



Fundamental Accounting Principles

Basic Accounting Equation

Assets = Liabilities + Equity

This equation is the foundation of double-entry accounting. It ensures that the balance sheet always balances.

- **Assets:** Resources owned by the company (e.g., cash, accounts receivable, equipment).
- **Liabilities:** Obligations owed to others (e.g., accounts payable, loans).
- **Equity:** The owners' stake in the company (e.g., common stock, retained earnings).

Key Accounting Principles

Accrual Accounting	Recognize revenues when earned and expenses when incurred, regardless of when cash changes hands.
Matching Principle	Match expenses with the revenues they helped generate in the same accounting period.
Going Concern	Assume the business will continue operating in the foreseeable future.
Conservatism	Recognize losses when probable and only recognize gains when realized.
Consistency	Use the same accounting methods from period to period to allow for comparability.
Materiality	Only disclose information that is significant enough to influence the decisions of users of financial statements.

Double-Entry Bookkeeping

Every transaction affects at least two accounts. Debits increase asset, expense, and dividend accounts, while credits increase liability, equity, and revenue accounts. The total debits must always equal the total credits.

Example:

Cash (Debit) \$100
 Service Revenue (Credit) \$100

Financial Statements

Income Statement

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

Format:

Revenues - Expenses = Net Income (or Net Loss)

Key Items:

- Revenue
- Cost of Goods Sold (COGS)
- Gross Profit
- Operating Expenses
- Operating Income
- Net Income

Balance Sheet

Presents a company's assets, liabilities, and equity at a specific point in time.

Format:

Assets = Liabilities + Equity

Key Items:

- Current Assets (Cash, Accounts Receivable, Inventory)
- Non-Current Assets (Property, Plant, and Equipment)
- Current Liabilities (Accounts Payable, Salaries Payable)
- Non-Current Liabilities (Long-term Debt)
- Equity (Common Stock, Retained Earnings)

Statement of Cash Flows

Summarizes the movement of cash both into and out of a company. It is split into three main activities.

Operating Activities: Cash flows from the normal day-to-day running of the business.

Investing Activities: Cash flows related to the purchase and sale of long-term assets.

Financing Activities: Cash flows related to debt, equity, and dividends.

Format:

Net cash from operating activities
Net cash from investing activities
Net cash from financing activities
Net increase/decrease in cash
Cash at beginning of period
Cash at end of period

Statement of Retained Earnings

Shows the changes in retained earnings over a period of time. Retained earnings is the accumulated profits of the business less any dividends paid out.

Format:

Beginning Retained Earnings + Net Income - Dividends = Ending Retained Earnings

Journal Entries and Ledgers

Common Journal Entries

Service Revenue	Debit: Cash Credit: Service Revenue
Purchase of Supplies on Credit	Debit: Supplies Credit: Accounts Payable
Payment of Rent	Debit: Rent Expense Credit: Cash
Depreciation Expense	Debit: Depreciation Expense Credit: Accumulated Depreciation
Salaries Expense	Debit: Salaries Expense Credit: Cash
Inventory Purchase	Debit: Inventory Credit: Cash/Accounts Payable

The General Ledger

The general ledger is a record of all the business's transactions. It holds all the debit and credit entries. The information in the ledger is then used to create the financial statements.
It is usually organised by account, showing the increases and decreases to each account.

Chart of Accounts

A list of all the accounts used by a business. It is organized by category (assets, liabilities, equity, revenue, expenses).
It's important to have a well-organized chart of accounts to ensure accurate financial reporting.

Accounting Ratios and Analysis

Liquidity Ratios

Current Ratio	Current Assets / Current Liabilities (Measures a company's ability to pay short-term obligations)
Quick Ratio (Acid-Test Ratio)	(Current Assets - Inventory) / Current Liabilities (More conservative measure of short-term liquidity)
Cash Ratio	(Cash + Marketable Securities) / Current Liabilities (The most conservative liquidity ratio)

Profitability Ratios

Gross Profit Margin	(Revenue - Cost of Goods Sold) / Revenue (Measures the percentage of revenue remaining after covering the cost of goods sold)
Net Profit Margin	Net Income / Revenue (Measures the percentage of revenue that translates into profit)
Return on Equity (ROE)	Net Income / Average Stockholders' Equity (Measures how effectively a company is using its equity to generate profit)
Return on Assets (ROA)	Net Income / Average Total Assets (Measures how effectively a company is using its assets to generate profit)

Solvency Ratios

Debt-to-Equity Ratio	Total Debt / Total Equity (Measures the proportion of debt a company uses to finance its assets relative to equity)
Times Interest Earned Ratio	EBIT / Interest Expense (Measures a company's ability to cover its interest expense)