employer Medicare Contribution Payable
      - Employer Federal Unemployment Payable
      - Employer State Unemployment Payable
      - Employer Workmen's Compensation Insurance Payable
    - Optional
      - Employer Provided Health Insurance Payable
      - Employer Provided Life Insurance Payable
      - Employer Provided 401 K Contributions Payable
      - Employer Provided IRA Contributions Payable
- Sales Tax Payable
- Unearned Revenues
- Customer Advances and Deposits Payable
- Interest Payable
- Bank Loans (Notes Payable) - Current principal portion of Long-Term Notes
- Notes Payable (other than bank notes) - Current principal portion of Long-Term Notes
- Accrued and Estimated Liabilities
  - Accrued / Estimated Taxes Payable
    - Accrued Real Estate and Property Taxes Payable
    - Accrued Income and Franchise Taxes Payable
      - Accrued Federal Taxes Payable
      - Accrued State Taxes Payable
      - Accrued Local Taxes Payable
  - Other Accruals Payable
- Other Current Liabilities

Long-Term Liabilities

Long term liability accounts are the portions of debts with due dates greater than a year or the operating cycle. These are obligations that are not expected to be paid within the current operating cycle.

- Bank Loans (Notes Payable) - Long Term principal portion
- Notes Payable (other than bank notes) - Long Term principal portion
- Other Long-Term Liabilities

- ## Equity Capital

  Formal Definition:The owner's rights or claims to the property (assets) of the business.

  Informal Definition:What the business owes the owner(s). The good stuff left for the owner(s) assuming all liabilities (amounts owed) have been paid.

  The accounts set up in this section will depend on the legal structure of your business. These accounts report the Owner's Capital Invested and the Accumulated Profits or Losses for the business since it began. Owner sub ledgers may also be maintained to keep up with and track shares and interests and amounts owed individual owners.

  - ### Sole Proprietorship
    - Owner's Capital
    - Owner's Drawing

  - ### Partnership or Limited Liability Company
    - Partner's or Member's Capital
    - Partner's or Member's Drawing

  - ### Corporation
    - Capital Stock
      - Common Stock
        - Common Stock Par or Stated Value
        - Premium Paid on Common Stock
      - Preferred Stock
        - Preferred Stock Par or Stated Value
        - Premium Paid on Preferred Stock
    - Retained Earnings

Common Accounting Terms

[A][B][C][D][E][F][G][H][I][J][L][M][N][O][P][Q][R][S][T][U][V][W]

A

accelerated depreciation method
method that charges larger depreciation charges in the early years of an asset's life and smaller charges in later years.

account
a separate record for each type of asset, liability, equity, revenue, and expense used to show the beginning balance and to record the increases and decreases for a period and the resulting ending balance at the end of a period.

account balance
beginning account's balance plus the increases less the decreases posted to the account with debits and credits.

accountant
a person formally trained to prepare, maintain, and analyze financial information.

accounting
is the art of analyzing, recording, summarizing, reporting, reviewing, and interpreting financial information.

accounting cycle
recurring procedures (steps) performed each accounting period.

accounting equation
mathematical expression of the relationship of property and property rights. Also called the Balance Sheet Equation.

The equation Assets = Liabilities + Equity, which demonstrates the two-sided nature of accounting and is useful for explaining the concept of double-entry accounting (or double-entry bookkeeping).

accounting period
length of time covered by financial statements-months, quarters, and years.

accounting principles
the rules and guidelines that companies must follow when reporting financial data. The common set of accounting principles is called generally accepted accounting principles (GAAP).

accounts payable
creditor's claims against the business's property arising from the business's purchase of goods and/or services on account.

accounts receivable
business claims against the property of a customer arising from the sale of goods and/or services on account.

accrual method (basis) of accounting
method of accounting that records income in the period earned and records expenses and capital expenditures such as buildings, land, equipment, and vehicles in the period incurred.

accrued expenses
expenses incurred but not yet recorded

accrued revenues
revenues earned but not yet recorded

accumulated depreciation
cumulative sum of all depreciation expenses recorded for assets.

adjusting entry
journal entry made at the end of a period to update an asset or liability account's balance to its actual amount and update the related expense and revenue account balances.

advertising
expense account used to record promotional expenditures, such as newspapers, handbills, television, radio and mail.

aging
preparing reports that sort amounts due or owed into categories by age of when they are due to be paid or received.

allowance for uncollectible accounts
contra asset account whose balance contains amounts that match bad debt expenses with sales for a period.

asset
properties used in the operation or investment activities of a business.

all the good stuff a business owns (anything with value). The goodies.

audit
an independent review of financial records to verify their accuracy.

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B

bad debts
amounts owed a business that are unlikely to be collected.

balance sheet
the financial statement which shows the amount and nature of business assets, liabilities, and owner's equity (capital) as of a specific point in time. It is also known as a Statement Of Financial Position or a Statement Of Financial Condition.

balance sheet account
a type of account that is included in the Balance Sheet; namely the Assets, Liabilities, and permanent Equity Accounts.

balance sheet-account form
horizontal balance sheet form that lists assets on the left side and liabilities and equity on the right side.

balance sheet-report form
The report form of the balance sheet provides information in a vertical format -- essentially one column that goes the full width of the page. The report form starts with assets, providing a total value at the end of the assets section. It then lists liabilities and finishes with equity, with the final line of the report providing the total combined value of liabilities and equity.

bank reconciliation
the process of bringing the checkbook and bank statement balances into agreement.

bank statement
a copy of the bank's record of the business's account showing the balance of the account at the beginning of the month, the deposits and withdrawals (mostly checks) made during the month, service charges, and the balances at the end of the month.

book value
Original cost of a depreciable asset less accumulated depreciation.

bookkeeper

a person who records and classifies the financial transactions of a business

bookkeeping
is the process of recording and classifying business financial transactions (activities). Maintaining the records of the financial activities of a business or individual.

break even point
the sales level at which a business generates exactly zero profits, given a certain amount of fixed costs incurred in a period.

budgeting
preparing a report that forecasts (estimates) planned results for the future.

building rental
expene account used to record expenditures paid to an owner of property (building) for use of the property. A rental agreement called a lease contains the terms.

buildings
asset account used to record expenditures for structures erected on land and used for the conduct of business.

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C

cancelled check
checks that have been processed (paid) by the bank and deducted from the bank's customer's account.

capital
capital is also called equity-see the terms owner's equity and equity.

capital statement
the financial report that summarizes all the changes in owner's equity (capital) that occurred during a specific period.

cash
asset accounts that record monetary items that are available to meet current obligations of the business.

It includes bank deposits, currency, coins, checks, money orders, and traveler's checks.

cash basis
accounting method that records revenues when cash is received and expenses when cash is paid.

cash disburements (payments) journal

a special journal used to record only cash payment transactions.

cash discount
deduction from the invoice amount allowed for early payment.

cash forecast
estimate of the timing and amounts of cash inflows and outflows over a specific period (usually one year).

cash receipts journal
a special journal used to record only cash receipt transactions.

cash sale
a sale in which cash is received for the total amount of the sale at the time of the transaction.

chart of accounts
a coded listing of all the accounts in the general ledger.

check
a written order directing a bank to pay cash from the account of the writer (drawer) of the check.

check book
formal record of all checks written, deposits, bank charges, and miscellaneous charges and credits.

closing the books
process of transferring the balances from the temporary income statement accounts (revenues and expenses) to the permanent balance sheet equity account(s).

common stock
a corporation's basic ownership share -also called capital stock.

compound journal entry
a journal entry that affects at least three accounts.

contingent liabilities
liabilities not recorded in financial reports due to the uncertainty of future events.

contra account
an account which offsets and reduces or offsets the balance of another account.

contra-asset account
has a credit balance and offsets and decreases the debit balance of the related asset account. An

example account is Accumulated Depreciation which reduces the equipment account to arrive at the equipment's net value.

contra-liability account
has a debit balance and offsets and decreases the credit balance of the related liability account. An

example accounts is the bond discount account that reduces the bonds payable account to arrive at the bond's net value.

contribution margin
amount determined by subtracting variable costs from net sales.

control account
a general ledger account that has a subsidiary ledger that contains the detail balances that total to the amount contained in the summary control account.

corporation
an organization made up of many owners (stockholders) who normally are not active in the operations of the business.

correcting entry
a journal entry made to correct an error previously recorded in the general ledger.

cost of goods available for sale
beginning inventory plus net purchases for a period.

cost of goods sold
expense account that records the cost of inventory sold to customers during a period - also called cost of sales.

credit
an entry (amount) entered on the right side (column) of a journal or general ledger account that

increases a liability, owner's equity (capital) or revenue, or an entry that decreases an asset, draw, or an expense.

credit sales
sales made on account. Sales where the customer is allowed to pay at a later date. Noncash sales

creditor
a person or organization that a business owes money.

current asset
cash and other assets normally expected to be converted to cash or used up usually within a year.

current liability
amounts owed (liabilities) that need to be paid or settled usually within a year.

current ratio
ratio used to determine a business's ability to pay its short term obligations.

calculated by dividing current assets by current liabilities.

customer
a person or organization that buys goods or services from a business.

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D

debit
an entry (amount) entered on the left side (column) of a journal or general ledger account that increases an asset, draw or an expense or an entry that decreases a liability, owner's equity (capital) or revenue.

debtor
customers that owe a business money.

deposits in transit
deposits recorded by the business but not yet recorded by the bank.

depreciation
expense account that records expenses related to the usage of plant and equipment allocated to periods in which they are used.

direct labor
wages of employees who make products.

direct materials
materials of significant value that are an integral component of products.

direct write-off method
method that records bad expenses when specific accounts are determined to be uncollectible.

dividends
a company's distribution (payments) of profits to shareholders.

double entry
type of accounting/bookkeeping system that requires every transaction to be recorded in at least two places (accounts) using a debit and a credit. Every transaction is recorded in a formal journal as a debit entry in one account, and as a credit entry in another account. Periodically, usually monthly, the summarized balances from the journals are posted (transferred) to a formal business record called the general ledger.

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E

electronic funds transfer (EFT)
use of electronic communication to transfer cash from one part to another.

equipment
asset account used to record expenditures for physical goods used in a business, such as machinery or furniture. Equipment is used in a business during the production of income.

equity
owner's claim to the assets of a business - also called net assets and capital-see related terms capital and owner's equity

expense
decrease in owner's equity (capital) resulting from the cost of goods, fixed assets, and services and supplies consumed in the operations of a business.

the costs of doing business. The stuff we used and had to pay for or charge to run our business.

external users
users of accounting information who are not directly involved with a business such as governmental agencies, creditors, customers, and investors.

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Top

F

factory overhead
costs incurred during the manufacturing process, not including the costs of direct labor and materials.

Factory overhead is normally aggregated into cost pools and allocated to units produced during the period.

FIFO -first in first out
cost flow assumption that assumes the oldest products are the first sold.

Financial Accounting Standards Board
independent group of full time members responsible for setting accounting rules.

financial statements
accounting reports prepared periodically to inform the owner, creditors, and other interested parties as to the financial condition and operating results of the business.

finished goods
manufactured products that are fully completed and available for sale.

fixed assets
another name for property, plant, and equipment.

fixed costs
are costs that do not change when the quantity of output changes.

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G

general journal
a journal used to record transactions not recorded in special journals.

general ledger
a record containing the accounts and balances for all of a business's assets, liabilities, equity, revenue, and expense accounts.

Generally Accepted Accounting Principles
rules that specify acceptable accounting practices.

gross pay
amount earned by employees prior to any deductions.

gross profit
amount determined by deducting cost of goods sold from net sales.

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H

historical cost
original cost of an asset.

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I

income statement
the financial statement that summarizes revenues and expenses for a specific period of time, usually a month or a year. This statement is also called a Profit and Loss Statement or an Operating Statement.

income statement account
a type of account that is included in the Income Statement; namely the Revenue and Expense Accounts.

intangible assets
assets of a non-physical nature that have a value-patents-copyrights-trade names

interest expense
expense account that records money paid regularly at a particular rate for the use of money.

interest income
amounts earned from investments.

internal controls
methods put in place by a company to ensure the integrity of financial and accounting information, meet operational and profitability targets and transmit management policies throughout the organization.

internal users
users directly involved with a business such as managers, owners, and employees who work for the business.

inventory
asset account that records expenditures for items held for resale in the normal course of a business's operations.

invoice
a business document showing the names and addresses of the buyer and the seller; the date and terms of the sale; the description, quantity, unit price, and total price of goods purchased or sold and the method of delivery.

Selling business refers to this document as a Sales Invoice.

Buying business refers to this document as a Supplier Invoice.

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J

job costing
an order-specific costing technique, used in situations where each job is different and is performed to the customer's specification.

also called job order costing

journals
a preliminary record where business transactions are first entered into the accounting system. The journal is commonly referred to as the book of original entry.

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L

land
asset account that records expenditures for parcels of the earth such as building sites, yards, and parking areas.

liability
Claims by creditors to the property (assets) of a business.

Other's claims to a business's good stuff. Amounts the business owes to others.

LIFO -last in first out
cost flow assumption that assumes the newest products are the first sold.

limited liability company (LLC)
relatively new type of business structure that combines the benefits of a partnership and corporation.

loss
amount a business's expenses exceed (greater than) revenues. In other words, we earned less than we spent.

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M

maintenance & repairs
expense account that records expenditures paid to repair and or maintain buildings and/or equipment.

mark up
amount added to the cost of products to determine selling prices.

merchandising business
a business that buys and sells products to consumers.

mortgage payable
notes payable which are secured by a lien on land, buildings, equipment, or other property of the borrower (your company)

multiple step income statement
income statement format that has subtotals between sales and net income and categorizes expenses.

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N

net income
amount earned after subtracting all expenses from revenue (sales) for a period - also called net profit.

net loss
excess of expenses over revenues for a period -expenses are greater than revenues.

net pay
employee's earnings after all deductions.

net sales
sales less discounts and return and allowances.

normal balance of account
a debit or credit balance determined by the side of an account that represents an increase.

notes payable
formal written promises to pay definite sums of money owed at specified times.

notes receivable
formal written promises given by customers or others to pay definite sums of money to the business at specified times.

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O

office supplies
asset or expense account that records expenditures for maintaining a supply of on hand supplies such as typewriter, copier, and computer paper, pens, pencils, and special forms.

organization costs
expenditures incurred in order to start a business.

outstanding checks
checks written but not yet paid by the bank at the bank statement date.

owner drawings (withdrawals)
assets taken out of a business for the owner?s personal use.

owner's equity

owner's rights and claims to the property (assets) of a business-also called proprietorship and net worth.

what the business owes the owner(s). The good stuff left for the owner after all liabilities (amounts owed) are paid.

owner's investments

increase in owner's equity (capital) resulting from additional investments of cash and/or other property made by the owner.

amounts, either cash or other property, that the owner puts in his business.

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P

partnership
two or more people who share the ownership of a single business.

payroll taxes
expenditures for taxes based on wages paid to employees.

periodic inventory method
inventory determined by performing a physical inventory -counting, weighing, and measuring products on hand.

permanent or real account

A real account is a general ledger account that does not close at the end of the accounting year. In other words, the balances in the real accounts are carried over to become the beginning balances of the next accounting period.

perpetual inventory
a book inventory determined by maintaining detailed records of increases and decreases.

petty cash
small amounts of cash in a fund used to pay minor expenses.

posting
process of transferring balances from bookkeeping records called journals to a final bookkeeping record called the general ledger.

prepaid expenses
an asset representing items paid for in advance of receiving their benefits.

process costing
costing procedure used to assign costs when there is mass production of similar products, where the costs associated with individual units of output cannot be differentiated from each other.

profit
amount a business's revenues exceed (greater than) expenses. In other words, the amounts we earned were greater than our expenses.

property
another term for assets.

purchase order
a document originated by the purchaser (buyer) requesting the supplier to ship goods or perform services.

purchases
goods bought on credit and cash to be resold.

purchases journal
a special journal used to record transactions that involve purchases on credit.

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Q

quick assets
cash and other assets that can quickly be converted into cash.

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R

real property
land and anything attached to the land.

receiving report
a document originated by the buying business listing the quantities and condition of the goods and/or services received from a supplier.

rental income
revenue account that records amounts earned from renting properties.

report form balance sheet
a balance sheet that lists the accounts vertically in the order of assets, liabilities, and equity (capital).

retained earnings
total profit or loss from the start of the business to the present not paid out to owners.

revenue
the gross increase in owner's equity (capital) resulting from the operations and other activities of the business.

amounts a business earns by selling services and products. Amounts billed to customers for services and/or products

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S

salaries
expense accounts that record expenditures for work performed by employees.

sale of products
amounts earned from the sale of merchandise.

sale of services
amounts earned from performing services.

sale on account
sale where the customer is allowed to pay at a future date.

sales journal
a special journal used to record all of the company sales on credit.

sales order
a documented originated by the seller listing the goods and/or services ordered by a customer and other information such as prices and delivery dates.

sales return
amount owed to customers for the return of merchandise previously sold.

sales tax
tax collected for governmental agencies based on sales.

selling expenses
expenses related to promoting (increasing) sales such as sales commissions, catalogues, advertising, and customer support.

semi-fixed cost
see semi-variable costs

semi-variable cost

a cost composed of a mixture of fixed and variable components. Costs are fixed for a set level of production or consumption, becoming variable after the level is exceeded.

service business
a business that sells services and related materials.

single step income statement
income statement format that includes cost of goods sold and has only one subtotal for total expenses.

sole proprietorship
business owned by one person who is normally active in running and managing the business.

source documents
documents that evidence a business transaction has occurred such as invoices and checks.

specialized journals
journals used to initially record special types of transactions such as sales, cash disbursements, and cash receipts in their own journal.

statement cash flows
the financial statement that reports the sources and uses of cash for a specific period of time, normally a year.

stockholder's equity
value of the owner's equity (capital) in a corporation.

subsidiary ledgers
a separate record set up to record the individual items relating to a single general ledger account (control account). Examples include an accounts receivable and accounts payable ledger.

supplies
asset or expense account that records expenditures for incidental materials needed in the conduct of business.

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T

T-Account
a skeleton outline of an account which provides the same basic data as a formal ledger account. Used as a teaching aid.

temporary account
another term used to refer to the income statement accounts. The accounts are called temporary due to the fact that their balances are set to zero when the books are closed.

transaction
any event or condition that must be recorded in the books of a business because of its effect on the financial condition of the business, such as buying and selling. A business deal or agreement.

trial balance
a worksheet listing of all the accounts appearing in the general ledger with the dollar amount of the debit or credit balance of each account. Used to make sure the books are in balance -total debits and credits are equal.

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U

unearned revenue
a liability created when customers pay in advance for products or services that have not been delivered or rendered.

utilities
expenditures for basic services needed to function in the modern world, such as water, sewer, gas, electricity and telephone. Most businesses track the amount spent for each type of utility service.

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V

variable costs
are costs that varies in relation to changes in the volume of activity.

vendor
seller of goods and/or services-also called supplier.

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W

wholesaler
a business that buys and sells large quanties of products to others for resale.

work in process
unfinished products being manufactured.

working capital
net difference between current assets and current liabilities.

Working Capital = Current Assets - Current Liabilities

worksheets
forms which are used to summarize all the information necessary to complete the end-of-period financial reports and prepare other financial analysis.

Bean Counter's

So, you want to learn Bookkeeping!

Glossary Of Common Bookkeeping Terms

Account- a separate record for each type of asset, liability, equity, revenue, and expense used to show the beginning balance and to record the increases and decreases for a period and the resulting ending balance at the end of a period.

Accounting Equation-Mathematical expression of the relationship of property and property rights. Also called the Balance Sheet Equation.

Accounts Payable-TL Creditor's claims against the business's property arising from the business's purchase of goods and/or services on account.

Accounts Receivable-TA Business claims against the property of a customer arising from the sale of goods and/or services on account.

Accrual Method (Basis) of Accounting-Method of accounting that records income in the period earned and records expenses and capital expenditures such as buildings, land, equipment, and vehicles in the period incurred.

Advertising-TE Promotional expenditures, such as newspapers, handbills, television, radio and mail.

Assets

Formal: The properties used in the operation or investment activities of a business.

Informal Definition: All the good stuff a business has/owns (anything with value). The goodies.

Balance Sheet- The financial statement which shows the amount and nature of business assets, liabilities, and owner's equity (capital) as of a specific point in time. It is also known as a Statement Of Financial Position or a Statement Of Financial Condition.

Balance Sheet Account-A type of account that is included in the Balance Sheet; namely the Assets, Liabilities, and permanent Equity Accounts.

Bank Reconciliation-The process of bringing the checkbook and bank statement balances into agreement.

Bank Statement- A copy of the bank's record of the business's account showing the balance of the account at the beginning of the month, the deposits and withdrawals (mostly checks) made during the month, service charges, and the balances at the end of the month.

Building Rental-TE Expenditures paid to an owner of property (building) for use of the property. A rental agreement called a lease contains the terms.

Buildings-TA Expenditures for structures erected on land and used for the conduct of business.

Capital Statement-The financial report that summarizes all the changes in owner's equity (capital) that occurred during a specific period.

Cash Method (Basis) of Accounting-Method of accounting that recognizes revenues (earnings) in the period the cash is received and expenses in the period when the cash payments are made.

Cash-TA Monetary items that are available to meet current obligations of the business. It includes bank deposits, currency & coins, checks, money orders, and traveler's checks.

Chart Of Accounts-A coded listing of all the accounts in the general ledger.

Check Book-Formal record of all checks written, deposits, bank charges, and miscellaneous charges and credits.

Check-A written order directing a bank to pay cash from the account of the writer (drawer) of the check.

Closing the Books-Process of transferring the balances from the temporary income statement accounts (revenues and expenses) to the permanent balance sheet equity account(s)

Contra Account-an account which offsets and reduces or offsets the balance of another account.

Contra-asset account-Has a credit balance and offsets and decreases the debit balance of the related asset account. An example account is Accumulated Depreciation which reduces the equipment account to arrive at the equipment's net value.

Contra-liability account- Has a debit balance and offsets and decreases the credit balance of the related liability account. An example accounts is the bond discount account that reduces the bonds payable account to arrive at the bond's net value.

Credit-An entry (amount) entered on the right side (column) of a journal or general ledger account that increases a liability, owner's equity (capital) or revenue, or an entry that decreases an asset, draw, or an expense.

Current Asset-cash and other assets normally expected to be converted to cash or used up usually within a year.

Current Liability-Amounts owed (liabilities) that need to be paid or settled usually within a year.

Debit-An entry (amount) entered on the left side (column) of a journal or general ledger account that increases an asset, draw or an expense or an entry that decreases a liability, owner's equity (capital) or revenue.

Double Entry-Type of accounting/bookkeeping system that requires every transaction to be recorded in at least two places (accounts) using a debit and a credit. Every transaction is recorded in a "formal" journal as a debit entry in one account, and as a credit entry in another account. Periodically, usually monthly, the summarized balances from the journals are posted (transferred) to a formal business record called the general ledger.

Equipment-TA Expenditures for physical goods used in a business, such as machinery or furniture. Equipment is used in a business during the production of income.

Expense / Cost

Formal Definition:Decrease in owner's equity (capital) resulting from the cost of goods, fixed assets, and services and supplies consumed in the operations of a business.

Informal Definition:The costs of doing business. The stuff we used and had to pay for or charge to run our business.

Financial Statements-Accounting reports prepared periodically to inform the owner, creditors, and other interested parties as to the financial condition and operating results of the business. The three basic financial statements are:

General Ledger-A book containing the accounts and balances for all of a business's assets, liabilities, equity, revenue, and expense accounts.

Income Statement-The financial statement that summarizes revenues and expenses for a specific period of time, usually a month or a year. This statement is also called a Profit and Loss Statement or an Operating Statement.

Income Statement Account-A type of account that is included in the Income Statement; namely the Revenue and Expense Accounts..

Interest Income-TR Amounts earned from investments.

Inventory-TA Expenditures for items held for resale in the normal course of a business's operations.

Invoice-A business document showing the names and addresses of the buyer and the seller; the date and terms of the sale; the description, quantity, unit price, and total price of goods purchased or sold and the method of delivery.

Selling business refers to this document as a Sales Invoice.

Buying business refers to this document as a Supplier Invoice.

Journals-A preliminary record where business transactions are first entered into the accounting system. The journal is commonly referred to as the book of original entry.

Land-TA Expenditures for parcels of the earth. It includes building sites, yards, and parking areas.

Liabilities

Formal Definition:Claims by creditors to the property (assets) of a business until they are paid.

Informal Definition:Other's claims to the business's good stuff. Amounts the business owes to others.

Loss-Amount a business's expenses exceed (greater than) revenues. In other words, we earned less than we spent.

Maintenance & Repairs-TE Expenditures paid to repair and or maintain buildings and/or equipment.

Accounting Equation

Abbreviated or Simple Version:

Property = Property Rights

Expanded Version:

Assets = Liabilities + Owner's Equity (Capital)

Fully Expanded Version:

Assets = Liabilities + Beginning Owner's Equity (Capital) + Additional Owner Investments + Revenues - Expenses - Draws

Mortgage Payable-TL Notes payable which are secured by a lien on land, buildings, equipment, or other property of the borrower (your company).

Notes Payable-TL Formal written promises to pay definite sums of money owed at specified times.

Notes Receivable-TA Formal written promises given by customers or others to pay definite sums of money to the business at specified times.

Office Supplies-TA Expenditures for maintaining a supply of on hand supplies such as typewriter, copier, and computer paper, pens, pencils, and special forms.

Owner's Drawing

Formal Definition: Decrease in owner's equity (capital) resulting from withdrawals made by the owner.

Informal definition: Amounts the owner withdraws from his business for living and personal expenses.

Owner's Equity / Owner's Capital

Formal Definition:The owner's rights to the property (assets) of the business; also called proprietorship and net worth.

Informal Definition:What the business owes the owner; assuming all liabilities (amounts owed) have been paid.

Owner's Investments

Formal Definition: Increase in owner's equity (capital) resulting from additional investments of cash and/or other property made by the owner.

Informal definition: Additional amounts, either cash or other property, that the owner puts in his business.

Payroll Taxes-TE Expenditures for taxes based on wages paid to employees.

Permanent or Real Account-Another term used to refer to the balance sheet accounts.

Posting-Process of transferring balances from bookkeeping records called journals to a "final" bookkeeping record called the general ledger.

Profit-Amount a business's revenues exceed (greater than) expenses. In other words, the amounts we earned were greater than our expenses.

Property-Another term for assets. In future lessons the term property and assets both mean the same thing-all the good stuff a business has.

Purchase Order-A document originated by the purchaser (buyer) requesting the supplier to ship goods or perform services.

Receiving Report-A document originated by the buying business listing the quantities and condition of the goods and/or services received from a supplier.

Rental Income-TR Amounts earned from renting properties.

Revenue / Income

Formal Definition:The gross increase in owner's equity (capital) resulting from the operations and other activities of the business.

Informal Definition:Amounts a business earns by selling services and products. Amounts billed to customers for services and/or products

Salaries-TE Expenditures for work performed by employees.

Sale of Products-TR Amounts earned from the sale of merchandise.

Sale Of Services-TR Amounts earned from performing services.

Sales Order-A documented originated by the seller listing the goods and/or services ordered by a customer and other information such as prices and delivery dates.

Specialized Journals-Journals used to initially record special types of transactions such as sales, cash disbursements, and cash receipts in their own journal.

Statement of Changes in Cash-The financial statement that reports the sources and uses of cash for a specific period of time, normally a year.

Subsidiary Ledgers-A separate record set up to record the individual items relating to a single general ledger account (control account). Examples include an accounts receivable and accounts payable ledger.

Supplies-TE Expenditures for incidental materials needed in the conduct of business, such as office supplies.

T-Account-a skeleton outline of an account which provides the same basic data as a formal ledger account. Used as a teaching aid.

Temporary Account-Another term used to refer to the income statement accounts. The accounts are called temporary due to the fact that their balances are set to zero when the books are closed.

Transaction-Any event or condition that must be recorded in the books of a business because of its effect on the financial condition of the business, such as buying and selling. A business deal or agreement.

Trial Balance-A worksheet listing of all the accounts appearing in the general ledger with the dollar amount of the debit or credit balance of each. Used to make sure the books are "in balance" -total debits and credits are equal.

Types of Assets-Cash, Acct Receivable, Notes Receivable, Inventory, Office Supplies, Land, Building, Equipment, Furniture,

Types of Expenses-Supplies, Salaries, Payroll, Advertising/Promotional, Utilities, Building, and Maintenance Expenditures

Types Of Liabilities-Accounts Payable, Notes Payable and Mortgage Payable

Types of Revenue (Income)-Sale of Products, Sale Of Services, Rental Income, Interest Income

Utilities-TE Expenditures for basic services needed to function in the modern world, such as water, sewer, gas, electricity and telephone. Most businesses track the amount spent for each type of utility service.

Working Capital-Net difference between current assets and current liabilities.

Working Capital = Current Assets - Current Liabilities

Worksheets-Forms which are used to summarize all the information necessary to complete the end-of-period financial reports and prepare other financial analysis.

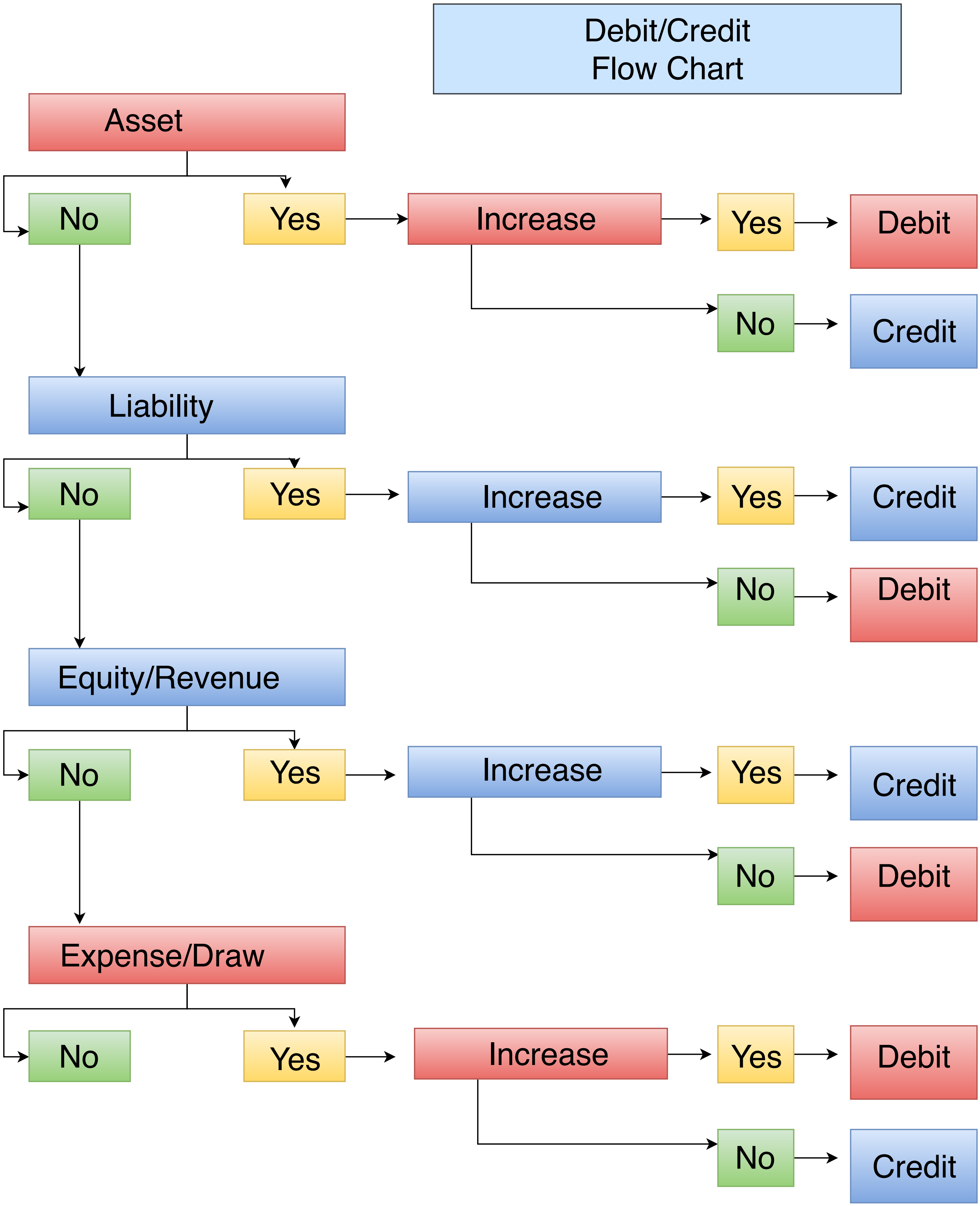
Abbreviations:

TA-Type Of Asset

TL-Type Of Liability

TE-Type Of Expense

TR-Type Of Revenue


Debit/Credit
Flow Chart
Asset
No
Yes
Increase
Yes
Debit
No
Credit
Liability
No
Yes
Increase
Yes
Credit
No
Debit
Equity/Revenue
No
Yes
Increase
Yes
Credit
No
Debit
Expense/Draw
No
Yes
Increase
Yes
Debit
No
Credit

Bean Counter's Accounting and Bookkeeping "Cheat Sheet"

Provided by: Bean Counter

Source Documents (Invoices, Checks, etc.)						
Journals -Transactions first recorded **using Debits and Credits**						
General Ledger -Summarized transactions posted to the General Ledger Accounts **using Debits and Credits**						
Abbreviated Accounting Equation	Property =		Property Rights			
Expanded Accounting Equation	Assets =		Liabilities +		Owner's Equity	
	Balance Sheet Accounts Permanent Accounts					
Types Of Accounts	Asset Accounts =		Liability Accounts +		Capital Accounts (Mom)	
Increase/Decrease Columns	Increase	Decrease	Decrease	Increase	Decrease	Increase
Account -Left / Right Side Columns	Left Side	Right Side	Left Side	Right Side	Left Side	Right Side
Debit / Credit Columns	**Debit**	Credit	Debit	**Credit**	Debit	**Credit**
Owner's Equity Equation that illustrates the effect of closing the temporary accounts -revenue-expenses-draws to the permanent Equity Accounts.					Owner's Equity = Beginning Capital + Profit or - Loss - Owners Draws + Owner's Investments	
					Income Statement Accounts	
Accounts Closed To Capital Account at End Of Period					Temporary (Nominal) Accounts	
"Mom" Equity's "Kids" - Revenue - Expense - Draws					Expenses Draws	Revenue
Effect On "Mom" Equity (Capital)					Decreases	Increases
Revenue , Expense, and Draw Account "Rules" These accounts are often referred to as temporary or nominal accounts because at the end of a year (period) they are closed and their balances are transferred to a permanent Equity (Capital) Account (Balance Sheet Account). **Debit / Credit Columns**					(see rules table below)	
Profit / Loss Equation					Profit / Loss = Revenue - Costs and Expenses	

Increase	Decrease	Decrease	Increase
Left Side	Right Side	Left Side	Right Side
Debit	Credit	Debit	**Credit**

Note: Bold highlighted items in my cheat sheet represent the Normal Type Of Balance For an Account - Debit or Credit

The purpose of my cheat sheet is to serve as an aid for those needing help in determining how to record the debits and credits for a transaction.

My "Cheat Sheet" Table begins by illustrating that source documents such as sales invoices and checks are analyzed and then recorded in Journals using **debits and credits**. These Journals are then summarized and the debit and credit balances are Posted (transferred) to the General Ledger Accounts and the amounts are posted to the left side of the general ledger accounts for debit balances and to the right side of the general ledger accounts for credit balances. The General Ledger Accounts are made up of Balance Sheet and Income Statement Accounts.

At the end of a year (period), the revenue and expenses accounts (Ma's Kids) are set to zero and their balances are transferred to a permanent equity account in the Balance Sheet such as Owner's Capital (Mom) or Retained Earnings. This process is what is known as Closing The Books. Since the balances of these accounts are set to zero (closed out) at the end of a period, these accounts are sometimes referred to as temporary or nominal accounts. After closing the books for a year, the only accounts that have a balance are the Balance Sheet Accounts. That's why the Balance Sheet Accounts are also referred to as Permanent Accounts.

Of course my cheat sheet is based on the Accounting Equation (Assets = Liabilities + Owner's Equity) which must be kept in balance and double-entry accounting, where for every debit to an account there must be an equal credit to another account.

Account Definition

An **Account** is a separate record for each type of asset, liability, equity, revenue, and expense used to show the beginning balance and to record the increases and decreases for a period and the resulting ending balance at the end of a period.

You should be aware that **All Accounts**:

- Can Be Debited and Credited
- Have an Increase Side and a Decrease Side
- Have a Debit Side and a Credit Side
  Debit Side is the Left Side (Left Column)
  Credit Side is the Right Side (Right Column)
- Have a Normal Balance Amount that is normally a Debit Balance or a Credit Balance
- Have a Type and are classified as an Asset, Liability, Equity, Revenue, Expense, or Draw
- Are Either a Balance Sheet or Income Statement Account

Major Types of Accounts

Assets
Formal Definition:The properties used in the operation or investment activities of a business.

Informal Definition:All the good stuff a business has (anything with value). The goodies.

Additional Explanation: The good stuff includes tangible and intangible stuff. Tangible stuff you can physical see and touch such as vehicles, equipment and buildings. Intangible stuff is like pieces of paper (sales invoices) representing loans to your customers where they promise to pay you later for your services or product. Examples of assets that many individuals have are cars, houses, boats, furniture, TV's, and appliances. Some examples of business type assets are cash, accounts receivable, notes receivable, inventory, land, and equipment.

Liabilities
Formal Definition:Claims by creditors to the property (assets) of a business until they are paid.

Informal Definition:Other's claims to the business's good stuff. Amounts the business owes to others.

Additional Explanation: Usually one of a business's biggest liabilities (hopefully they are not past due) is to suppliers where a business has bought goods and services and charged them. This is similar to us going out and buying a TV and charging it on our credit card. Our credit card bill is a liability. Another good personal example is a home mortgage. Very few people actually own their own home. The bank has a claim against the home which is called a mortgage. This mortgage is another example of a personal liability. Some examples of business liabilities are accounts payable, notes payable, and mortgages payable.

Owner's Equity also called Owner's Capital
Comment: Both terms may be used interchangeably. In my tutorial lessons, I may refer to both terms or just

use one or the other.

Formal Definition:The owner's rights to the property (assets) of the business; also called proprietorship and net worth.

Informal Definition:What the business owes the owner. The good stuff left for the owner assuming all liabilities (amounts owed) have been paid.

Additional Explanation:Owner's Equity (Capital) represents the owner's claim to the good stuff (assets). Most people are familiar with the term equity because it is so often used with lenders wanting to loan individuals money based on their home equity. Home equity can be thought of as the amount of money an owner would receive if he/she sold their house and paid off any mortgage (loan) on the property.

Revenue (Income), Expenses, Investment, and Draws
Revenues, expenses, investment, and draws are sub categories of owner's equity (capital). Think of owner's equity as a mom named Capital with four children to keep up with (I know she's only got one clinging to her leg but she left Expense, Investment, and Draws at home). The kids are named Revenue, Expense, Investment, and Draws and each kid has one job that they are responsible for in order to earn their allowance. **Kid Revenue** is responsible for keeping track of increases in owner's equity (Ma Capital) and **Kid Expense** is responsible for keeping track of decreases in owner's equity (Ma Capital) resulting from business operations. **Kid Draws** has the job of keeping up with decreases in owner's equity (Ma Capital) resulting from owner withdrawals for living expenses and other personal expenses. **Kid Investment** has the job of keeping up with increases in owner's equity (Ma Capital) resulting from additional amounts invested in the business.

Revenue also called Income
Formal Definition:The gross increase in owner's equity (capital) resulting from the operations and other activities of the business.

Informal Definition:Amounts a business earns by selling services and products. Amounts billed to customers for services and/or products.

Additional Explanation:Individuals can best relate by thinking of revenue as their earnings/wages they receive from their job. Most business revenue results from selling their products and/or services.

Expense also called Cost
Formal Definition:Decrease in owner's equity (capital) resulting from the cost of goods, fixed assets, and services and supplies consumed in the operations of a business.

Informal Definition:The costs of doing business. The stuff we used and had to pay for or charge to run our business.

Additional Explanation:Some examples of personal expenses that most individuals are familiar with are utilities, phone, clothing, food, gasoline, and repairs. Some examples of business expenses are office supplies, salaries & wages, advertising, building rental, and utilities.

Owner's Investments
Formal Definition: Increase in owner's equity (capital) resulting from additional investments of cash and/or other property made by the owner.

Informal definition: Additional amounts, either cash or other property, that the owner puts in his business.

Additional Explanation:Although these amounts can be kept up with as a separate item, they are usually recorded directly in the Owner's Capital Account. In other words, immediately put into Ma Equity's purse.

Owner's Drawing
Formal Definition: Decrease in owner's equity (capital) resulting from withdrawals made by the owner.

Informal definition: Amounts the owner withdraws from his business for living and personal expenses.

Additional Explanation:The owner of a sole proprietorship does not normally receive a "formal" pay check from the business, but just like most of the rest of us needs money to pay for his house, car, utilities, and groceries. An owner's draw is used in order for the owner to receive money or other "goodies" from his business to take care of his personal bills.

Definitions of Debits and Credits

Debit

- An entry in the financial books of a firm that increases an asset or an expense or an entry that decreases a liability, owner's equity (capital) or income.
- Also, an entry entered on the left side (column) of a journal or general ledger account.
- Let's combine the two above definitions into one complete definition.

An entry (amount) entered on the left side (column) of a journal or general ledger account that increases an asset, draw or an expense or an entry that decreases a liability, owner's equity (capital) or revenue.

Credit

- An entry in the financial books of a firm that increases a liability, owner's equity (capital) or revenue, or an entry that decreases an asset or an expense.
- Also, an entry entered on the right side (column) of a journal or general ledger account.
- Let's combine the two above definitions into one complete definition.

An entry (amount) entered on the right side (column) of a journal or general ledger account that increases a liability, owner's equity (capital) or revenue, or an entry that decreases an asset, draw, or an expense.

The term debit refers to the left side of an account and credit refers to the right side of an account. A debit is always entered in the left hand column of a Journal or Ledger Account and a credit is always entered in the right hand column. Debit is abbreviated Dr. and Credit is abbreviated Cr.

When you post (record) an entry in the left hand column of an account you are debiting that account. Whether the debit is an increase or decrease depends on the type of account. Likewise, when you post (record) an entry in the right hand column of an account you are crediting that account. Whether the credit is an increase or decrease depends on the type of account.

How To Use and Apply The Debit and Credit Rules:

(1) Determine the types of accounts the transactions affect-asset, liability, revenue, expense or draw account.

(2) Determine if the transaction increases or decreases the account's balance.
(3) Apply the debit and credit rules based on the type of account and whether the balance of the account will increase or decrease.

Our Simple Debit / Credit Rule:

- All Accounts that **Normally Have a Debit Balance** are **Increased with a Debit** by placing the amount in the **Left Column** of the account and **Decreased with a Credit** by placing the amount in the **Right Column** of the account.
  - **A**ssets
  - **D**raws
  - **E**xpenses
- All Accounts that **Normally have a Credit Balance** are **Increased with a Credit** by placing the amount in the **Right Column** of the account and **Decreased with a Debit** by placing the amount in the **Left Column** of the account.
  - **L**iabilities
  - **O**wner's Equity (Capital)
  - **R**evenue

All You Need To Know About Debits and Credits Summarized In One Sentence:

Enter an amount in the **Normal Balance Side** of an Account to **Increase the Balance** of an Account and in the **Opposite Side** of an Account to **Decrease the Balance** of an Account.

Additional Clarification:
Since **A**ssets, **D**raw, and **E**xpense Accounts **normally have a Debit Balance**, in order to Increase the Balance of an **A**sset, **D**raw, or **E**xpense Account enter the amount in the Debit or Left Side Column and in order to Decrease the Balance enter the amount in the Credit or Right Side Column.

Likewise, since **L**iabilities, **O**wner's Equity (Capital), and **R**evenue Accounts **normally have a Credit Balance** in order to Increase the Balance of a **L**iability, **O**wner's Equity, or **R**evenue Account the amount would be entered in the Credit or Right Side Column and the amount would be entered in the Debit or Left Side column to Decrease the Account's Balance.

The Debit and Credit Rules Presented as A Table

Account Type	Normal Balance	Increase To Account Balance	Decrease To Account Balance	Account Example
Property Accounts				
Asset	**Debit**	**Debit - Left Column** Of Account	**Credit - Right Column** Of Account	Cash, Accounts Receivable
Property Rights Accounts				
Liability	**Credit**	**Credit - Right Column** Of Account	**Debit - Left Column** Of Account	Accounts Payable
Owner's Equity	**Credit**	**Credit - Right Column** Of Account	**Debit - Left Column** Of Account	Owner's Capital
Revenue	**Credit**	**Credit - Right Column** Of Account	**Debit - Left Column** Of Account	Sales
Costs and Expenses	**Debit**	**Debit - Left Column** Of Account	**Credit - Right Column** Of Account	Rent, Utilities, Advertising
Owner Draws	**Debit**	**Debit - Left Column** Of Account	**Credit - Right Column** Of Account	Owner Draws

Typical Types Of Business Transactions
and the Debits and Credits and Accounts Used To Record Them

In a typical business transaction we get something and we give up something.

Sale-Sell goods and/or services

- **(1)** Cash Sale-customer pays at the time of sale
  The business **gets** cash or a check from their customer and **gives** up a product or service to their customer.
  Accounts Used:
  Debit: Cash
  Credit: Sales

- **(2)** On Account Sale-business allows the customer time to pay
  The business **gets** a promise to pay from their customer and **gives** up a product or service to their customer.
  Accounts Used:
  Debit: Accounts Receivable
  Credit: Sales

Purchase goods and/or services

- **(3)** Cash Purchase-business pays the supplier at the time of purchase
  The business **gets** a product or service from their supplier and **gives** up cash or a check to their supplier.
  Accounts Used:
  Debit: Expense or Inventory Account
  Credit: Cash

- **(4)** On Account Purchase-supplier allows the business time to pay
  The business **gets** a product or service from a supplier and **gives** up a promise to pay to their supplier.

  Accounts Used:
  Debit: Expense or Inventory Account
  Credit: Accounts Payable

(5) Pay Supplier Charge Purchases -pay suppliers for products and/or services that we promised to pay for later (charge).
The business **gets** the amount of their promise to pay the supplier reduced and **gives** up cash or a check.
Accounts Used:
Debit: Accounts Payable
Credit: Cash

(6) Receive Customer Charge Payments -receive payments from a customer that promised to pay us later (charge sale).
The business **gets** cash or a check from their customer and **gives** up (reduces the amount of) their customer's promise to pay.
Accounts Used:
Debit: Cash
Credit: Accounts Receivable

(7) Borrow Money (Loans) The business **gets** cash or equipment and **gives** up a promise to pay.
Accounts Used:
Debit: Cash or Equipment
Credit: Note Payable

(8) Repay a Loan
The business **gets** the amount of their promise to pay reduced and **gives** up cash or a check.
Accounts Used:
Debit: Note Payable
Credit: Cash

(9) Draw
The business **gets** the owner's claim to the business assets reduced and **gives** up cash or a check.
Accounts Used:
Debit: Owner's Draw
Credit: Cash

(10) Payroll (not covered in this tutorial)
The business **gets** services from their employees and **gives** up a check.
Accounts Used:
Debit: Salary & Wages Expense
Credit: Cash

Income Statement Accounts

The Chart of Accounts is normally arranged or grouped by the Major Types of Accounts. The Balance Sheet Accounts (Assets, Liabilities, & Equity) are presented first, followed by the Income Statement Accounts (Revenues & Expenses).

Here we're going to discuss the Income Statement Portion of the Chart Of Accounts (Revenues and Expenses) and how it's organized,

The Income Statement portion of the chart of accounts normally begins by listing Revenue Accounts followed by the Expense Accounts. The revenues are grouped or classified based on whether they are related to the normal operations of the business (primary business activities) called Operating Revenue or result from incidental (secondary business activities) called Non-operating Revenue.

Likewise, the expenses are grouped or classified based on whether they are related to the normal operations of the business (primary business activities) called Cost of Goods Sold and Operating Expenses or result from incidental (secondary business activities) called Non-operating Expenses.

While most revenue and expense accounts that need to be set up are common to all businesses, some depend on the type of business. Cost Of Sales is needed for those businesses that produce and sell goods or "inventoriable" services as well as those that just buy and resell the goods.

- ## Revenue
  Formal Definition:The gross increase in owner's equity resulting from the operations and other activities of the business.

  Informal Definition:Amounts a business earns by selling services and products and investing. Amounts billed to customers for services and/or products.

  - ### Operating Revenue
    Revenues resulting from the normal operations of a business such as the revenues resulting from the sale of products and services to your customers.

    - Sales
      - Products
      - Services
    - Sales Discounts (Contra-Revenue Account)
    - Sales Returns and Allowances (Contra-Revenue Account)

  - ### Non-Operating Revenue and Gains
    Non-operating revenue accounts include all types of income that you receive that are not part of your main line of business. In other words, revenues or gains resulting from something other than from normal business operations.

    - Interest Income
    - Dividends
    - Commissions
    - Rental Income
    - Gain On Sale Of Assets

        - Gains -Other Unusual

- # Expenses

  Formal Definition:Decrease in owner's equity resulting from the cost of goods, fixed assets, and services and supplies consumed in the operations of a business.

  Informal Definition:The costs of doing business. The stuff we used and had to pay for or charge to run our business.

  - ## Cost of Sales or Cost of Goods Sold

    Cost of Goods Sold - the cost of the products purchased or manufactured and sold by a business.

    - Cost Of Goods Purchased and Sold
      - Purchases
        A temporary account used in the periodic inventory system to record the purchases of merchandise for resale. This account reports the gross amount of purchases of merchandise. Net purchases is the amount of purchases minus purchase returns, purchase allowances, and purchase discounts. While the Purchases Accounts are normally classified as temporary expense accounts, they are actually "hybrid" accounts. The purchase accounts are used along with freight and the beginning and ending inventory to determine the Cost Of Goods Sold.
      - Purchase Discounts (Contra Account)
      - Purchase Returns and Allowances (Contra Account)
      - Freight
    - Cost Of Goods Manufactured and Sold

  - ## Operating Expenses

    Operating Expenses - the expenses related to normal daily operations such as wages, rent, advertising, insurance, etc. These expenses are related to the normal operations of the business (primary activities) and are incurred in order to earn normal operating revenues. In other words, amounts spent on products and services related to normal business operations.

    While not absolutely necessary, the Operating Expenses are often grouped into two main functional areas of operation:

    - Selling Expenses
      Selling Expenses are expenses incurred and related to making sales. Examples are sales salaries & wages, fringe benefits, advertising, travel, entertainment, catalogues, rent, utilities, telephone, commissions, warehousing, shipping, depreciation, office supplies, postage, etc.

    - General and Administrative Expenses (G&A)
      G & A Expenses are related to the general operations or overall administration of the business. Examples are administrative salaries & wages (officers, office, accounting, management, and human resources), fringe benefits, supplies, rent, utilities, telephone, travel, entertainment, depreciation, office supplies, postage, legal & accounting fees, etc.

    The following listing of types of expenses, where needed, can be used and included in both groups. There are no rigid rules as to the order that the operating expenses are listed within a category.

    - Salaries and Wages
      - Salaries - Other
      - Salaries - Officers
      - Wages - Regular
      - Wages - Overtime
      - Incentive Pay
      - Commissions

- Bonuses
- Severance Pay

- Required Payroll Related Expenses
    - Employer FICA
    - Employer Medicare
    - Workersâ€™ Compensation Insurance
    - Federal Unemployment
    - State Unemployment
- Fringe Benefits
    - Vacation Pay
    - Holiday Pay
    - Sick Pay
    - Other Paid Leave
    - Parking
    - Meals
    - Employer Provided Health Insurance
    - Employer Provided Life Insurance
    - Employer Provided 401 K Contributions
    - Employer Provided IRA Contributions
    - Employer Provided Pensions & Retirement
    - Other Employer Provided Benefits
- Employee Recruitment
    - Travel
    - Lodging
    - Meals
    - Other
    - Entertainment
    - Advertising
    - Employment Agency Fees
- Temporary Help
- Cash Over / Short
- Supplies Expense
    - Operating Supplies
    - Maintenance Supplies
    - Cleaning Supplies
    - Office Supplies
    - Computer Supplies
    - Other Supplies
- Rent Expense
    - Land
    - Buildings
    - Equipment
    - Vehicles
    - Other
- Leasing Expense
    - Land
    - Buildings
    - Equipment
    - Vehicles
    - Other
- Repairs & Maintenance
    - Buildings
    - Grounds
    - Equipment
        - Office
        - Store
        - Manufacturing

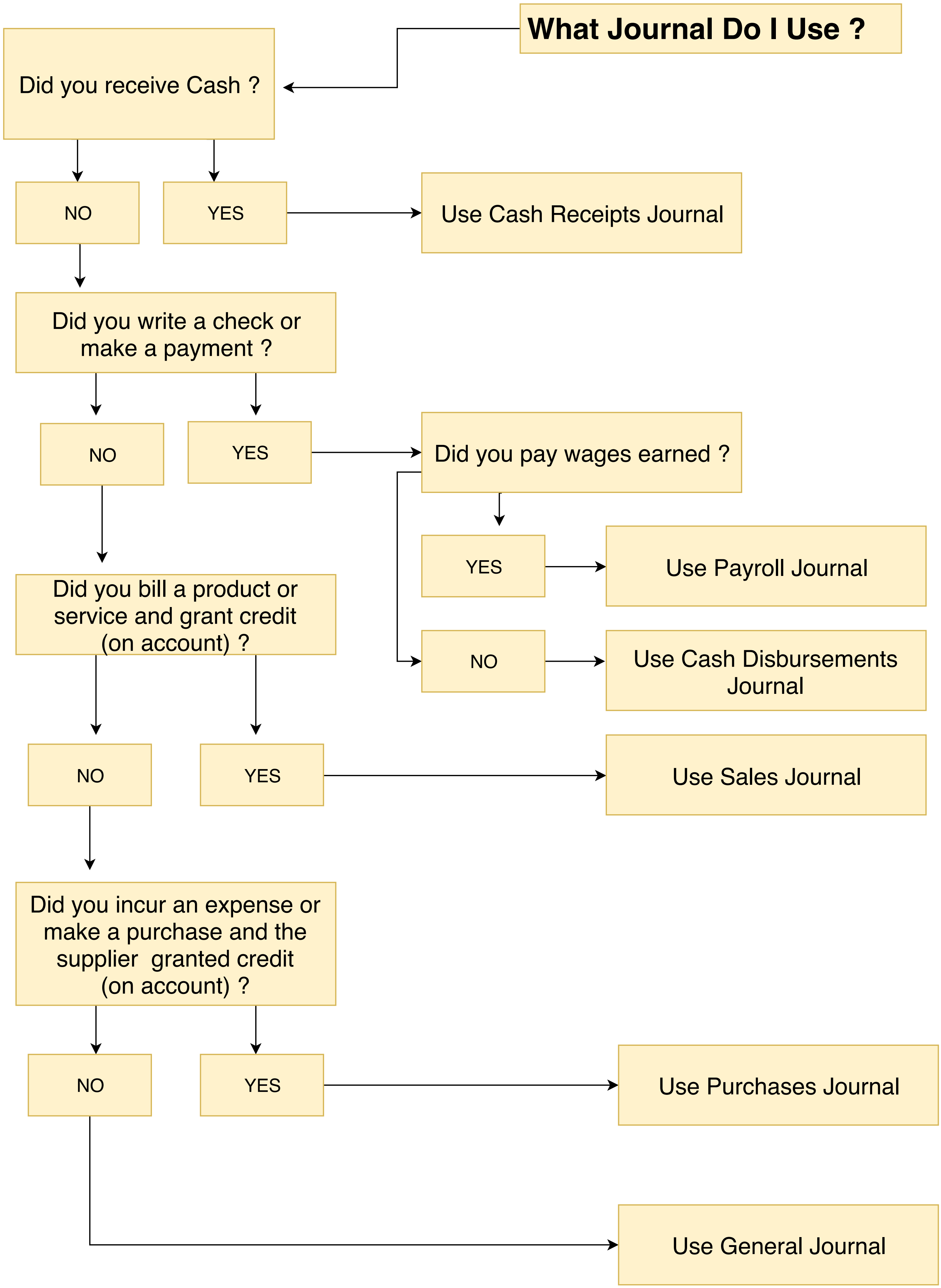
    - Vehicles
    - Other
- Vehicle Operating Expenses
- Delivery Expenses
- Insurance Expense
    - Building & Contents
    - Vehicles
    - Business Interruption
    - Casualty
    - Product Liability
    - Professional Liability
    - Other
- Fees , Licenses, and Permits
- Security
- Janitorial Services
- Uniforms
- Bank Charges and Fees
- Credit Card Fees
- Postage
- Cleaning
- Memberships
- Subscriptions
- Training and Education
    - Tuition and Fees
    - Transportation
    - Lodging
    - Meals
    - Other
- Travel
    - Travel - Overnight
        - Lodging - Overnight
        - Transportation - Overnight
        - Meals - Overnight
        - Other - Overnight
    - Travel - Local
        - Lodging - Local
        - Transportation - Local
        - Meals - Local
        - Other - Local
- Entertainment
    - Meals
    - Gifts
    - Events
    - Other
- Catalogues and Publications
- Advertising
    - TV Ads
    - Radio Ads
    - Newspaper & Magazine Ads
    - Internet Ads
    - Website
    - Promotional Events
    - Other
- Royalties
- Franchise Fees
- Professional Fees
    - Legal

    - Auditing
    - Accounting
    - Tax Preparation
    - Consulting
    - Other
  - Utilities
    - Electricity
    - Gas
    - Water
    - Garbage Collection
    - Other
  - Telephone
  - Internet Access & Services
  - Credit and Collections
    - Bad Debts Expense
    - Collection Expense
    - Credit Reports & Background Checks
  - Depreciation Expense
    - Depreciation - Vehicles
    - Depreciation - Buildings
    - Depreciation - Building Improvements
    - Depreciation - Machinery and Equipment
    - Depreciation - Office Equipment
    - Depreciation - Computer Equipment
    - Depreciation - Vehicles
    - Depreciation - Furniture & Fixtures
    - Depreciation - Computer Software
    - Depreciation - Other Property, Plant, or Equipment
  - Amortization
    - Amortization - Leasehold Improvements
    - Amortization - Goodwill
    - Amortization - Organization Costs
    - Amortization - Other
  - Property Taxes
    - Personal Property
    - Real Property
    - Other

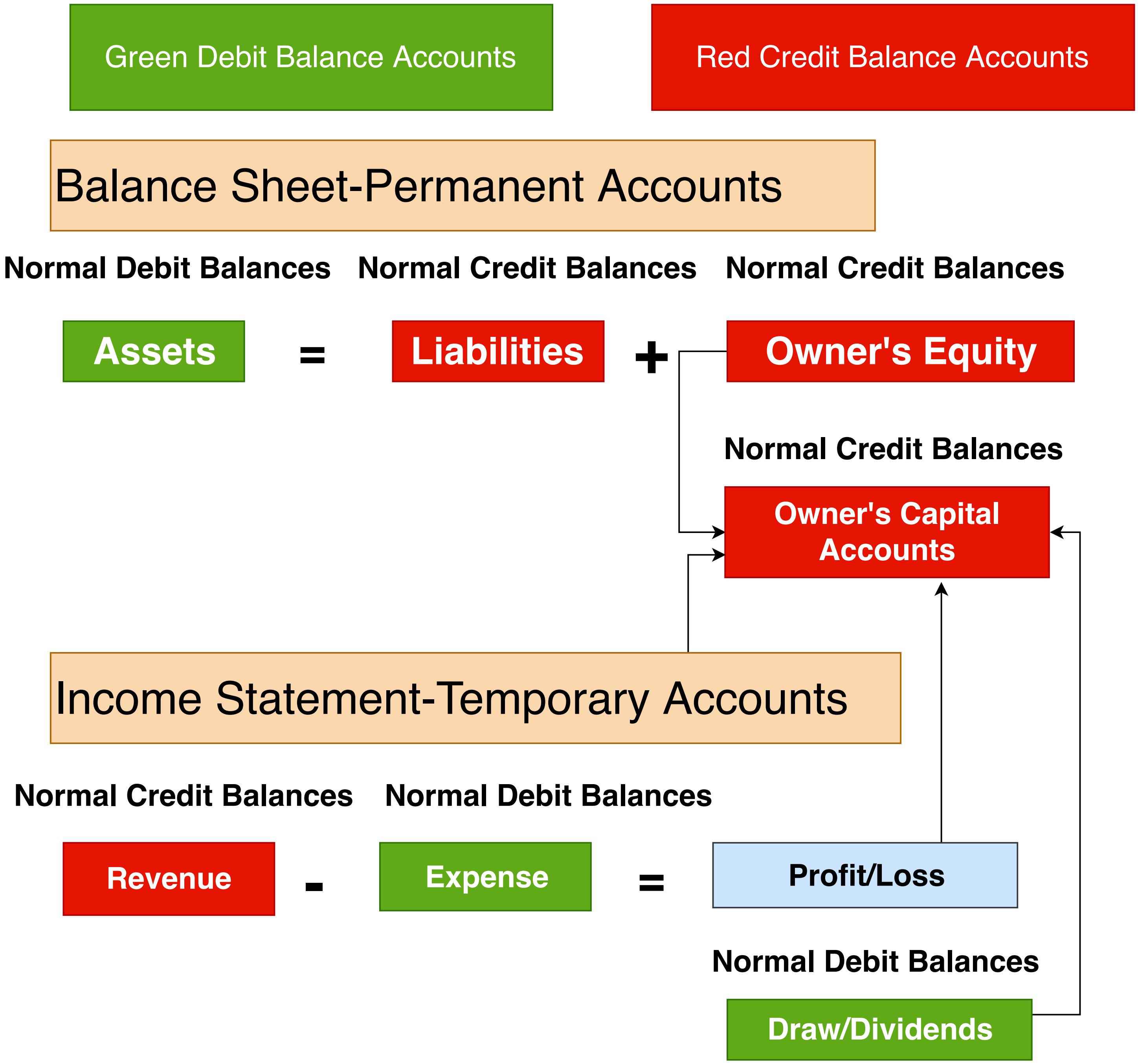
- **Non-Operating Expenses and Losses**

  Amounts spent on products and services not related to normal business operations (secondary activities). In other words, expenses and losses resulting from something other than from normal business operations.

  - Donations
  - Penalties & Fines
  - Loss On Sale Of Assets
  - Losses - Other Unusual
  - Interest
  - Taxes
    - Franchise & Excise Taxes
    - Federal Income Taxes
    - Other Taxes


What Journal Do I Use ?
Did you receive Cash ?
NO
YES
Use Cash Receipts Journal
Did you write a check or make a payment ?
NO
YES
Did you pay wages earned ?
YES
Use Payroll Journal
NO
Use Cash Disbursements Journal
Did you bill a product or service and grant credit (on account) ?
NO
YES
Use Sales Journal
Did you incur an expense or make a purchase and the supplier granted credit (on account) ?
NO
YES
Use Purchases Journal
Use General Journal

Major Types Of Accounts
and Relationships



What Does The Diagram Tell Ya ?

1.The Major Types Of Accounts or Categories are:

Assets Liabilities Owner's Equity Revenue
Expense Draws/Dividends

2. All Accounts have a Normal Balance which is either a Debit or Credit Balance

3. Accounts with a Normal Debit Balance are:

Assets Expenses Draws/Dividends

Accounts with a Normal Credit Balance are:

Owner's Capital Accounts Liabilities Revenues

4.The Balances in Temporary Accounts are transferred (closed) to the Permanent Owner's Capital Accounts

5. Revenues - Expenses = Profit or Loss

If Revenues > Expenses = Profit

If Expenses > Revenues = Loss

6. Assets = Liabilities + Owner's Equity which is the Basic Accounting Equation and the basis for the Double Entry Bookkeeping System

Debit Account Balances= Credit Account Balances