Basic Accounting for Successful Entrepreneurs

How to read your financial statements

Basic Accounting Rules

- Every accounting transaction has 2 sides (debits and credits)
- Debits = credits
- Accounting Equation has to balance

Accounting Equation

Assets = Liabilities + Equity

What does this mean?

Assets

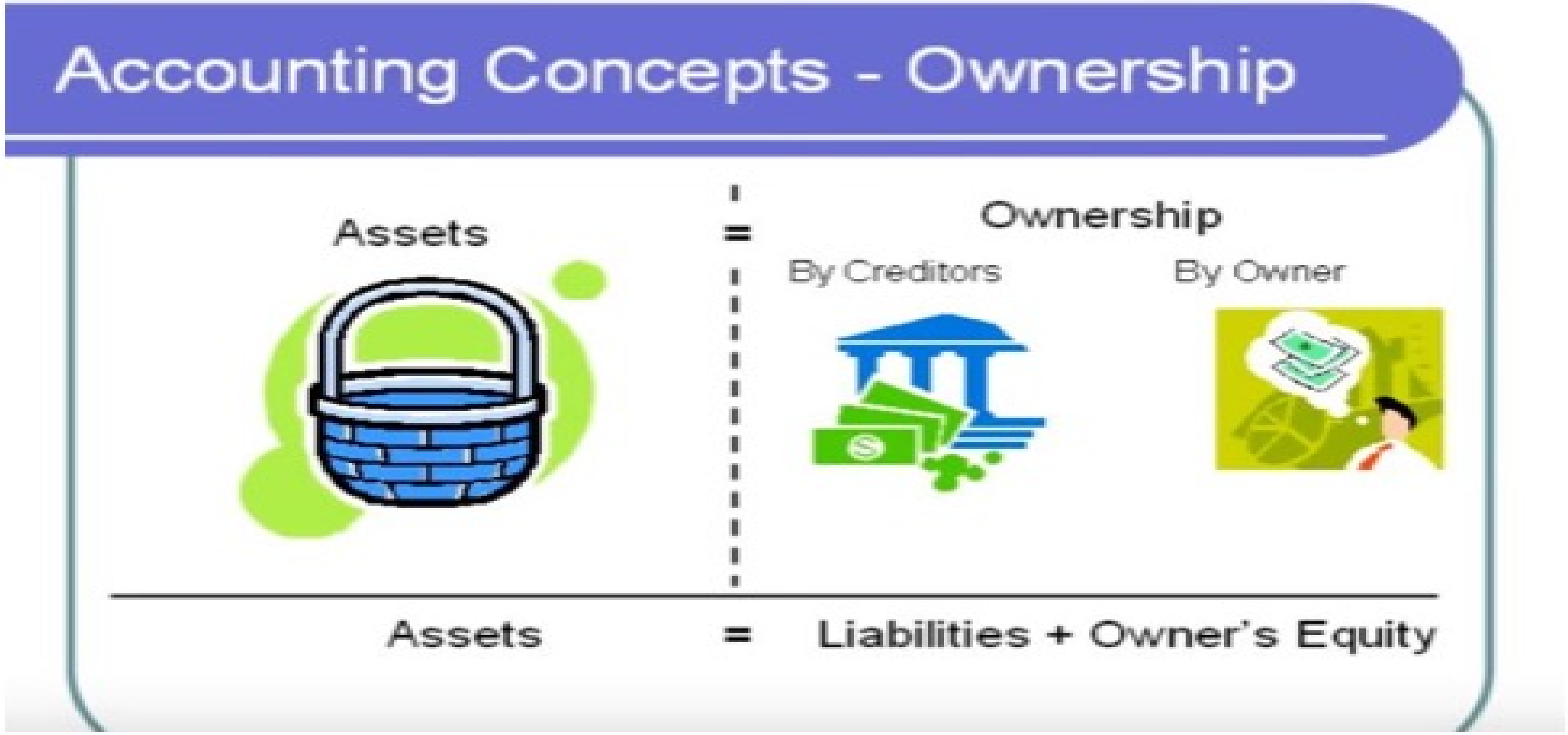
Things that your company OWNS

Examples

- Cash
- Investments
- Accounts Receivable
  - What goes in has to come out – this is a current listing of who owes you what.
- Equipment
- Buildings

How do you Acquire Assets

- There are 3 ways to acquire assets:
  - Borrow the money
  - Put in your own money into the business
  - Use money earned in the business


Accounting Concepts - Ownership
Assets
=
Ownership
By Creditors
By Owner
Assets
=
Liabilities + Owner's Equity

Liabilities

This is also knows as DEBT

This is the portion of the business owned by creditors

This is money you borrowed

Can be short term:

- Accounts Payable
- Taxes payable
- Credit cards

Can be long term:

- Vehicle Loans
- Mortgages
- Other Bank loans

More on Debt and Liabilities

- What goes in has to come out
  - paying off the debt
  - writing off the debt
  - declaring bankruptcy

Equity

- The least understood word in accounting
- This the portion of the business owned by YOU
- Take all of your assets, pay off the debt and this is what is left
- On paper, this is what your business is worth
  - Does not include goodwill, value of a client list, value of your employees, etc.

Types of Equity

Net Income

Retained Earnings

- Net income/losses from PRIOR YEARS since the beginning of time
- At the end of the year, the current year net income rolls into the retained earnings and you start again on January 1 with zero net income.

Shareholder Contributions/Distributions

- Personal money from the owner
- Can be contributed or distributed

Common Stock

How to build Equity

- Put in your own money
- Have Profits from the business
- Issue Stock

Net Income or Profits

Revenue

Less

Expenses

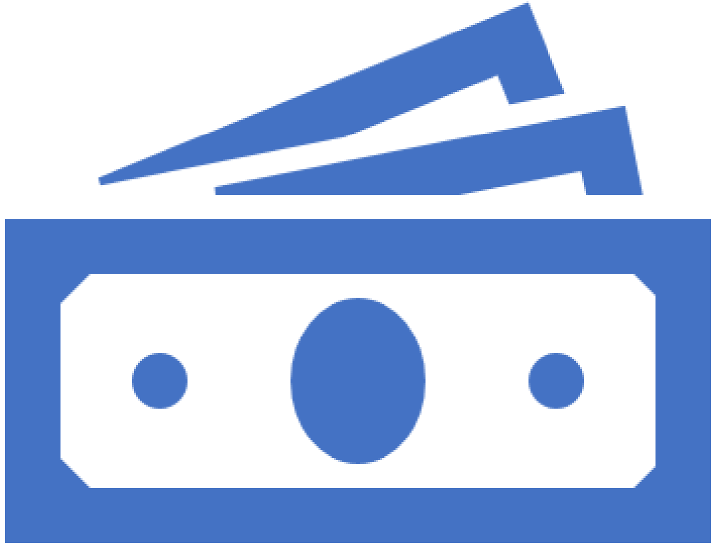
Expenses

- Payroll
- Insurance
- Professional Fees
- COGS
- Office Supplies
- Fuel
- Bank Fees
- Interest
- Utilities

Double Entry Accounting

Every transaction in accounting has 2 sides.

AND those 2 sides have to make the Assets = Liabilities + Equity equation balance.



Sale of a product or service for cash

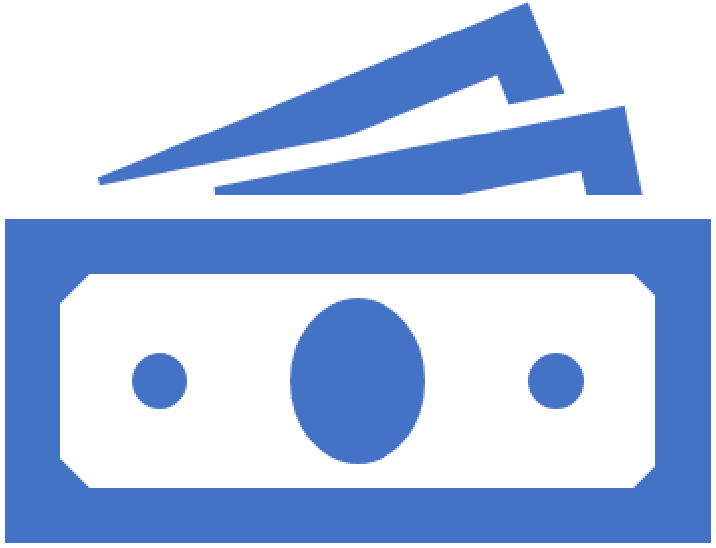
- What 2 accounts are affected and where are they on the accounting equation?
- Revenue goes UP. Revenue is in the Equity section
- Cash goes UP. Cash is in the asset section
- So for the equation Assets = Liability + Equity, assets go up and equity goes up.
- The world is in balance!

Sale of a product or service on credit

- What 2 accounts are affected and where are they on the accounting equation?
- Revenue goes UP. Revenue is in the Equity section
- Accounts Receivable goes UP. Accounts Receivable is in the asset section
- So for the equation Assets = Liability + Equity, assets go up and equity goes up.
- The world is in balance!

Payment of a receivable from a customer

- What 2 accounts are affected and where are they on the accounting equation?
- Cash goes up when the customer pays. Assets increase
- Accounts Receivable goes down – it is no longer owed. Assets decrease
- Assets go both up and down – no affect on the total statement



Comparing the sale on credit and the sale for cash

- Absolutely no difference in the assets, liabilities and equity of the business.
- Cash and Accounts Receivable are both assets.
- Both increase revenue (equity) and both increase assets
- One you are waiting for cash the other you have the cash

Go to the office supply store and purchase a ream of paper with a check

- What 2 accounts are affected and where are they on the accounting equation?
- Expenses go up, but since expenses reduce equity, EQUITY GOES DOWN
- Cash goes down
- Assets = Liabilities + Equity is in balance

Go to the office supply store and purchase a ream of paper and they send a bill

- What 2 accounts are affected and where are they on the accounting equation?
- Since you have the paper, you still have an expense so Equity goes DOWN
- Assets were not affect, but the liabilities were – Accounts Payable goes up – you owe that vendor
- Asset = Liabilities + Equity balances. Liabilities go up, Equity goes down. No affect on assets

Time to pay the office supply bill

- What 2 accounts are affected and where are they on the accounting equation?
- Cash goes down when you pay the bill
- Liabilities – Accounts Payable goes down because you no longer owe this vendor.
- Assets = Liabilities + Equity. Assets go down, Liabilities go down, no affect on equity

Making a loan payment

- What 2 accounts are affected and where are they on the accounting equation?
- This entry actually has 3 pieces and not just 2.
- Assets go DOWN (cash when the check is written)
- Liabilities go DOWN for the amount of the principal of the loan
- Equity goes DOWN with the amount of the interest on the loan
- Remember with liabilities, what goes in has to come out – and only the amount of the actual loan. Any amounts paid above and beyond the loan (interest), is an expense and not a liability payment.

Difference between asset and expense

- If you buy a $500 Ipad, is that an office supply expense or an asset?
- Assets have FUTURE value and are usually large
- Expenses happened in the PAST
  - Payroll
  - Utilities
- Assets are usually larger and have future value
  - Equipment
- Most companies have policies with a dollar amount that will go to an asset and not an expense

More on Assets

- Assets have FUTURE VALUE – you can do something with them in the future – sell them, trade them, etc.
- Equipment has future value – it will help you generate revenues in the future.

Cash versus Profit

A Business CAN have profit and have no cash to pay the taxes on the profit

A Business can also have cash and show a loss or small profit

Cash and no profit

If a business receives payment on an old receivable. That transaction was recorded as revenue in a prior year

If a business had a “fire sale” where old inventory was sold at a loss. The business will generate cash but those items were sold at a loss.

Profit and no cash

A business has significant debt payments. Debt payments require cash but are not an expense. They are a reduction of a liability. Therefore, cash is needed to pay down debt but not deductible as an expense

Large capital assets were purchased with cash – those assets are not an expense – they will be eventually be an expense through depreciation but for now cash was used and is not an expense

Any Questions?

- Thanks for attending the session with me!
- I can be reached via e-mail with any questions
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- My office phone is 406-454-8988 (rarely in the office – e-mail is better)
- You can text me at 406-205-4480
- Have a great rest of your summer!