Accounting Made Simple Summary

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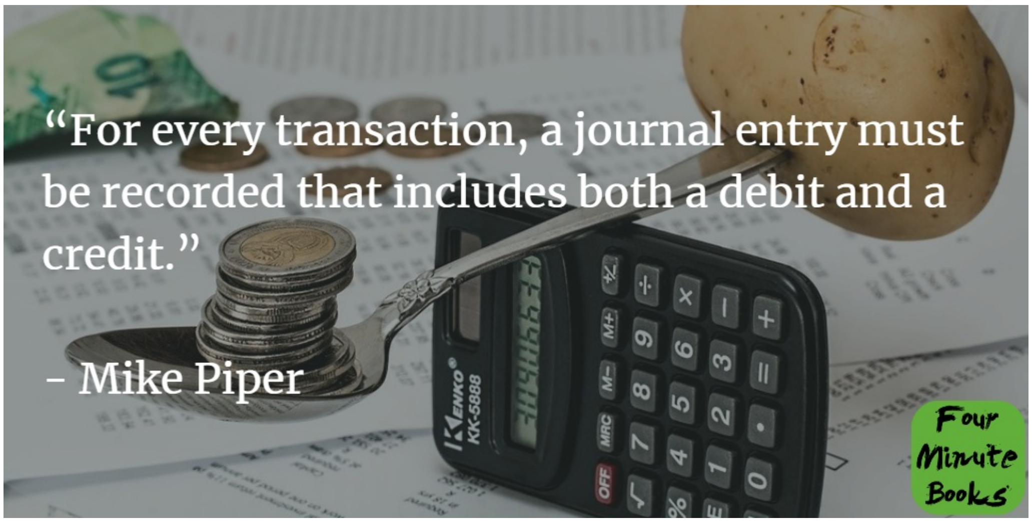
1-Sentence-Summary: *Accounting Made Simple is your guide to learning the fundamental charts, equations, and concepts of managing a business's financial statements.*

Read in: 4 minutes

Favorite quote from the author:



Nearly a year ago I lost my job. I didn't want to go back to working for someone else, so I began the process of starting a company. Two, actually. Part of the work I had to do was get an accountant. Luckily I've got a friend nearby that is one, so setting up my books was the easy part.

But then I started to see all of the charts of accounts and it got really confusing really fast. What is a chart of accounts anyway? Why did I have to know my profit and loss? These are just little companies, couldn't I just make money and leave it at that?

I've since come to find out that, although confusing sometimes, accounting is a powerful tool to check the health of your business and many other things. And this is what we get in Mike Pipers *Accounting Made Simple: Accounting Explained in 100 Pages or Less*. After this, you'll be far wiser about what the money in your business is doing and how to be smarter with it.

Here are the 3 best lessons for making accounting easier to figure out:

1. Accounting uses assets, liabilities, and owner's equity to see where a company is financially, prepare for taxes, and find ways to improve.

2. If you want to know how economically healthy your firm is, calculate ratios like liquidity and current ratios.
3. The double-entry system is the golden standard for best practices, and understanding it will help you grasp the big-picture of accounting.

Are you excited for the best crash course in accounting you've ever had? Let's go!

Lesson 1: Accounting helps companies prepare for taxes and understand their finances through assets, liabilities, and owner's equity.

There are many benefits to taking good care of your books. In my companies, it lets me estimate taxes and know how healthy they are. We'll start with the basics of accounting with the equations that are fundamental for the balance sheet.

The *accounting equation*, as it's known, lets you get a picture of the financial position of your business using three terms:

- Assets: these include everything the company owns. Some of my company's assets include my laptop, car, and phone.
- Liabilities: anything the company owes is in this category. If you have a car loan, for example, this would go here.
- Owner's (or Shareholder's) Equity: This value is what's left of the assets after subtracting liabilities.

The basic principle here is that two equations are always true of these terms:

1. Assets = Liabilities + Owner's Equity
2. Owner's Equity = Assets – Liabilities

Let's see a more concrete example. Imagine you own a lemonade stand. You've got assets including the stand itself, cups, and lemonade worth, say, $100. But to start you had to borrow $60 from your parents, so that's your liabilities. Calculating your Owner's Equity, then, is simple:

Owner's Equity = Assets – Liabilities = $100 – $60 = $40

You also have other accounts to work with these figures to understand your business's money situation, including:

- Balance Sheet: this helps you sort out assets and liabilities more specifically and represents a specific moment in time, like a month.
- Income Statement: creating this lets you see what your net income is after all costs.

- Cash Flow Statement: a record of inflows and outflows of cash, this account is vital to your company's financial health.

Lesson 2: Financial ratios like liquidity and current ratios will help you understand how well your company is doing at managing money.

Alright, so all those accounts are done but now what? How do they tell you about the health of your business? This is where the *liquidity ratio* and *profitability ratio* come in handy.

There are a few different types of liquidity ratios, all of which help you see how well your company can meet its short-term financial commitments. The *current ratio*, for example, gives you an idea of how well you can pay liabilities with assets at the moment. To calculate this, use the following equation:

> Current Ratio = Current Assets/Current Liabilities

The higher the ratio, the better the health of your business. A more revealing way to look at the liquidity ratio, however, is through the lens of the *quick ratio*. This is the same as the current ratio, but without inventory balances:

> Quick Ratio = (Current Assets – Inventory)/Current Liabilities

You might have $200,000 in assets and $200,000 of liabilities, so your current ratio is 1 and you're fairly healthy. But excluding an inventory of, let's say $100,000, gives you a quick ratio of only 0.5, which isn't great. Now it's easy to see why all of those different accounts and equations are useful!

Lesson 3: Everything that goes into or out of a business is recorded twice, and understanding why will help you see how all accounting principles work together.

Double-entry accounting is probably the most important part of Generally Accepted Accounting Principles (GAAP). Why record everything twice? Well, it actually makes perfect sense when you think about all of the different types of accounts.

Take a new laptop, for example. Say it costs me $1,000. On my personal budgets, I'd see a negative $1,000 show up, right? Well in a business, that money is debited, or taken out of your account, but the company owns the computer now.

That means one account has to increase and another must decrease for everything to balance correctly. **So on your business accounts, you would show both a debit of -$1,000 and a credit of +$1,000 on your assets side.**

Any increase in assets is a debit, while a decrease is a credit. Similarly for liabilities, an increase in liabilities is a credit and a decrease is a debit.

On your chart of accounts for this laptop example, you would see two lines with special indenting. One represents the debit and the other is the credit to your assets, as follows:

Dr. (debit) Office Equipment – Laptop $1,000

    Cr. (credit) Material expenses $1,000

Seeing it this way makes it all come together. Now accounting is truly made simple for you!

Accounting Made Simple Review

As a new business owner, *Accounting Made Simple* has exactly what I need to know about my finances. The way this book explains things makes accounting easy to grasp. Now it makes a lot more sense where my money is going, how profitable my company is, and how well I'm managing cash!

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Who would I recommend the Accounting Made Simple summary to?

The 31-year-old who is new to owning a business and feels lost about what their accountant is talking about, the 54-year-old manager who is trying to understand where their company's cash flow is at, and anyone who's curious about whether or not they want to become an accountant.