



Accounting Basics

Fundamental Accounting Equation

Assets = Liabilities + Equity

This equation is the foundation of the double-entry accounting system, ensuring that the balance sheet always balances.

- **Assets:** What a company owns (cash, accounts receivable, inventory, etc.)
- **Liabilities:** What a company owes to others (accounts payable, loans, etc.)
- **Equity:** The owners' stake in the company (common stock, retained earnings, etc.)

Key Accounting Principles

Accrual Accounting	Recognizes revenues when earned and expenses when incurred, regardless of when cash changes hands.
Matching Principle	Expenses should be recognized in the same period as the revenues they helped generate.
Going Concern	Assumes the business will continue to operate in the foreseeable future.
Conservatism	Recognize potential losses immediately but delay recognizing potential gains.
Consistency	Use the same accounting methods from period to period.

Debits and Credits

Debit (Dr)	Increases assets, expenses, and dividends. Decreases liabilities, equity, and revenues.
Credit (Cr)	Increases liabilities, equity, and revenues. Decreases assets, expenses, and dividends.
Basic Rule	Debits must always equal credits in every transaction to maintain the balance of the accounting equation.

Bookkeeping Essentials

The Accounting Cycle

1. **Identify Transactions:** Recognize and document business activities.
2. **Journal Entries:** Record transactions in the general journal.
3. **Posting to Ledger:** Transfer journal entries to the general ledger accounts.
4. **Trial Balance:** Prepare an unadjusted trial balance to verify debits equal credits.
5. **Adjusting Entries:** Make necessary adjustments (e.g., depreciation, accruals).
6. **Adjusted Trial Balance:** Prepare an adjusted trial balance.
7. **Financial Statements:** Create income statement, balance sheet, and cash flow statement.
8. **Closing Entries:** Close temporary accounts (revenues, expenses) to retained earnings.

Common Journal Entries

Sales on Credit	Dr. Accounts Receivable Cr. Sales Revenue
Purchase of Inventory	Dr. Inventory Cr. Accounts Payable/Cash
Payment of Expense	Dr. Expense (e.g., Rent Expense) Cr. Cash
Depreciation Expense	Dr. Depreciation Expense Cr. Accumulated Depreciation
Accrued Revenue	Dr. Accounts Receivable Cr. Service Revenue
Accrued Expense	Dr. Expense (e.g., Interest Expense) Cr. Accounts Payable

Chart of Accounts

A list of all accounts used by a business to record its financial transactions. Typically organized by account type (assets, liabilities, equity, revenue, expenses).

- **Example Account Numbers:**
 - Assets: 1000-1999
 - Liabilities: 2000-2999
 - Equity: 3000-3999
 - Revenue: 4000-4999
 - Expenses: 5000-5999

Key Accounting Formulas

Profitability Ratios

Gross Profit Margin	$(\text{Revenue} - \text{Cost of Goods Sold}) / \text{Revenue}$
Net Profit Margin	$\text{Net Income} / \text{Revenue}$
Return on Assets (ROA)	$\text{Net Income} / \text{Average Total Assets}$
Return on Equity (ROE)	$\text{Net Income} / \text{Average Shareholders' Equity}$

Liquidity Ratios

Current Ratio	$\text{Current Assets} / \text{Current Liabilities}$
Quick Ratio (Acid-Test Ratio)	$(\text{Current Assets} - \text{Inventory}) / \text{Current Liabilities}$
Cash Ratio	$\text{Cash} / \text{Current Liabilities}$

Activity Ratios

Inventory Turnover Ratio	$\text{Cost of Goods Sold} / \text{Average Inventory}$
Accounts Receivable Turnover Ratio	$\text{Net Credit Sales} / \text{Average Accounts Receivable}$
Asset Turnover Ratio	$\text{Net Sales} / \text{Average Total Assets}$

Solvency Ratios

Debt-to-Equity Ratio	$\text{Total Debt} / \text{Shareholders' Equity}$
Debt-to-Assets Ratio	$\text{Total Debt} / \text{Total Assets}$
Times Interest Earned Ratio	$\text{EBIT (Earnings Before Interest and Taxes)} / \text{Interest Expense}$

Financial Statements

Income Statement

Reports a company's financial performance over a period of time.

Format:

Revenue

- Cost of Goods Sold
= Gross Profit
- Operating Expenses
= Operating Income
+/- Other Income/Expenses
= Income Before Taxes
- Income Taxes
= Net Income

Balance Sheet

A snapshot of a company's assets, liabilities, and equity at a specific point in time.

Format:

Assets = Liabilities + Equity

Assets

Current Assets

Non-Current Assets

Liabilities

Current Liabilities

Non-Current Liabilities

Equity

Shareholders' Equity

Statement of Cash Flows

Reports the movement of cash both into and out of the company during a period.

Sections:

- Operating Activities: Cash flows from normal business operations.
- Investing Activities: Cash flows from buying and selling long-term assets.
- Financing Activities: Cash flows from debt, equity, and dividends.