

# Accounting 101

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A resource guide for small business owners

# What is Accounting?

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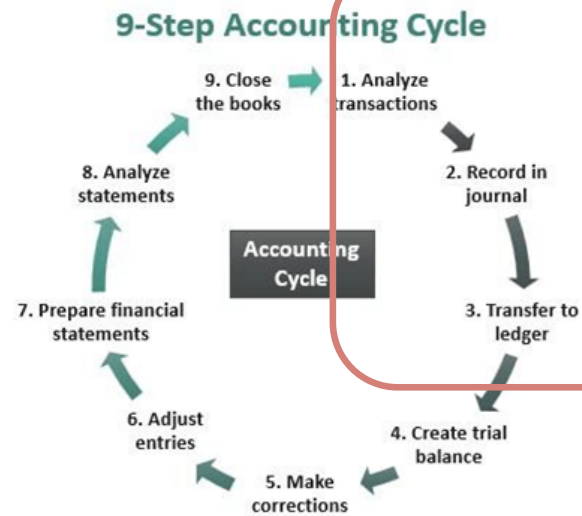
*"the art of recording, classifying, and summarizing in a significant manner and in terms of money, transactions and events which are, in part at least of financial character, and interpreting the results thereof." ~ The American Institute of CPAs*

# Why is accounting important for my business?

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- The **purpose** of accounting is provide useful information to economic entities (profit & non-profit) in order to make **informed decisions**
- Internal Decisions
  - Money makers vs money pits
  - Outsource vs make in house
- External Decisions
  - Lines of credit
  - Funding/grants

# The Accounting Cycle



As a business owner, steps 1-3 is the part of the accounting cycle that you can keep up to date and organized

# The Accounting Cycle - Analyze the Transaction

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- The first step in the accounting cycle is to examine the **source document** and determine the effects of the business event to the accounts of the company. After that, record the transaction through a journal entry .
  - Source document examples
    - Receipt
    - Invoice
    - Purchase order
  - Business event examples
    - Buy inventory
    - Make a sale
    - Sell a piece of equipment

\*Note: EVERY business event produces a source document

# The Accounting Cycle – Record the Transaction

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- aka book of original entry
- where business transactions are first **recorded**
- Recorded in chronological order
- Include brief description of the business event for your own reference
  - Ex: Purchased a book of stamps
- Should be done frequently
  - Once per week depending on activity level of the business

# Account Classifications

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The following are the basic foundational accounts every business starts with:

- Assets
- Liabilities
- Owner's Equity
- Revenue (Income)
- Cost of Goods Sold
- Expenses

# Assets

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- Definition – resources that the company owns
  - Cash and equivalents
  - Accounts receivable
  - Inventory
  - Fixed assets – property, plant and equipment
  - Pre-paid expenses
  - Other assets



# Liabilities

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- Claims against the company's assets
  - Accounts payable
  - Payroll liabilities
  - Notes payable

# Owner's Equity

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- Owner's total investment in the business or net claim to assets
- Aka net worth
- $\text{Assets} - \text{Liabilities} = \text{Net worth}$ 
  - Owner's capital – assets owner puts into the business
  - Owner's draw – assets the owner withdraws and converts for personal use

# Revenue (Income)

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- aka gross sales
- aka gross receipts
- Includes income received related to the business

# Cost of Goods Sold (COGS)

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- The cost of the product a company sells

\*\*Note: Service businesses do not usually have COGS

# Expenses

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- Selling, general, and administrative
  - Expenses that do not directly relate to making or wholesaling a product
  - Not COGS

Examples include:

- Postage
- Utilities

# Other Income & Expenses

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- Other Income - non business related income
  - Gain on the sale of an asset
  - Interest income
- Other expenses
  - Loss on the sale of an asset
  - Interest expense

# The Accounting Cycle – Transfer to the General Ledger

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- **Posting** refers to the process of transferring entries from the *journal* into the accounts in the *ledger*. Posting to the ledger is the ***classifying phase*** of accounting.
- Should be done periodically
  - Once per month

# Chart of Accounts

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A master list of accounts set up to handle company transactions. Usually assigned a three or four digit code and organized as follows

- Assets – 1000s
- Liabilities – 2000s
- Equity – 3000s
- Income – 4000s
- Expense -- 5000s



# Bank Reconciliations

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- The process of matching the what's in the cash account per the accounting records to the bank statements
  - Bank statement is what actually happened – this is the point of reference
  - Accounting records are what you say happened
- Should be done at least monthly

# Financial Reports

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- Provide useful information in an organized manner for
  - Decision making
  - Potential investors
  - Financing
- Most common
  - Balance sheet
  - Income Statement

# Balance Sheet

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- aka Statement of Net Position
- Shows the health of a business
- Accounting equation

$$\text{Assets} = \text{Liabilities} + \text{Owners Equity}$$

**or**

$$\text{Assets} - \text{Liabilities} = \text{Owner's Equity}$$

# Income Statement

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- aka Profit & Loss Statement
- Shows financial results for a period of time
  - Usually a fiscal year
- The are items reported on the income statement are normally entered on the Schedule C of your income tax return as well

# Tax Planning 101

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# Taxes

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- Set up an account for taxes payable to the federal and state government
  - Set money aside from sales and make periodic estimated payments to prevent underpayment penalties
  - 35 percent is a good provision
  - Making quarterly estimated payments is ideal contingent upon level of business activity throughout the year

# Most Common Business Tax Deductions

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- Meals and entertainment
- Travel
- Charitable contributions
- Advertising
- Professional & legal
- Depreciation
- Business use of home

# References

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- Accounting Basics: Accounting 101 (2022). [Accountingverse](https://www.accountingverse.com/accounting-basics/).  
<https://www.accountingverse.com/accounting-basics/>
- Loughran, M. (2011). *Financial Accounting for dummies*. John Wiley & Sons.