

The Accounting game

1. Balance sheet: cash, Asset, Liability (not gross profit)
2. Accurate accounting: Accrual accounting.
3. Account Receivable: Asset
4. Cash: Important for daily operations
5. Net profit: Bottom line
6. Prepaid expense: Asset
7. FIFO/LIFO: Inventory tracking
8. Income Statement: Expense, Earnings
9. Depreciation account: No effect on Cash.
10. Asset = Liability + Owner's equity

1. Received \$50 from parents (Repay: yes), my cash: \$5.

Cash 15	original investment 5 → owner's equity. notes payable 50 → liability
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2. week 1: purchase 150 lemons (\$10), 5 pounds sugar (\$2)

cash 3	org inv 5 notes pay 10	Cost of production = 12 No. of glasses = 60
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3. Sales: \$25, COGS: \$10.

cash 28	org 5 → DE
Inven 2	Inv 10 → L
	Earnings 15 → O.E

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A. Glazeb rental, Advertisements, Rent: \$2, \$1, \$2, paid mom: \$10

Cash	13	NP	①
Inv	2	Org	5
Earnings	10	→ Sub \$5 (expense)	

5. Income/Profit or Loss Statement

Sales - COGS = Gross profit
Gross profit - expenses = Net profit / bottom line

Income	25
Beg Inv	0
Purchase	12
Avail. Sale	12
End Inventory	2
COGS	10
Profit(gross)	15. (Sale - COGS)

Sales: Glazeb, lawn, logo: \$5 (Sales - COGS) = Net profit: \$2

Net = \$10

Week 2

* 50 from bank, 2: inventory sold to neighbour

Cash: 13 + 50 + 2	Acc Pay: 50
Inv: 0	NP: 0
	Org Inv: 5.
	Retained Earnings: 10
	Earning this week: 0 (Sold as CP)
	Owner's eq = 15

* \$4 : cash (Sugar), \$20 worth of lemons

Cash: 45	AP: 50
Inv: 24	NP: 4

Org Inv: 5

R.E: 10

Earn: 0

Expenditure = 2

Inventory = 95 + 3

Expenditure

* \$1 to make lemonade for sister (labor to produce product: \$1 to inventory
\$1 from cash)

Cash: 44	Same
Inv: 12	
13(12+1)	
<u>69</u>	

* \$20 Sales, 10 AR

Cash: 64	AP: 4
AR: 10	NP: 50
Inv: 12	Same
	Org Inv: 5
	R.E: 10
	Earning: 17

$30 - 13 = 17$

* Bad debt: \$4

Cash: 64	AP: 54
AR: 6	NP: 50
Inv: 12	Same
	O.I: 5
	R.E: 10
	Earning: 13

* Pay \$25 to bank + \$2 interest

Cash: 37	AP: 4
AR: 6	NP: 25
Inv: 12	O.I: 5, R.E: 10, Earning: \$1 (13-\$2 interest)

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* Insurance \$3 (3 years)

Cash : 34	AP : 4
AR : 6	NP : 25
Inv : 12	O.I : 5
P.E : 3-1	R.E : 10
	Earnings : $11 - 1 = 10$
	54
	54

(used this year insurance)

Balance Sheet week 1

Cash : 13	NP : 0
Inv : 2	O.I : 5
Cash : 0	R.E : 10
	Earning : 0

week 2

Cash : 34	AP : 4
AR : 6	NP : 25
Inv : 12	O.I : 5
PE : 2	R.E : 10
	Earning : 10

Cash method:

Sales: Beg Inv: 22
Beg Inv: 0

purchase: 20 (50 lemons)

Labor : 1

End Inv : 0 (not cash)

G.P : $22 - 21 = 1$

(COGS)

Spent (20+1)

Not matters: how left

matters: how much paid / got

exp:

Interest + = 2+3

Insur

= 5

Net profit = $\boxed{-4}$

* 14: CASHF (end) = \$50 worth of lemons

Accrual

Income Statement

Sales : 32
Sales : Beg Inv : 2

purchase : 24

Labor : 1

Total : 27

End Inv : 12

G.P : 17

COGS : 15 ($13 + \$2$)

↓
at SP = CP

Expense

Int + Bad debt + Insurance = $2 + 4 + 1 (\text{this year})$

7

Net profit = 10

Accrual: Accurate (incurred/expensed)
(Bankers) → good looking! accurate
Cash method: Tax purposes

Rules:

- * Any company/business with inventory: must use Accrual!
why: Say Saw profit (lets buy more inventory, ↓ income)!

- * Cash method: Lawyers, doctors, Accountants, Seminar Companies, Real estate, (service)

"Delay profit": Advantage : Delay taxes

- * 2 sets of books (1 for us (accrual), 1 for govt): creative accounting.
- * Govt allows Accrual → cash switching: not vice versa.
- * In Cash: need to choose from beginning (not switching)

Service business

- * Cost of service = direct cost to deliver service

- * Sales: ₹8

COGS: Consultant fee: 12

Demo products (lemon, sugar): 3

Travel : 6

21

Gross profit: $48 - 21 = 27$

Expense: $47dv + \text{Sales commission} + \text{Office task} = 4 + 1 + 2 + 3 + 3$
 $+ \text{Friday work} + \text{R&D}$
 $= 13$

Net profit = ₹14 (₹7-₹3)

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Income Statement

Sales: 48

$$\text{CoGS} = \underline{21}$$

$$\text{G.P} = \underline{27}$$

Exp: sales & Ad + General + R&D

$$5 + 5 + 3$$

$$\text{N.P} : \underline{27 - 13 = 14}$$

Week 3: Back to Lemonade Stand

* All earnings @ week 2 → Retained earnings

Cash: \$34.00	A.P: \$4
AR: 6	N.P: 25
Inv: 12	O.I: 5
P.E: 2	R.E: 20
	Earnings: 0

\$20 lemons at credit:

Cash 34	AP 24
AR 6	NP 25
Inv 32 (Raw)	<hr/>
P.E 2	O.I: 5
	RE 20
	Ea: 0

we have 50 lemons @ 20 cents, 50 lemons @ 40 cents

1. FIFO (50 lemons)

$$50 @ 20 = \$10$$

$$5 \text{ pounds sugar} = \$2$$

$$\text{Cost of production } \underline{\$12}$$

Cash 34	AP 24
AR 6	NP 25
Inv 20(R)	<hr/>
12 (F)	O.I: 5
P.E 2	RE: 20
	Ea: 0

* \$25 cash, \$5 account (Sales)

Cash 59	AP 24	30 - 12 = 18
AR 11	NP 25	
Inv 20(R)	<hr/>	
P.E 2	O.I: 5	
	RE 20	
	E 18	

FIFO Income Sheet:

Sales	\$ 30
Beg Inv:	12
Purchase:	20
Labor:	0
Total Av. Sale:	32 ($12+20$)
Ending Inv:	<u>20</u>
CoGS:	12
G.P:	$= 30 - 12 = 18$
Total exp:	Nothing!
NP:	= 18

LIFO

Cost eq production 50×40 cents = \$ $20 + 2 = 22$

Cash	AP	NP
89	24	
AR	11	
Inv	<u>10 (R)</u>	25
	$20(F)$	
BE	2	$OI = 5$
		$RE = 20$
		$E = 0$

25 cash, 5 AR (Sales)

Cash	AP
59	24
AR	11
Inv	<u>10 (R)</u>
PE	2
	$OI = 5$
	$RE = 20$
	$E = 30 - 22 = 8$

Income Statement:

Sales	\$ 30
BI:	12
pur:	20
Lab:	0
To A.S =	32
End. I = <u>10</u>	
CoGS:	22
G.P:	8
NP =	8

Low profit, Low taxes: LIFO : on paper (who knows, I give old/new stock?)

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Prices rising : LIFO
Prices falling : FIFO

Strategy: which direction price goes?

Difference will be in Balance Sheet (FIFO: Ending Inv = 20)
(LIFO: E I : 10)

LIFO, LIFO : Valuing inventory, not using them

Switch:

- * FIFO → LIFO : 1st time switch (Inflationary Economy)
- * Second time: Need permission (Same to get permission)
 - ↳ May also pay taxes saved on FIFO → LIFO!
- * Footnotes: must reveal inventory valuation it is used
(Financial statements, Tax reports: Both need to be same
FIFO / LIFO: not both / one another)

week - 4 (From now on LIFO)

* Roll up earnings

Cash	59	AP	24
AR	11	NP	25
Inv	10(R)	OI	5
PE	2	RE	28

* \$5 in AR received,

Cash	64	AP	24
AR	6	NP	25
Inv	10(R)	OI	5
PE	2	RE	28

(2 weeks ago
\$5: accounted for sale
(Sales incurred))

Cash flow statement:

Collection	5	50
Inv. paid	0	35 (T\$ + 50)
Fixed ass. Inv	0	
Expense paid	0	
change in cash	0	5
Beg Cash	59	59
End Cash	64	

other cash comes in/out

* Bought lot + lemonade stand: \$10

Cash 54	AP 34
AR 6	NP 25
Inv 10 (R)	OI 5
PE 2	RE 28
Fixed asset: 10	E 0

Capitalizing assets: Buy & add in to Balance sheet (why not expense: 10+ yrs life)
significant value!

* Paint: \$2 (Not long: expense)

Cash 52	Same
<u>Same</u>	<u>exp: -2</u>
80	82

* Sink: credit (\$2): Capitalize

repair \$1

Cash 52	AP 26
AR 6	NP 45
Inv 10 (R)	OI : 5
PE 2	RE : 28
F.A 12	E : -2
82	82

E: -3
AP: 27 (Credit)

>1yr: capitalize
<1yr: Expense

+ min asset (\$500, ...): each company rules

Cash Statement

Collections:	0
Inv Paid:	20
FA: Inv:	0
exp paid:	0
change:	-20
Beg:	52
end:	32

* \$20 ready-made lemonade

Cash 32	Same
AR 6	
Inv 10 (R)	
20 (F)	
PE 2	
FA 12	
82	

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* \$40 salary, \$10 credit (Sales)

Cash: 72	AP 27
AR: 16	NP 25
Inv: 10(R)	OI 5
RE: 2	RF 28
F.Avg: 12	E $50 - 20 - 3 = 27$ (Paint + repair)
	112

* paid \$4 for sugar (credit)

Cash: 68	AP 23
	33

* Bank: \$25, \$2 interest

Cash: 41	AP 23
AR: 16	NP 0
Inv: 10(R)	OI 5
RE: 2	RF 28
FA: 12	E 25 (Interest \$2)
81	81

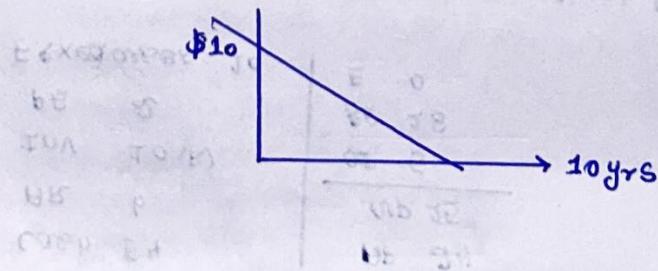
Cash Statement

Collection	40
Inv Paid	24 (20 (Readymade), 4 Credit))
FA	0
exp paid	-2
Change in cash	18
Beg Cash	59
End Cash	41

Depreciation:

- * Land: can't! (\$2) → forever, no wear out
- * Stand: Stand (\$8) : Stand + Sink: \$10

Straight line depreciation:



equal percentage

1/10 : Per year.

Asset: still \$12
Net book asset value: \$11 (\$1 depreciated) → Expense!

Cash	41	AP	23
AR	16	NP	0
Inv	10(R)		
RE	2	OI	5
FA	<u>10(1+8)</u>	RE	28
	80	Ear	<u>28</u>
			80

\$20 cash

Depreciation: Non cash expense → Balance sheet!

Prepaid expense: Once used, can't sell!

Asset: can depreciate, can buy more/less!

Each year: Reduce book value of the asset by \$1
Not true value

Adv: Reduces Earnings, without Cash ↓

Cash Statement:

Collections: 45

I.P.: 21

F.A.I: 0

E.P.: -2

Change:	18	80
Beg:	59	0
End:	41	28

(Skip: previous week) (Inv): 8kip ✓ ✓
This week: \$6 cash from credit, \$10: lot + land, \$2: permit (charge), \$1: Repair

\$20: Pre made Remondado,

\$40 cash, \$10: account

\$4: AP (paid), \$25+\$2: Bank

Depreciate: \$1

Skip
(2 weeks ago
accrual)

Sales:

50

BI: 10

Pur: 20+8

Lab: 0

To.A.S: 30 - end.I (10) = 20

G. Profit: 20

exp: 3+8+2+1

35-6 = \$29

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24: Net profit

week 5

Cash	41	AP	23
AR	16	DI	5
Inv	10(R)	RE	52
PE	2	E	0
FA	$2+9=11$		
	<u>80</u>		

* Softball Tournament (mobile stand)

\$20 dollars: But not fixed asset = equipment! (vehicle)

Cash	21	AP	23
AR	16	NP	0
Inv	10(R)	DI	5
PE	2	RE	52
FA	$2+9=11$	E	0
ENW	<u>20</u>		
	<u>60</u>		

\$30 (readymade): price high (new store)

* Only \$21

* can't spend retained earnings, only cash!

Everything on right side: on paper!

: No cash, plenty sales

↳ still big problem!

Cash runs the business
Not profits

Running Business no profit: Possible
without cash: Not even a day

* \$50 cash

Cash:	50	AP:	32
AR:	16	NP:	0
Inv:	10(R)	DI:	5
PE:	2	RE:	52
FA:	$2+9=11$	Ea:	20
ENW:	<u>20</u>		

owner's expense \$4

Cash: 46

TRA: 16

Inv:

Cash Inv

AP: 32

DI: 5

RE: 52

Ea: 16 - 4 (dep)

Equipment: straight / accelerated

Building: straight line

* govt often changes depreciation formulas (2x): Double declining balance
(straight line)

* $\frac{1}{2}$ (declining balance): Accelerated Cost Recovery System
(ACRS)

* MACRS: modified Acc. Cost Recovery System.

* Govt changes year % depreciation, rate!

10 yrs: \$20 \rightarrow \$2/year

2x: \$4/year

Vehicle: $20 + (4) \text{ dep}$

E: 12

Key word: Base [\$20]

New base: \$16

Saving current dollars > future dollars

govt lets acc. depre
Support business!

Taxes: (25%): owe taxes

* Current assets: Cash, inventory, prepaid expenses (cash within a year)

* Gross fixed assets: Total purchase price of all fixed assets

* Accumulated depreciation: all dep taken of all fixed assets

* Net fixed assets = Net book value of assets.

* Net 2001 cash flows = $89 - 14 = 75$

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* Gross fixed assets: ~~10 + 20~~ = 32

$$\begin{aligned} \rightarrow \text{Total Assets} &: 46 + 16 + 10 + 2 + 12 + 20 \\ &= 101 - 4 \\ &= 101 \end{aligned}$$

* Net Total fixed assets = 32 - 1 - 4 = 27

* Total Liability (including) : \$3 → 32 + 3 = 35

* Total Equity: 5 + 52 + 10 - 3

$$= 69 - 3 = 66$$

Review

1. \$20: mobile stand (10 yrs)
2. \$30: 21 cash, 9 acc (Lemonade)
3. Sales: \$50
4. paid: \$4 (To owner)
5. 2x dep: Equipment \$4
6. 25% net profit (25% of 12 = 3)

$$\text{Total Current Assets} = 46 + 10 + 16 + 2 = 74$$

Wrap up

Cash	46
AR	16
Inv	10
PE	2
FA	12 <input type="checkbox"/>
Equ	20 <input checked="" type="checkbox"/>
	<u>101</u>

AP	32
NP	0
Th	3
OI	5
RE	52
EA	9
TOK	66
	<u>101</u>

Totaly: 66 → %, 25% → \$16 (Tax Payable)

1 month

Cash	46
AR	16
Inv	10
PE	2
FA	12 <input type="checkbox"/>
Equ	20 <input checked="" type="checkbox"/>

Tax	16
AP	32
OI	50 → 16 (gob)
RE	52
EA	14
	<u>101</u>

108

Throw inventory (write off) : Reduce earnings!

Inv 0	EA: -14
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clean inventory

- * mistaken: written off long time ago (when rotten)
- * Get an expert: Buy/sell inventory related business!

- * pay \$14 tax
- * Pay \$32 to suppliers
- * Collect \$16
- * Receive \$2 refund insurance

$$46 - 40 + 16 + 2 \longrightarrow \text{Cash } 18$$

Assets: ordered based on the order of liquidity!

1 month Income statement: (Do!)

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