The Montana Small Business Development Center presents:

BASIC ACCOUNTING FOR SUCCESSFUL ENTREPRENEURS
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

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Assets = Liabilities + Owner’s Equity
Liabilities

This is also known 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.
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

Types of Equity
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.
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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• You can text me at 406-205-4480
• Have a great rest of your summer!