



## 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

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

### Debits and Credits

|                    |   |
|--------------------|---|
| <b>Debit (Dr)</b>  | Increases assets, expenses, and dividends. Decreases liabilities, equity, and revenues.                   |
| <b>Credit (Cr)</b> | Increases liabilities, equity, and revenues. Decreases assets, expenses, and dividends.                   |
| <b>Basic Rule</b>  | 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

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

|                               |   |
|-------------------------------|---|
| <b>Gross Profit Margin</b>    | (Revenue - Cost of Goods Sold) / Revenue  |
| <b>Net Profit Margin</b>      | Net Income / Revenue                      |
| <b>Return on Assets (ROA)</b> | Net Income / Average Total Assets         |
| <b>Return on Equity (ROE)</b> | Net Income / Average Shareholders' Equity |

### Liquidity Ratios

|                                      |  |
|--------------------------------------|--|
| <b>Current Ratio</b>                 | Current Assets / Current Liabilities               |
| <b>Quick Ratio (Acid-Test Ratio)</b> | (Current Assets - Inventory) / Current Liabilities |
| <b>Cash Ratio</b>                    | Cash / Current Liabilities                         |

### Solvency Ratios

|                                    |  |
|------------------------------------|--|
| <b>Debt-to-Equity Ratio</b>        | Total Debt / Shareholders' Equity                            |
| <b>Debt-to-Assets Ratio</b>        | Total Debt / Total Assets                                    |
| <b>Times Interest Earned Ratio</b> | EBIT (Earnings Before Interest and Taxes) / Interest Expense |

### Activity Ratios

|   |  |
|---|--|
| <b>Inventory Turnover Ratio</b>           | Cost of Goods Sold / Average Inventory         |
| <b>Accounts Receivable Turnover Ratio</b> | Net Credit Sales / Average Accounts Receivable |
| <b>Asset Turnover Ratio</b>               | Net Sales / Average Total Assets               |

# 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.