Basic Bookkeeping

ABSTRACT

Numbers! Numbers! Numbers! Wherever you go, you are bound to see them. On addresses, license plates, phones, prices, and of course, money! Numbers connect us all to each other in many more ways than we might imagine. Essentially, our world revolves around numbers. Some of us enjoy dealing with numbers while others may have a fear of them, or even a phobia.

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The company accountant is shy and retiring. He's shy a couple of million bucks, that's why he's retiring!

Milton Berle

Preface

Numbers! Numbers! Numbers! Wherever you go, you are bound to see them. On addresses, license plates, phones, prices, and of course, money! Numbers connect us all to each other in many more ways than we might imagine. Essentially, our world revolves around numbers. Some of us enjoy dealing with numbers while others may have a fear of them, or even a phobia. For those of you who have already recognized and appreciate the impact that numbers actually have on just about everything, you deserve a cookie.

A bank is a place that will lend you money if you can prove that you don't need it.

Bob Hope

Chapter One: Basic Terminology (I)

The good thing about accounting is that you can start out wherever you want, at the beginning, the middle, or the end and you will still wind up at the same place, nowhere. You really have to start at the beginning, or you will get lost. Some of this stuff may ring a bell for those of you who took accounting previously, were hired to keep the books at the corner Mom & Pop's shop, or, were too cheap to hire a "real Accountant" and tried to do your own books. Either way, when we are done here, you are bound to be familiar with a lot of these basic bookkeeping and accounting terms.

Balance Sheet

A balance sheet is a financial statement that shows the assets, liabilities, and owner's equity at a specific point in time. Assets and liabilities are usually listed first, followed by the equity which is the difference between the assets and the liabilities. The balance sheet will ultimately provide a snapshot of the company's current financial condition.

Balance Sheet

<table>
<tr><td colspan="3">Business Title: Bob & Tom’s Crunchy Cookie Co.
Date:</td></tr>
<tr><th colspan="2">Assets</th><th>Liabilities</th></tr>
<tr><th>Current Assets</th><th>$</th><th>Current Liabilities</th></tr>
<tr><td>Cash</td><td>$</td><td rowspan="6">Accounts Payable
$______________

Notes Payable $______________

Interest
Payable$______________

Taxes Payable

Federal Income Tax
$______________

Self-Employment Tax
$______________

State Income Tax
$______________

Sales Tax Accrual
$______________</td></tr>
<tr><td>Petty Cash</td><td>$</td></tr>
<tr><td>Accounts Receivable</td><td>$</td></tr>
<tr><td>Inventory</td><td>$</td></tr>
<tr><td>Short-term Investments</td><td>$</td></tr>
<tr><td>Prepaid Expenses</td><td>$</td></tr>
</table>

<table>
<tr><td></td><td></td><td rowspan="6">Property Tax $______________

Payroll Accrual $______________

Long-term Liabilities

Notes Payable
$______________</td></tr>
<tr><td>Long-term Investments</td><td>$</td></tr>
<tr><td colspan="2"></td></tr>
<tr><td>Fixed Assets</td><td>$</td></tr>
<tr><td>Land (Valued at Cost)</td><td>$</td></tr>
<tr><td>Buildings

1. Cost

2. Less acc. Depr.</td><td>$</td></tr>
<tr><td rowspan="2">Improvements

1. Cost

2. Less acc. Depr.</td><td rowspan="2">$</td><td>Total Liabilities
$______________</td></tr>
<tr><td rowspan="2">Net Worth (Equity)

Proprietorship
$______________

Or

Partnership

(Name) ________, _____% equity</td></tr>
<tr><td>Equipment

1. Cost

2. Less acc. Depr.</td><td>$</td></tr>
</table>

Furniture 1. Cost 2. Less acc. Depr.	$	$______________ (Name) ________, ______% equity $______________ Or
Automobiles 1. Cost 2. Less acc. Depr.	$	**Corporation** Capitol Stock $______________ Surplus Paid in $______________ Retained Earnings $______________
Other Assets 1. 2.	$ $	Total Net Worth $______________ Assets – Liabilities = Net Worth & Liabilities + Equity = Total Assets
Total Assets $		

Assets

Assets are probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events. Anything that has an economic value and can be owned or controlled to produce value has the potential to produce such future economic benefits. Whether tangible or intangible, ownership of any form of value such as cash money or stock is considered to be an asset.

Liabilities

Probable future sacrifices of income or assets, arising from present obligation to a particular entity. If liabilities are settled, they may become transferred assets or provide services to other entities in the future as a result of past transactions or events. A liability is a duty or responsibility to another in return for some form of debt such as a business loan which would entail the settlement of that loan.

Equity

Ownership in assets after all debts owed for that asset has been paid off. Assets such as stock and home ownership can be considered equity if no associated debts remain. Once a house or automobile is paid off, the asset is now the owner's equity. Equity is any asset that can be sold for monetary gain without any attached debts being owed. The owner should gain 100% of the revenue from the sale of an asset if that asset is his or her own equity.

Income Statement

A financial statement is used to summarize the amounts of revenues earned, and the expenses incurred by a business or entity over a period of time. It is used to measure a business's financial performance. This statement includes a summary of how a business typically incurs its revenues and expenses over a fiscal quarter or year.

Revenue

The fee paid to a lender for a loan or all transactions for which monies are received. It can be the income from products and services sold and the use of investments. Revenue can also be a transaction and the resulting income for which monies are received, however, loan funds and equity deposits are not considered revenue.

Cost of Goods Sold

The cost of producing products that are delivered to customers to create revenue or the cost of inventory sold during an accounting period. This includes the cost of purchases made during an inventory period minus the ending inventory for that period. This term is often abbreviated as COGS.

Expenses

Expenses are the cost of producing revenue through the sale of goods or services. They can come in many forms such as salaries or wages, and depreciation of assets. An expense can be almost anything that is incurred when doing business.

Accounting Period

The Accounting period is the amount of time in which income statements and other financial statements are utilized to track and report operating results. They usually run for twelve months between January to December, but can begin and end anytime depending on the businesses needs or wants.

Knowledge is like money: the more he gets the more he craves.

Josh Billings

Chapter Two: Basic Terminology (II)

In this chapter, we will finish up with the basic accounting terms that are bound to impress at the next corporate fundraiser for the IRS. I know what you're thinking. There is no such thing as a corporate fundraiser for the IRS because the only funds the IRS will be raising are those out of our wallets. Below are the next few terms you will need to know!

Accounts Receivable

This type of record is used to keep track of money that is owed to a business. Such money can come from extending credit to a customer who purchases the businesses products or services. The best way to keep track of these figures is to set up a separate accounts receivable record for each customer.

Accounts Payable

This type of record is used to keep track of debts owed by a business to creditors for purchased goods or services. Though the business will likely be billed regularly by its creditors for the balance on the account, having its own records will allow the business to be aware of their financial standing with the creditors at any given time.

Depreciation

Involves both the decline in value of assets, usually due to unfavorable market conditions as well as the allocation of the costs of tangible assets over their useful lifetime to the periods in which the assets are actually used. The decline in value will have an effect on the value of business and entities while the allocation of cost effects net income.

General Ledger

In double-entry accounting, these are forms used for the accounts on separate sheets, in a book or binder and are called the general ledger. This is considered to be a permanent, classified record for each business account.

Interest

Interest is a sort of compensation to a lender for taking a risk of principal loss when money or another asset is loaned. When money is borrowed the, borrower usually pays a percentage of the total amount owed also known as the principal, as a fee, along with a certain amount of the original balance for each billing period. It is a sum amount charged for borrowing.

Inventory

Inventory can be described as either a list of goods and materials or the goods and materials themselves. It is considered an asset and usually refers to materials held in stock by a business. Inventory is one of the most important assets that a business possesses because they are ready or will be ready to be sold thus; inventory is often a primary source for revenue.

Journals

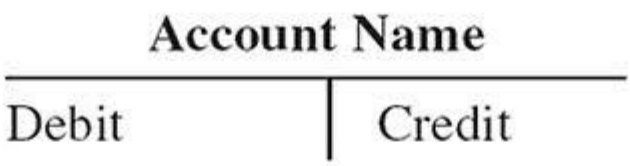
A journal is used to record the financial transactions made by a business. Whether the transactions are credits or debits, they should be input into a journal at the time and date which they occur. These recordings can then be used for future reference and reconciling and can be transferred to other official records such as the general ledger. All journal entries should include the transaction date, type, and amount.

Payroll

Payroll can refer to either the total sum in compensation that a business owes to its employees for a set period of time, or the actual list of employees the business must pay along with the amount owed. It is usually a major expense for businesses but will likely differ from time to time depending on the business' need of its employees at the time, amongst other things.

Trial Balance

A worksheet usually prepared at the end of each recording period. The balances of all ledgers are recorded into two columns labeled “debits” and “credits”. This worksheet helps to ensure that all numerical data entered into the business’ bookkeeping system is correct. If the total debits are in fact equal to the total credits, the trial balance is balanced. This worksheet method is also referred to as a T-Account due to the shape the data takes on with the two column format.



You can't do today's job with yesterday's methods and be in business tomorrow.

Anonymous

Chapter Three: Accounting Methods

Since the preceding chapters of this course were a piece of cake, now let's talk about accounting methods, starting with the topics of cash and accrual. When you were a child, if your parents allowed you to go door to door selling items for your school's fundraiser, you have used cash and accrual methods. It's a simple concept that allows you to record the sale or purchase of an item even if you have not yet received payment.

Cash Method

This means that you will record the money once you receive it. The receipts for such transactions are recorded during the periods they are received. An example of this method is when you are making a cash deposit in the bank and they record it into your account as receiving cash. If you present the teller with a check, then she would not be able to document it as cash. If the teller does not record the cash as she receives it, she would not be able to properly account for the cash later.

Accrual Method

Accrual is the method of accounting in which all income and expenses are recognized on the income statement at the time when they are earned and incurred, regardless of when the cash for that transaction is received or paid. An example of this method would be, when you work, your hours are documented, and although you are earning a salary, you won't receive the money you have accumulated until you get a pay check, and it is cashed. The accounting department still has to recognize that those funds are going to be paid in the future.

Differences between Cash and Accrual

The differences between the two are that the cash method is recorded when you receive the actual cash whereas with the accrual method, you will record it even if you have not received it or paid for it. For example, you are selling candy bars for your child's school, when you receive the cash; you mark it down in the paid section. This is considered the cash method. If you were using the accrual method, you would want to record the transaction with anticipation of receiving the funds at a later date. This method will help you keep track of anticipated funds so that you can better manage your business. With the cash method, you receive the revenue at the time of the transaction like when you go into a store and purchase something vs. putting something on a "pay later" plan.

Never ask of money spent, where the spender thinks it went, nobody was ever meant, to remember or invent, what he did with every cent.

Robert Frost

Chapter Four: Keeping Track of Your Business

Knowing how to keep track of your business will prove to be very valuable in the short run and long run. There are a number of different aspects involved in keeping track of any business the right way. Many businesses go out of business within the first year or two if things are not handled properly. Have you ever been up late at night, just craving one of those good old roast beef sandwiches from the local 24 hour deli? You find that the craving gets so bad, you get up, leave (in your plaid jammies) and take a ride over there, with your mouth watering the whole way. You pull up, and hop out of the car (very excited), only to find that your favorite business is no longer “in business.” One could assume they did not keep very good track of their business or, they moved.

Knowing how to keep track will hopefully help keep you in business, not to mention having customers, capital, and all those other things that keep a business afloat. In this section, we will discuss the ins and outs of accounts payable, accounts receivable, the journal, the general ledger, and cash management.

Accounts Payable

As discussed earlier, this type of record is used to keep track of debts owed by a business to creditors for purchased goods or services on an open account. Though the business will likely be billed regularly by its creditors for the balance on the account, having their own records will allow the business to be aware of their financial standing with the creditors at any given time.

Accounts payable is the actual debt of a business that is due or payable to another entity. These debts must be paid off within a given period of time so as to avoid defaulting on the account. Accounts payable debts are similar to those many of us have at home. Household bills such as electricity and cable are like our personal accounts payable. The companies from which we receive these services are like our creditors. Just as our personal accounts can go into default if the services rendered are not paid for by a certain time, so can those of a business.

Accounts Payable

Account Record

Client: ______________________
Address: ______________________
Tel #: ________________________
Fax #: ________________________
Email: ________________________
Account #: ____________________

Invoice Date	Invoice #	Invoice Amount	Terms	Date Paid	Amount Paid	Balance

Accounts Receivable

This type of record is used to keep track of money which is owed to a business. Such money can come from extending credit to a customer who purchases the business' products or services. The best way to keep track of these records is to set up a separate "accounts receivable" record for each customer.

If a business makes a sale or renders a service, it has "receivables." This means that the business has money to collect or receive for its products or services. Such collectable money is usually in the form of an operating line of credit. Accounts receivable can be recorded as an asset on a business's balance sheet because it represents a future payment. The customer who has received the products or services from the business is legally obligated to pay for them per the agreement set between the two parties, thus the business can list this customers debt to them as an asset. An example of a receivable in the everyday world is a paycheck. Employers are legally bound to pay their employees for the services they have already rendered.

Accounts Receivable

Account Record

Client: _______________________
Address: _______________________
Tel #: _________________________
Fax #: _________________________
Email: _________________________
Account #: _____________________

Invoice Date	Invoice #	Invoice Amount	Terms	Date Paid	Amount Paid	Balance

The Journal

The journal is a way to keep track of all inputted information or data with regard to a business to allow for the books to be properly balanced.

The Balancing Act: When dealing with journals, you will also be dealing with debits and credits. You cannot use one without the other, for every debit there must be a credit in order to keep things balanced. You can use one journal for all transactions or several journals for similar or like transactions. A simple example is when we keep track of our checkbooks by entering both our purchases, which would be considered debits and our deposits, which would be considered our credits or money received. This is known as balancing a checkbook. Keeping a journal is basically the same concept. Remember, always try to be as accurate as possible or you will throw everything off balance.

The General Ledger

In double-entry accounting, these are forms used for the accounts on separate sheets, in a book or binder and are called the general ledger. This is considered a permanent, classified record for each business account.

The general ledger is usually the main record of accounting that a business uses. It can include assets and liabilities as well as gains and losses, along with the revenue and expense items that caused the gains and losses. This record will often take the form of a "T-Account", showing all debits on the left side of a T-shaped chart and all credits on the right. The ledger is an accumulation of all of a business’ finances, from their journals and other records. It can then be used as a basis for both the balance sheet and income statement because it provides all of the needed transactions. The size of a general ledger can vary immensely depending on the size of the business.

Cash Management

Cash management is the process of collecting, managing, and investing cash. Cash management can ensure a business' financial stability by avoiding insolvency. In a business, the term "cash" does not only refer to money or the amount of money at the end of the year. Cash and the management of cash can also be used to refer to managing anything that can be made liquid like, certificate of deposits by selling them, short term investments, and anything that can be used as a cash equivalent. The art of cash management in a business is very important because it is essential in keeping a business operating properly. If there is a mismanagement of cash, it may result in a big loss of revenue for any business. Proper cash management will help make sure a business does not become insolvent. Anytime a business cannot pay any of its bills due to a lack of cash that means it has become insolvent. Insolvency is the main reason a company may go bankrupt.

Finding oneness and balance is the only source of genuine happiness.

Anonymous

Chapter Five: Understanding the Balance Sheet

In this chapter we will be discussing the accounting equation, double- entry accounting, types of assets, types of liabilities and equity. The balance sheet will help provide balance to your business. It helps keep everything organized and on point. One of the worst things in accounting is un-organization. So, don't treat your balance sheet like your sock drawer at home or that mysterious junk drawer in your kitchen that no one wants to organize.

A balance sheet is a financial statement that shows the assets, liabilities, and owner's equity at a specific point in time. Assets and liabilities are usually listed first, followed by the equity which is the difference between the assets and the liabilities. The balance sheet will ultimately provide a snapshot of the company's current financial condition.

Example: Bob & Tom's Crunchy Cookie Co. had an impressive increase in sales this past month however, the company is only three months old and they therefore still have a number of liabilities to attend to. In order to keep track of their increases and to determine the financial position of their business this month, Bob and Tom will need to summarize their business assets, liabilities, and equity into what is known as a balance sheet.

Balance Sheet

Business Title: Bob & Tom’s Crunchy Cookie Co. Date:		
Assets		**Liabilities**
Current Assets	**$**	**Current Liabilities**
Cash	$	Accounts Payable $___________ Notes Payable $______________
Petty Cash	$	Interest Payable $____________
Accounts Receivable	$	Taxes Payable Federal Income Tax $__________ Self-Employment Tax $_________
Inventory	$	State Income Tax $____________ Sales Tax Accrual $____________
Short-term Investments	$	Property Tax $_______________ Payroll Accrual $______________
Prepaid	$	

<table>
<tr><td>Expenses</td><td></td><td rowspan="6">Long-term Liabilities

Notes Payable $____________</td></tr>
<tr><td>Long-term Investments</td><td>$</td></tr>
<tr><td colspan="2"></td></tr>
<tr><td>Fixed Assets</td><td>$</td></tr>
<tr><td>Land (Valued at Cost)</td><td>$</td></tr>
<tr><td>Buildings

1. Cost

2. Less acc. Depr.</td><td>$</td></tr>
<tr><td rowspan="2">Improvements

1. Cost

2. Less acc. Depr.</td><td rowspan="2">$</td><td>Total Liabilities $______________</td></tr>
<tr><td rowspan="2">Net Worth (Equity)

Proprietorship $______________

Or

Partnership

(Name) ________, _____% equity $_____________

(Name) ________, _____% equity</td></tr>
<tr><td>Equipment

1. Cost

2. Less acc. Depr.</td><td>$</td></tr>
</table>

<table>
<tr><td>Furniture

1. Cost

2. Less acc. Depr.</td><td>$</td><td rowspan="2">$____________

Or

Corporation

Capitol Stock $______________

Surplus Paid in $______________

Retained Earnings $____________</td></tr>
<tr><td>Automobiles

1. Cost

2. Less acc. Depr.</td><td>$</td></tr>
<tr><td rowspan="2">Other Assets

1.

2.</td><td>$</td><td rowspan="3">Total Net Worth
$______________

Assets – Liabilities = Net Worth

&

Liabilities + Equity = Total Assets</td></tr>
<tr><td>$</td></tr>
<tr><td colspan="2">Total Assets $</td></tr>
</table>

The Accounting Equation

The accounting equation is simple. It is the combination of liabilities and equity, which equals assets.

Assets = Liabilities + Equity

The accounting equation helps to identify the relationship between crucial elements of accounting. An asset is anything of value, that which a company owns. Assets consist of tangible and intangible assets. Examples of current assets include: stocks, bonds, cash, and property. Liabilities are, a company's existing debts that are owed to third parties .Examples of liabilities would be, accounts payable, wages payable and interest payable.

Double-Entry Accounting

Double entry accounting involves credits and debits. This will show information about increases and decreases in one balance statement. This can also be known as a "T" account because it looks like the letter "T" on paper, consisting of the debits on one side and the credits on the other. This method provides a simple way to accurately and efficiently balance the sums in accounts using the debit and credit method. Remember, debits should be equivalent to credits. You should not do a debit without a credit if you want to keep everything balanced.

Types of Assets

Liabilities + Equity = Total Assets

Assets are probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events. Anything that has an economic value and can be owned or controlled to produce value has the potential to produce such future economic benefits. Whether tangible or intangible, ownership of any form of value is considered to be an asset.

Basically anything worth anything can be an asset. Now let's not get carried away here, we're not talking about the pack of gum at the bottom of your purse, or the teddy bear that's missing an eye you had when you were a child. We're also not talking about that blue velvet armchair sitting in your man cave that you inherited from your uncle's, cousins', Brother-in-law. Then again, you know what they say about another man's trash. Anyway let's get back to business. There exist both tangible and intangible assets. Cash is a tangible asset whereas ownership in stock is an intangible asset.

Tangible assets are belongings that can be physically touched and/or seen, they are real and actual rather than hypothetical. As mentioned before, cash is a tangible asset. Others include real estate, equipment, automobiles, and other physical valuables. Intangible assets are non-physical assets which have a useful life, lasting usually more than one year. They can include patents, trademarks, internet domain names, literary and musical works, and patented technology.

Example: Bob and Tom have ordered a few industrial sized ovens for their growing cookie business. These ovens along with refrigerators, dining furniture, and other supplies and equipment essential for their business, are all tangible assets. Bob and Tom have also created an original slogan for their cookie company which is growing to be quite popular; this slogan can be viewed as one of their intangible assets.

Types of Liabilities

Probable future sacrifices of income or assets, arising from present obligation to a particular entity. If liabilities are settled, they may become transferred assets or provide services to other entities in the future as a result of past transactions or events. It is a duty or responsibility to another in return for some form of debt such as a business loan which would entail the settlement of that loan. These can be current or long-term.

I know that’s a mouth full, so let’s clarify. An example of a liability would be, before Bob and Tom purchased their top of the line ovens, they attempted to borrow the money from a family member who would in-turn receive a small percentage of the company’s revenue. Since the cookie company was a new business, the family member decided not to go through with the deal because their potential loss would be greater than the potential gain, if the company folded. Whereas the bank agreed to loan them the money based on their projected business potential and business plan, because the bank could afford to do so.

Equity

The interest in the assets of an entity that is left over after all liabilities are deducted or ownership in assets after all debts owed for that asset have been paid off. Assets such as stock and home ownership can be considered equity if no associated debts remain. Once a house or automobile is paid off, the asset is now the owner's equity. Equity is any asset that can be sold for monetary gain without any attached debts being owed. The owner should gain 100% of the revenue from the sale of an asset if that asset is their own equity. However, if there are more liabilities than assets, then negative equity exists.

In the stock world, equity involves an investment in shares or stock on a stock market. Just as individuals can buy stock, so can businesses. As the value of stock rises, so will their equity. Many individuals do not hold their shares directly; instead they are involved in what is called a mutual fund. These funds are usually managed by larger companies and management firms. Having the support and management of a company will allow individuals to leave the management of their shares in the hands of a skilled, professional fund manager. Larger, private businesses and investors however will often hold their own stock rather than seeking a third party Management Company. Equity in stock is generally termed shareholders equity.

Finance is the art of passing money from hand to hand until it finally disappears.

Robert Sarnoff

Chapter Six: Other Financial Statements

In this chapter, we will introduce the income statement, cash flow statement, capital statement, and budget versus actual. These terms all involve money or the use of money in some form. When we are done, you will have a better understanding of how the use of these methods will help your business run more efficiently. You'll be swapping accounting terms with that hotshot accountant friend of yours in no time.

Income Statement

An income statement is a financial statement that summarizes the amounts of revenue earned and the expenses incurred by a business or entity over a period of time, which measures the financial performance of a business. This statement includes a summary of how a business typically incurs its revenues and expenses over a fiscal quarter or year. "Profit and Loss Statement" or "Statement of Revenue and Expense" are also terms used in reference to the income statement.

Income statements are divided into two parts, which are the operating and non-operating sections. The operating section will cover information with regard to revenues and expenses, which are directly related to or resulting from normal business operations. For instance, for a restaurant, the food the business must buy and then sell can be listed as both revenue and an expense. The non-operating section on the other hand, deals with revenues and expenses that are not directly related to the business' normal operations. For instance, if a business were to have an all-expense paid company picnic for its employees, this could be considered an abnormal expense, unrelated to normal business operations and would therefore go under the "non-operations" section as a non-operations expense. Additionally, if the business as a whole had shareholders equity or "stock" in another business or company's product, any profits obtained from the stock would be non-operations revenue.

Cash Flow Statement

The Cash Flow Statement is a part of a total of four statements which also include: Balance Sheet, Income Statement, and Statement of Retained Earnings. The cash flow statement shows the flow of cash within the business, where that money came from, and how that money may have been spent during a certain time period. This statement can prove to be very important because it allows the cash flow of the company to be tracked from its origin, by indicating which types of transaction help create cash flow.

There are three forms of cash flow: operating cash flow, outbound cash flow, an inbound cash flow, each of which can be found on the statement of cash flows.

- Operating cash flow would be any cash generated from normal operations of the business, which is then calculated and adjusted to produce the net income. This is basically the money a business gets for being a business, whatever type it may be. It provides a better look at what profits the business makes rather than just its earnings. This type of cash flow would be used to pay debts and bills.

- Outbound cash flow is any money that a business must pay out when they complete a transaction with another party. This includes wages for employees, federal and state taxes, as well as the money it pays for the products it sells. Basically, whenever the business is required to pay money, this money is outbound cash flow.
- Inbound cash flow is the opposite of outbound cash flow and is quite similar in some ways to operating cash flow. It is any money a business receives via a transaction with another party. This can include cash flow generated from normal business operations sales, refunds received from suppliers, and gains from legal proceedings. It is any positive monetary addition to the bank account of a business.

Capital Statement

The Capital Statement is a statement that is concerned with, or keeps track of the items that are going to last for longer than one year, like the long term assets of a company (e.g. buildings).

The Capital Statement's major duty includes keeping track of the owner's account prior, current as well as the ending balance. It also serves as a connector between the income statement and the balance sheet. Capital Statements are usually checked monthly or annually.

Budget vs. Actual

The main purposes of a budget are to plan for the future and to control the long term operations and spending of a company. Just like any budget, at a certain time, it may be adjusted according to what is needed, or changes that have occurred since the budget was created. Past financial statements are often used when creating a budget. These allow one to see what has worked in the past and what has not.

Additionally, a list of all possible sources of income should be kept as reference and updated when necessary. Creating a budget mainly involves considering all possible expenses. Some expenses are fixed and others are variable. This means some do not change and others have the ability to change from month to month or year to year, for example. Though a budget is the ideal or projected amount of money a business expects to spend, things are not always so. This is where actual expenses come in. The actual on the other hand is when the revenues or expenses are recognized on an income statement when they are incurred whether or not the cash for them has been received. While expenditures can easily change from the budgeted amount due to unexpected costs, revenue or income can also turn out to be more or less than the forecasted amount. This is why it is important to create a budget that is very much within the means of a business and based on past financial experiences and statements.

I don't really care about money. I find money boring and accounting boring, so I'm probably not going to ever make a lot of money.

Juliana Hatfield

Chapter Seven: Payroll Accounting / Terminology

In this chapter, we will be discussing many terms which involve dealing with the financial aspects of your business. We will also be discussing the accounting methods and terms used in reference to your employees, by briefly going over the following terms: gross wages, net wages, employee tax withholdings, employer tax expenses, salary deferrals, employee payroll, employee benefits, tracking accrued leave, and government payroll returns and reports. After this chapter, you will be familiar with all of the terms listed above and possibly ready to hire new employees. So look at it like this, you can spread joy to a few of the unemployed hopefuls out there, given the state of our current economy.

Gross Wages

The amount of compensation paid to employees for work before taxes have been removed. The gross wage is based on the number of hours worked multiplied by the rate of pay per hour. Hourly wages are usually paid to those in non-managerial positions as well as other positions.

Net Wages

The amount of compensation paid to employees for work after taxes have been removed. The net wage is based on the number of hours worked multiplied by the rate of pay per hour (gross wage) minus taxes and other fees. Hourly wages are usually paid to those in non-managerial positions as well as other positions.

Employee Tax Withholding's

The tax amount deducted each time an employee is paid. Law requires that each taxpayer pay their estimated income tax throughout the year. This withholding tax is usually the responsibility of the employer before rendering payment to an employee. The function of withholding taxes is to allow for proportionate amounts of tax payments to the IRS rather than a lump sum. This method can make the IRS collection less noticeable and therefore less "painful" for some.

Employer Tax Expenses

Several payroll taxes are levied by both state and federal government. Some of these taxes will be paid by the employees and are known as employee tax withholdings. In addition to these withholdings, employers must pay additional taxes which add an employer tax expense to the cost of labor. There are three general forms of such taxes: Social Security tax, State Unemployment tax (SUTA), and a Federal Unemployment tax (FUTA).

Salary Deferrals

A provision within a retirement plan approved and sponsored by an employer that allows eligible employees to elect to have a fraction of their compensation to be deducted and contributed to the employer's retirement plan. This deferral often occurs before taxes are deducted. Such employer-sponsored retirement plans include 401(K) plans, 403(b) arrangements, and 457 plans.

Employee Payroll

The wages paid to any employee who performs work for an entity and is paid directly by that entity is an employee of that entity and is on its payroll. It is important for a business to keep very accurate records of all wages paid to employees mainly for tax purposes. Whether the pay occurs weekly, monthly, or just periodically, it is all considered part of an employee payroll.

Employee Benefits

Employer-provided compensation received by employees in addition to wages or salary. Such compensation includes but is not limited to health care, child care, and life insurance. These benefits, also known as fringe benefits are meant to increase the economic security of employees.

Tracking Accrued Leave

Leave that has been earned and taken should be tracked at the end of each month. Vacation days that have not yet been taken are a liability to the business until they are taken. A business should keep accurate records of all days taken off and/or vacation days fulfilled by its employees.

Government Payroll Returns/Reports

Payroll returns are those that are required to be submitted with one's payroll tax. It must be submitted within a certain timeframe known as the return period.

Debt is like any other trap, easy to get into,
but hard to get out of.

Henry Wheeler Shaw

Chapter Eight: End of Period Procedures

As we start winding down to the last few chapters, we can also look at how much we've learned thus far. Now you can consider yourself to be almost as knowledgeable as that person who went to an accounting seminar in Japan last year. See what you can accomplish if you just put your mind to it? One thing about accounting, it's hard to fake it until you make it without first learning the basics. So in this chapter, we will be providing you with some basic knowledge with regard to depreciating your assets, reconciling cash, reconciling investments, working with the trial balance, bad debt, as well as posting adjustments and corrections.

Depreciating Your Assets

As you have probably heard, when you drive your brand new vehicle off that car lot, it automatically depreciates in value. This same concept can be applied in accounting. If you buy something that has a life expectancy of over one year, and it is not expected for resale, it is considered a depreciable asset. Depreciation is taken at a fixed rate. The portion allowed for that current year can be deducted as an expense.

Reconciling Cash

Cash reconciliation, is whenever you need to compare two lists of data and find either differences or the similarities, reconciling two accounts that represent the same information, or when migrating data from an old system to a new one. For example, when you compare your bank statement with amounts of money you deposited or have withdrawn to make sure they match. You will need to compare daily deposits on a cash activity report. You will also need to compare summary totals.

Reconciling Investments

When reconciling investments, you will be basically doing the same thing as reconciling cash, only using investments. You will be comparing all documents making sure everything matches appropriately. Some items that can be reconciled are: interest from stocks, bonds, and mutual funds.

Working with the Trial Balance

A trial balance simply entails making a list of all accounts that have a balance other than zero. It is basically a list of all the accounts that still owe money. The balances of each account will be shown, along with their debits and credits and totaled.

Bad Debt

Every now and then a company will accumulate some bad debt, for example, debt from customers who have not paid their bills (You know who you are). Information is retrieved so that an attempt to collect can be pursued. Most times it is very difficult to collect the bad debt, so it should be removed from the books. Collection accounts should be pursued after a certain period of time (usually 90 days). Un- collectible accounts should be written off, only if they are legitimate.

Posting Adjustments and Corrections

It is important to post any corrections or adjustments to the general ledger. Such a posting may consist of a simple entry which summarizes the corrections that were needed and those which were made. Adjustments and corrections should be made when necessary in order to create uniformity in all journals and other transaction documents for a business.

A budget tells us what we can't afford,
but it doesn't keep you from buying it.

William Feather

Chapter Nine: Financial Planning, Budgeting and Control

Now that we've learned all of these terms, let's put some of them to use by exploring reasons for budgeting, creating a budget, and comparing budgets to actual expenses. For many of us who have tried to use a budget at home to curtail that internet shopping obsession, you have either discovered how difficult it is to stay within a budget or how much easier it is to stay within your means, using a budget.

Reasons for Budgeting

A budget, in the business world, is like an owner's plan of action. Such a budget allows for better planning of the business' expenditures which can be matched to the sales revenue. It is a set of financial goals which can be used in evaluation of the performance of a business, based on whether or not the goals have been met. The budget will also project expectations of cash inflow and outflow as well as other items that are often found on a balance sheet.

Budgets should be used to look back at previous time periods in order to look forward and make any changes to future time periods before they happen. A master budget should first be developed to include numbers that are based on the expected sales and expenses, and should reflect a specific time such as a month, a quarter, or a year. Budgets also allow for control of spending, which in turn will help prevent overspending.

Creating a Budget

Past financial statements are often the best references when creating a budget. Any bank statements, utility bills, and records of income and expenses will help. A list of all sources of income should be kept and updated at all times. Knowing the possible ways that income might be gained will allow a business to create a realistic budget. It might be helpful to combine all sources of income and create a grand total for each month and each year. Expenses should be considered as either fixed expenses or variable expenses. A fixed expense is one that usually does not or should not change, such as rent. A variable expense is one that may vary from time to time, such as a utility bill.

Check the expected monthly income against the expected monthly expenses. Do the same for the year. If the income turns out to be less than the expenses, adjust your expenses. Eliminate any unnecessary expenses if possible. If the income equals more than the expenses, great! Plan to save some of the money your business will have left after expenses. This saved money can be used if ever the income does in fact equal less than the expenses. Once your budget has been created, this is not the end. A budget should be reviewed and updated periodically as changes in income and/or expenses occur.

Comparing Budget to Actual Expenses

While budgets are a projected or expected amount in terms of spending, “actual expense” is the realized amount that was ultimately spent by the end of the period. Expenditures can easily change from the budgeted amount, and revenues (income) might also not reflect what was previously forecasted. For this reason, it is important for businesses to recognize the differences in their budgets as compared to their actual expenses. It is very rare that actual expenses will match exactly with the budget at the end of a period. However, this does not mean that budgets are unnecessary; they still provide limits and guidelines to spending before the spending actually occurs. Remember, it can be hard to stop a spending spree once it has begun (all you shoppers should know this quite well) thus, a budget can aid a business in controlling its spending. Looking at actual expenses and comparing them to the initially planned expenses can allow a business to improve its budgeting plans for the future.

The trick is to stop thinking of it as your money.

IRS Auditor

Chapter Ten: Auditing

For this chapter, we will be discussing what an audit is, when and why you audit, as well as internal and external audits. I hope you've enjoyed learning this vital information and we're sure you will find much use for it in the near future.

What is an Audit?

An audit is basically an examination of the accumulation of financial records, in order to determine if such records and, or financial statements are in accordance with the rules of Generally Accepted Accounting Principles or (GAAP). An audit can also help to determine if all records are free from any errors or material misstatements, or fraud. Any discrepancies may be reported to the Internal Revenue Service (IRS).

Interestingly enough, the practice of auditing is not only unique to present day government structures. Auditing was first introduced under the reign of Queen Elizabeth I in 1559, who established the Auditors of the Empress. They were responsible for auditing the exchequer payments. But even before then, there is said to have been a public official charged with auditing government expenditure as an Auditor of the Exchequer in 1314 England. Queen Elizabeth's system, however did not sustain. Then finally in 1780, statute appointed the Commissioners for Auditing the Public Accounts

When and Why Would You Audit?

As stated above, an audit is usually done to make sure everybody is on the same page and appropriately and legally preparing their records in accordance with the proper rules and regulations of the (GAAP). Let’s not also forget about “BIG BROTHER" "UNCLE SAM" or whatever you choose to call that big government agency in the sky......... (No, not that one yet, let’s assume you’re still alive and kicking for the purposes of this training), but yes we are talking about the IRS. An audit, unlike accounting, is not concerned about the preparation of the proper documents, but is most concerned if they were prepared correctly and according to the guidelines of (GAAP) and free of fraud. There are six parts of every audit report, which include: the report title, the report address, the introductory paragraph, the scope paragraph, opinion paragraph, and the lastly the signature of CPA firm. Keep in mind the order may vary from auditor to auditor, but for the most part, the audit should contain all the elements listed above.

The best time to do an audit would probably be, when you are prepared to handle the stress of actually going through one. For the people who took this course, no worries, because you have all been taught to do everything the right way. For the rest, they might need to take a towel to collect all the sweat their going to accumulate during the audit. All joking aside, an audit is usually done before the release of the financial statements, but typically on an annual basis, before the end of each year.

Internal

There are two kinds of audits, internal and external. An internal audit is usually done by someone hired by a company or within the company, and doesn’t necessarily have to be a CPA (Certified Public Accountant). For the purposes of internal audits, some companies may have CIA's, no not the Central Intelligence Agency, but a Certified Internal Auditor.

There is also a governing agency called (IIA), which is called the Institute of Internal Auditors. An internal audit is designed to add value and improve an organization’s operations, as well as improve the effectiveness of risk management, control, and governance processes. When there is room for improvement, an internal auditor may make suggestions, or recommendations for enhancing, processes, policies, and procedures.

External

An external audit is an audit that is done periodically by an independent entity, one outside of a company, to determine if accounts are accurate and complete, prepared in accordance with the regulations of the GAAP, and that the financial records have been done fairly, and appropriately.

A conclusion is the place where you got tired of thinking

Arthur Bloch

Closing Thoughts

- **Yogi Berra:** In theory there is no difference between theory and practice. In practice there is.
- **Dwight Eisenhower:** Plans are nothing; planning is everything.
- **Jonas Salk:** The reward for work well done is the opportunity to do more.