INTRODUCTION TO BASIC ACCOUNTING

FOR Beginners and Non Accounting Professionals

- A PUBLICATION OF COMPANY XYZ -

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INTRODUCTION

Hi,

Accounting is pictured as boring subject for many years. When you are seeing someone learning accounting, you will think what will be his future or why is he wasting his time?

But that person is clever.

In day to day life, accounting and finance is applicable in each transaction. It is starting from buying a shirt to purchasing your bungalow. You need to learn accounting to understand how business works, where is your salary going or whether your business is actually making profit or whether your investment is debt or asset? Via learning accounting, you not only understand more about money but also impress your boss or friends with your knowledge

In this book, you will become familiar with basic accounting and learn about principles of accounting, accounting cycle and financial statements.
Before you start reading this book, I invite you to join my udemy course (worth 59$) on basic accounting at 99% discount at $1 .

Thanks, Tarannum

What is accounting?

Accounting is system of financial reporting that identifies , records and communicate transactions and result of business.

Three important elements of accounting are

1. **Identification:** In account, first accountant is needed to identify the transaction and decide whether it should be recorded or not. He applies accounting principles in this process.

2. **Recording:** After that, he records the transaction as per double entry system or accounting equation and following accounting cycle process.

Communication: Finally, financial statements are prepared from accounts and the result of business and position of assets and liabilities are communicated to stakeholders and management.

Through accounting, we can know result of business. Accounting is tool to measure result of business and leads to future plans.

Can you imagine Amazon without accounts? How can it measure sales without account management? How can it design growth strategy without accounts? How can it publish revenue and income reports to its stakeholders without maintaining accounts?

Account is simple but necessity in each business. From small proprietor to global enterprise, Accounting is must.

That's why it is necessary that each should get basic accounting knowledge to understand and do financial transactions smoothly in day to day life.

Career in accounting

Another side of learning accounting is make serious career in finance. Many consider finance as boring and time consuming activity but they are wrong. Finance has bright career opportunity if you consider and work in this career line with interest.

Here is opportunity of finance person in following **sectors**:

Commercial banking
Corporate finance
Insurance
Money management
real estate

With finance knowledge, a person can work as

Tax advisor
Financial adviser
Finance manager
Internal auditor
Investment analyst
Retail banker
Corporate treasure
Chartered Accountant (CPA)
Tax Investor
Actuary
Accounting technician
Business person
Manufacturer

If you select job as your career, Annual salary of finance profession is ranging **from $70000 to $150000 average.** You can earn more than triple if you start your own business in finance field. You can also use your finance skill in managing your business and increase profitability.

So **learning finance is win- win situation for every person.**

How Accounting works?

Financial transactions are recorded in four major accounting cycles:

Revenue cycle
Purchase
Payroll
General journal

We can elaborate various major cycles as per under:

Revenue cycle: In this cycle, order entries , cash receipts and account receivables are covered.

Purchase cycle: In this cycle, Purchase orders/ purchases, cash expenses or cheque and account payables are covered.

Payroll cycle: In this cycle, all the data regarding employees payroll (Employees salary) is recorded.

GAAP Principles

There are some basic accounting principles accepted by GAAP (Generally accepted accounting principles). Accounting is based on this principles and violation of those principles leads to inaccurate result of business.

Here is brief overview of accounting principles as per GAAP:

Cost principles:
It means that assets of business are required to be recorded at cost value. Example: Cost of land is $100000 but market value of land is $400000. In this situation, we will record land at $100000 in financial statements.

Monetary unit assumption:
It means transactions which can be measured in money are only recorded in accounts. Example: efficiency of employees are useful in growth of business but it can't be measured in money. So it will not be included in accounting. Other assumption is that inflation is ignored in accounting.

Economy entity assumption:
As per this principle, owner of business and business should be considered as separate entity. That's why capital invested by proprietor or partner is shown as internal liability.

Time period assumption:
As per this assumption, accounts are written for specific time period. (One year). Year can be start from January or from April.

Matching concept:
As per this principle, revenue should be matched with expenses. Example: Business sale for quarter is $200000. We will consider expense incurred to earn that revenue while calculating profit for that quarter. It is not relevant that expenses are paid or payable. This is called matching concept.

Going concern Principle:
As per this principle, it is assumed that there is no intention of winding up of business and business will be continued for long period.

Conservatism:
As per this principle, expected future income or gain should not be recognized but estimated future losses or expenses should be recognized in accounting.

Accounting Equation

Accounting equation is formula representing three factors: Asset , liability and capital.

Assets - Liability = CAPITAL.

Accounting equation is always remained in balance for each transaction of business.

Before understanding accounting equation, first we need to understand what is assets, liability and capital?

Assets: assets are property of business like land, building, furniture, machinery, plot, debtors, stock , cash, bank etc. Through asset, business will gain any future benefit or gain.

Liability: liability is debt of business like creditors, loans from bank, outstanding expenses etc.

Capital: Capital is owner's equity or investment in business.
Revenue: Revenue is income of business and it will increase capital.

Expenses: Expenses are day to day cost of running business.

When we reduce liability from asset, it will be business capital.

We can understand it with following examples.

Example 1:

Xoya has started business with $500000. Now, let's make accounting equation for this transaction.

Xoya is owner of business so owner's equity is $500000. Other side, as she started business with cash, cash balance is $500000. So asset is $500000.

Equation is
$500000- 0 = $500000.

Example 2:

Xoya has sold service to peter at $5000. Peter has not paid yet. In this transaction, Xoya has sold service so income will increase by $5000. Similarly capital will be increased by $5000.

Other side, Debtor (Peter) balance will be increased by $5000.
Equation is
$5000- 0 = $5000.

Example 3:

Xoya has paid $1000 as salary.
In this transaction, salary (Expense) will be increased which will reduce the profit and capital by $1000. Other side cash will be reduced by $1000.

Equation is
-$1000 - 0 = -$1000.

Accounting equation can be used to do journal entry or understand transactions easily. Accounting equation is 100% accurate and it never varies for any transaction.

What is double entry system?

Accounting is maintained at double entry systems.

What is a double entry system?
As per double entry system, there is always two effects or two accounts are involved in each transactions.

Examples:

Rozy purchase car by cheque. In this transaction, bank account is reduced and car which is asset is increased. In this transaction, two accounts are involved. Bank and Car.

Xen has paid cash to Lara. In this transaction, cash is reduced and Lara which is our creditor is also reduced. There are two accounts involved in this transaction. Lara and Cash.

Share purchased in XYZ ltd. In this transaction, two accounts are involved bank and Shares in XYZ ltd. Investment account (Shares in XYZ ltd) is increased and Bank account is reduced.

I hope now you are able to understand what double entry system is. We can use this system to do journal entry or posting in ledgers.

Accrual Accounting

There are two accounting methods:

Accrual accounting
Cash accounting

In cash accounting, transactions are recorded when cash changes hand means when cash income or cash expenses are done. Other side, in accrual accounting, transactions are recorded when they incurred, no matter the transactions are cash transactions or credit transactions.

Cash accounting is used in rare case but accrual accounting is popular because it is showing actual result of business.

Due to accrual accounting, concept of prepayment, accruals are needed to be understood.

Prepayment :
Prepayment means when we pay someone money in advance and we do not receive goods or service yet. Example: prepaid expenses.
Prepayments are shown on asset side of balance sheet.

Accruals:
Accrued expenses: Sometimes expenses are due but we have not paid them yet. They are our liability and should be considered in current financial year as expenses.

Accrued income:

Accrued income means we have provide service or sold goods but have not received money for it yet. They are our accruals. They are also need to be recorded in financial statements as current income.

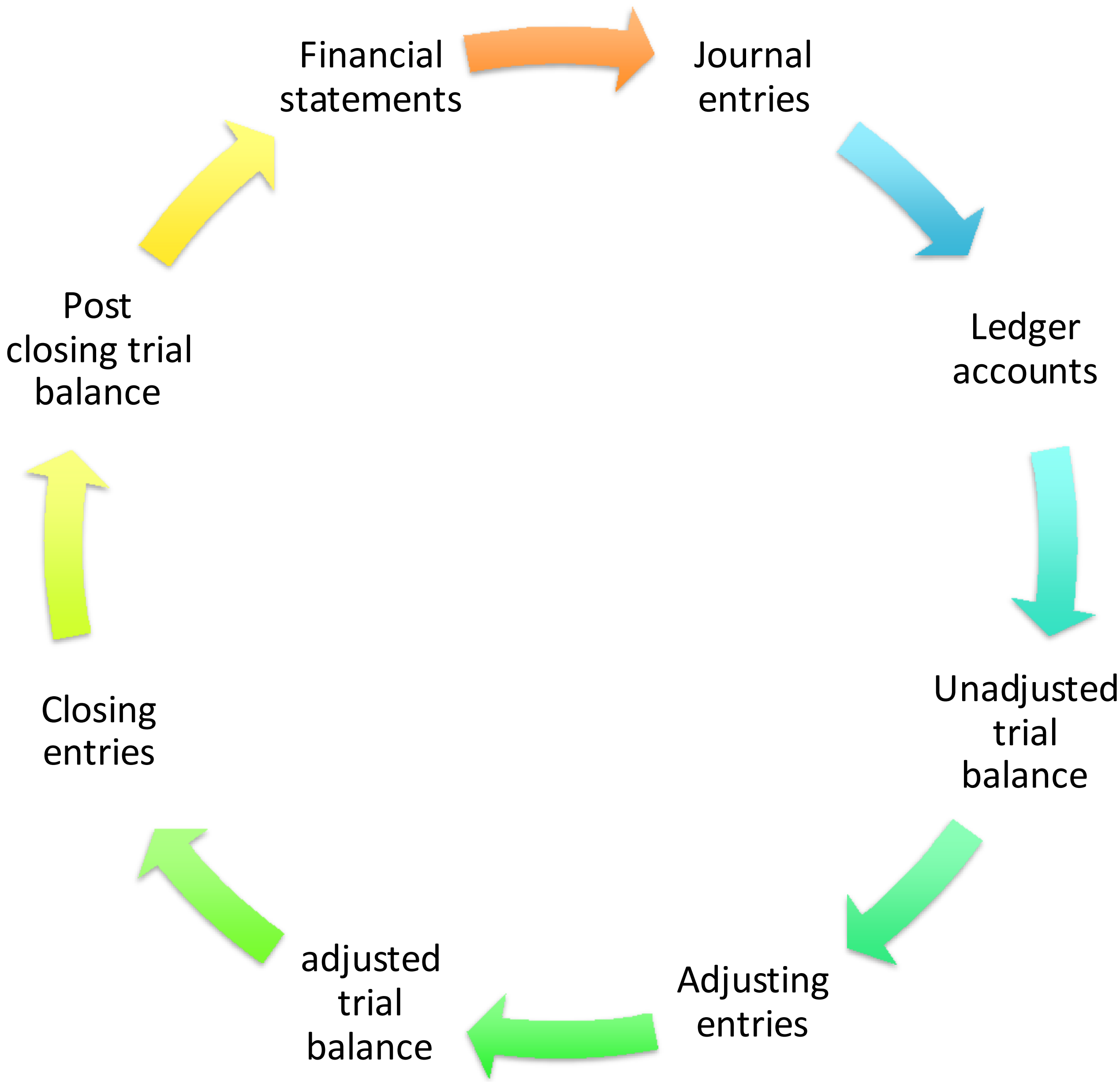
Result as per Accruals accounting

Transactions		$
Sale of goods		
Cash received	5,00,000	
Credit sale -debtor	1,20,000	
		6,20,000
Purchase of goods		
Cash purchase	2,20,000	
Credit purchase	1,00,000	3,20,000
	10,000	
selling exp paid		
salary payable	10,000	20,000
Net profit		280000

Result as per Cash accounting

Transactions			$
Sale of goods			
Cash received	5,00,000		
Credit sale -debtor	1,20,000		
			5,00,000
Purchase of goods			
Cash purchase	2,20,000		
Credit purchase	1,00,000		2,20,000
		10,000	
selling exp paid			
salary payable		10,000	10,000
Net profit			270000

Accounting Cycle


Financial statements
Journal entries
Ledger accounts
Unadjusted trial balance
Adjusting entries
adjusted trial balance
Closing entries
Post closing trial balance

Accounting cycle is process starting from recording transactions to closing books of accounts.

We can understand accounting cycle from above image.

First step is recording transactions in journal.

Second step is doing ledger entry from journal.

Third step is balancing ledger and preparation of trial balance.

Fourth step is doing adjusting entries.

Fifth step is preparation of adjusted trial balance.

Sixth step is preparation of profit and loss account and balance sheet (preparation of financial statements)

Last step is doing closing entry and preparation of closing trial balance.

Financial Statements

Financial statements consists three statements:

Income statement
Balance sheet
Cash flow statement (Not mandatory for all organization).

Income statement: Income statement is summary of all income and gains during the year and all expenses and losses during the year. If the company is manufacturing or dealing in purchase and sale of goods, trading account is also prepared. From income statement, we can find actual net profit of business.

We record all the income and expenses as per accrued accounting. So record current years income (Received or not) and matching expenses (Paid or payable) to prepare financial statements.

In next page, you can get access of income statement.

Profit and loss account for the year ended			
Particulars	$	Particulars	$
Opening stock	2000	sales	940000
Purch ase	71000	Commission received	4000
Administrative exp	60000		
Travelling exp	12000		
Discount given	400		
Salary	1000		
Net profit	797600		
	944000		944000

Balance sheet: Balance sheet is statement showing assets and liability position of business. It is prepared for last day of the year. Balance sheet is useful to know about credit worthiness of business.

Assets and liabilities are current and long term. Like current assets, fixed assets, Long term loan.
Here is the balance sheet of XYZ ltd.

Liability	**$**	**Asset**	**$**
Capital		Cash	532900
Mr. Smart 283000		Bank	209990
Drawing 10100		Jenny	20000
Profit 491490	764390	Commission receivable	2000
		Insurance paid in advance	2000
Salary payable	2500	Building	33000
Creditors	32000	Investment in shares of LM ltd	10000
Advance received	10000		
Provision for taxes	1000		
	809890		809890

There is no mandatory requirement to prepare cash flow statements for all enterprise. Cash flow statement represents cash inflow and outflow during the year.
It represents cash movement of three activities:
Operational activities
Investing activities
Financial activities
here is cash flow statement of xyz ltd.

Particulars	$	$
Cash Flow from operation activity		
Cash receipts	200000	
Less Cash payment	120000	80000
Cash Flow from investing activity		
Sale of Plot	100000	
Less Purchase of shares	20000	80000
Cash Flow from financial activity		
Share capital issued	100000	
Less Debentures	10000	90000
Net increase in cash and cash equivalent		250000
Opening balance of cash		10000
Closing balance of cash		260000

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