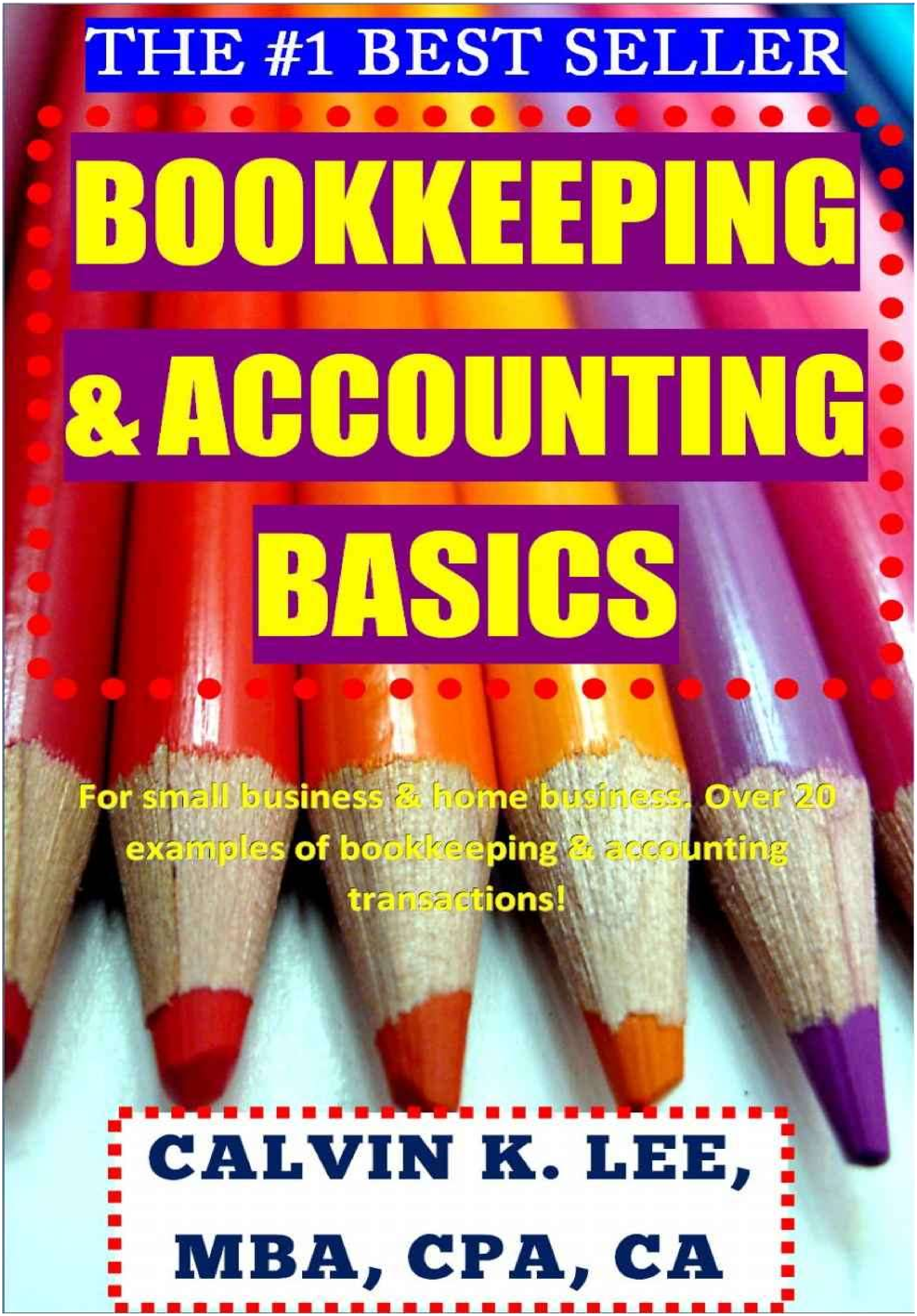

THE #1 BEST SELLER

BOOKKEEPING & ACCOUNTING BASICS

For small business & home business. Over 20 examples of bookkeeping & accounting transactions!

CALVIN K. LEE, MBA, CPA, CA

Bookkeeping & Accounting Basics: Over 20 Examples of Bookkeeping & Accounting Transactions!

Calvin K. Lee, MBA, CPA, CA, CPA (Illinois)

This book is dedicated to all the accounting partners and colleagues I've had the privilege to work with.

Praise for “Bookkeeping & Accounting Basics”

“This is awesome! I love the short chapters with clear examples.”

“I’m 100% certain to say that this book should be accounting 100 pre-requisite course for anyone who wants to take introduction to accounting! Very clear, concise, and concrete. Well done!”
- K.T., CPA, CA

Praise from readers of Calvin’s books:

“Very practical, good reading!”

“I really enjoy your books.”

“Well done, very informative. I like how you used your example.”

“By using his own example, Calvin gives hope for the readers.”

“Great real life experience that you can relate to easily.”

“Very clear, concise, and concrete. Well done.”

“Practical tips and relatable examples. A pleasant read. Congratulations on your recent publications! Keep writing more.”

“I’ve taken notes on my smart phone and will implement them in my life.”

“Thanks for the little pearls of wisdom and optimism.”

Table of Contents

Introduction

After reading this book, you will be able to do basic bookkeeping with confidence.

Accounting is the language of business. Whether the company is a global Fortune 500 company or a local mom and pop shop, both of these companies need a system to keep track of income, expenses, assets purchased like computers or furniture, liabilities obtained like mortgages, and equity components such as number of shares issued or how much the owner has invested in the company. Of course, the bigger the company and the more transactions it has, the more complex the accounting.

Small & medium sized businesses and home businesses do not need sophisticated accounting software. They just need a simple system to keep track of the company's transactions. This book is written for beginners to accounting and bookkeeping.

I am a designated CPA accountant in both Canada and the U.S., and have worked since 2007 as an accountant and auditor in public accounting firms and companies. The majority of my clients were small to medium sized businesses. Some of my clients' bookkeepers struggle with the accounting software and the basic accounting concepts.

I have also taught accounting courses at York University's reputable Schulich School of Business in Toronto while I was obtaining an MBA degree myself there. I taught in the Bachelor of Business Administration (BBA) program and Master of Accounting (MAcc) program.

I enjoyed teaching accounting concepts to first year students, and I understand that many of them struggle to learn the accounting language. Textbooks are sometimes long and difficult to follow. My greatest satisfaction in teaching is to explain a concept that is challenging a student, and watch a proverbial light bulb light up as they begin to understand the concept.

Since you've picked up this book, I believe you want to learn the basic concepts of accounting and bookkeeping for small & medium sized enterprises and home businesses. ***I will use the simplest language to explain basic concepts so that you can perform accounting and bookkeeping duties for your business or company. This book is designed to be as practical as possible, so I'm going to focus on application rather than explaining detailed theory and concepts.***

Think of this book as a quick reference guide rather than a detailed textbook. Therefore, it does not cover all the topics in a first year accounting course. This book covers the most common transactions an entry accountant or bookkeeper will do on a daily basis.

Your first day on the job as a bookkeeper or accountant

Congratulations! You got the job!

Imagine your first day on the job as a bookkeeper or accountant. You are handed a stack of invoices from your company to its customers, a cheque book with cheque stubs of cheques written by the shareholders, and a stack of expense receipts like hydro & electric bills, travel, meals & entertainment, and office supplies. You are expected to enter all the transactions into the company's Quickbooks or Sage accounting software.

What do you do?

I was in this situation many times whenever I did the books for a company. The first thing you need to know are what kinds of accounts there are in a company. After you understand the basic types of accounts, you know where to post your accounting transactions.

Bookkeepers and accountants are expected to be efficient. You may be swamped and stressed with work. Management relies on bookkeepers and accountants to provide them with the financial data needed to make business decisions. Bookkeepers and accountants need to know how to work smart to keep up with the demands of their work.

Sometimes our work as a bookkeeper or accountant becomes mundane and repetitive. It's important to focus on what you want in life and to reflect on whether you are living the life you want. All it takes is to change your way of thinking and then take small steps towards living a better life. As a bookkeeper or accountant, you are given the mandate to record past transactions, which can then be used to project future trends of the business. Your work is significant!

Let's get started.

Types of accounts in accounting

The main types of accounts are:

- Assets
- Liabilities
- Owner’s Equity
- Revenue
- Expenses

Examples of asset are: cash, accounts receivable, prepaid expenses, inventory, capital assets like land, buildings, computers, and cars.

Examples of liabilities are: accounts payable, loans payable, and mortgages payable.

Examples of owner’s equity are: common shares, preferred shares, and retained earnings.

Examples of revenue are the price that you sell a product or service.

Examples of expenses are a telephone bill payment or a rent payment.

Balance sheet and income statement

One of the goals of bookkeeping is to produce financial statements. The statements that most people look at are the balance sheet and income statement. These statements show stakeholders how the company is performing.

Assets and liabilities go on the balance sheet. It is sometimes called the Statement of Financial Position. It is called a balance sheet because this formula must always be true:

Assets = Liabilities + Owner's Equity

If at anytime your balance sheet doesn't balance, for example, you have $500 worth of assets but your liabilities + owner's equity equals $490, you've made a mistake somewhere in your bookkeeping. Fortunately, today's accounting software won't let you make any mistakes that upset the basic accounting formula.

The balance sheet is a **snapshot** in time. For example, the balance sheet may be as of December 31.

The income statement contains transactions for a **period of time.** For example, the income statement can be for the period from January 1 to December 31. This will record the **accumulated** revenues and expenses for that entire period.

Ok, so how do we record transactions? We'll get to that after I explain debits and credits.

Debits and credits must equal

Debits and credits are the most fundamental system of accounting. Accounting is based on debits and credits.

Another basic accounting formula must also be true:

Debits (Dr.) = Credits (Cr.)

Another words, whatever number you post on the debit side must equal to what you post on the credit side.

Example: You purchase a computer for $300 and you pay with cash.

The journal entry will be:

Dr. Capital assets 300
Cr. Cash 300
To record purchase of computer paid with cash

Notice that the debit side (300) equals the credit side (300).

Example: You perform a service and receive $50 payment from your client.

The journal entry will be:

Dr. Cash 50
Cr. Revenue 50
To record revenue received in cash

Notice again that the debit side (50) equals the credit side (50).

Assets

Assets are usually in a debit position. When you gain an asset, like when a customer pays you cash for a product or service, you would debit cash for the increase in cash. On the other hand, if you use an asset, for example you use cash to pay for rent, you decrease the asset cash and so you credit the cash account.

Remember:
Gain an asset = debit
Use an asset = credit

Let's revisit the example in the debits and credits section and make sure you understand this point.

Example: You purchase a computer for $300 and you pay with cash.

The journal entry will be:

Dr. Capital assets	300	
Cr. Cash		300

To record purchase of computer paid with cash

Notice you increased the capital assets account by debiting it, and you decrease the cash asset account by crediting it.

Liabilities

Liabilities are usually in a credit position. When you gain a liability, for example, you take on a mortgage, and then you would credit the liability account. When you decrease a liability, for example, you make a payment on your mortgage, you would debit the liability account.

Remember:
Gain a liability = credit
Decrease a liability = debit

Example. You purchase a building and take on a $100,000 mortgage.

Dr. Building 100,000
    Cr. Mortgage liability 100,000
To record a purchase of building using a mortgage

Notice you are increasing the mortgage liability, so you credit the liability account.

Example. You make a $10,000 payment on your mortgage.

Dr. Mortgage liability 10,000
    Cr. Cash 10,000
To record a mortgage payment using cash

Notice here you are decreasing the mortgage so you debit the liability account. Cash is an asset so when it is decreased, you credit the cash asset account.

Revenue

Revenue is one of the most important accounts on the books of any company. Without revenue, a company will not last very long.

Remember:
Record revenue as a credit

Example. If a customer buys one of your products, you would do this journal entry to record cash and revenue of $25:

Dr. Cash 25
Cr. Revenue 25
To record revenue on sale of product

There is also a journal entry needed to record the selling of inventory. This will be discussed in the inventory section.

Expenses

Expenses include advertising, bank charges, depreciation of capital assets, meals & entertainment, office expenses, professional fees, rent, supplies, telephone, wages, etc.

Remember:
Record expenses as a debit

Example. For example, you pay for a business meal of $30.

Dr. Meals & entertainment	30	
Cr. Cash		30

To record meal expense paid with cash

You record meals & entertainment as a debit because it is an expense, and you credit cash to decrease the asset account.

Taxes

If your business is registered with a sales tax account, it is able to claim back some of the sales taxes it paid on its purchases. The other feature of having a sales tax account is the business has to collect applicable sales tax on its sale of products or services.

Example. You sell a product worth $100, and it has a sales tax of 5%.

Dr. Cash	105	
Cr. Revenue		100
Cr. Sales tax payable		5

To record sale of product

Notice that the $5 sales tax goes into a liability account. It is a liability because you collected the sales tax on behalf of the government, and you need to pay it out on your next sales tax return remittance. The $5 collected doesn't belong to you.

Example. You purchase a desk for $80. It has a sales tax of 5%.

Dr. Capital asset – desk	80	
Dr. Sales tax receivable	4	
Cr. Cash		84

To record purchase of desk

Here, the sales tax of $4 that was paid can be claimed from the government on your next sales tax return.

Let's imagine the above two example transactions are the only transactions your company had during the sales tax period. On your sales tax return, you would net the two amounts to find the amount you owe to the government.

Example.

Sales tax payable	5
Sales tax receivable	(4)
Net sales tax payable	1

You would need to pay $1 to the government, because you owed $5 for collecting sales tax on behalf of the government, and could get back $4 as a credit for the purchase you made.

Example.

After you file your sales tax return and pay the government, you would do this journal entry:

Dr. Sales tax payable	5	
Cr. Sales tax receivable		4
Cr. Cash		1

This will clear out the sales tax payable and sales tax receivable accounts.

Accounts receivable

It is very common in business that a company sells a product or performs a service and gets paid later. Accounting rules require that as soon as the product is sold or the service is performed with no outstanding obligations remaining, revenue should be recognized. But since cash has not been received, the debit goes into accounts receivable.

Example. You perform a service for your client for $200. The client said they would pay you within 30 days.

Dr. Accounts receivable 200
Cr. Revenue 200
To record revenue on performance of service

When the client pays you, you will then reverse accounts receivable and record the cash received.

Dr. Cash 200
Cr. Accounts receivable 200
To record cash received on outstanding accounts receivable

Accounts payable

Accounts payable is similar to accounts receivable. You have an obligation to pay for an expense in the future. For example, say your year-end is December 31. Your electric bill for the month of December is due on January 8 of the next year. You have to accrue the expense for the current year because the expense pertains to the current year. When you actually pay the amount in cash, you would then reverse out the accounts payable. The expense will be recorded in the current year.

Example. The electric bill for December is $50. The payment isn't due until January 8 of the next year.

Dr. Utilities expense 50
Cr. Accounts payable 50
To accrue utilities bill for December

Notice the expense will be recorded in the current year because it is for the month of December.

When you actually pay the electric bill the following year, this journal entry will be recorded.

Dr. Accounts payable 50
Cr. Cash 50
To record payment on accounts payable for electric bill

Purchasing inventory

If you sell products, you have to record inventory transactions. If you only sell services, you can skip this section.

To record a purchase of inventory, you may have to account for sales tax that you can claim and receive back from the government.

Example. You purchase $50 of inventory and you paid $5 sales tax that you can claim.

Dr. Inventory 50
Dr. Sales tax recoverable 5
Cr. Cash or Accounts payable 55
To record purchase of inventory

Notice that the debits (50+5 = 55) equals credits (55).

When you sell inventory, you have to take it out of your inventory. The cost of goods sold account gets debited.

Example. You sell inventory worth $500.

Dr. Cost of goods sold 500
Cr. Inventory 500
To record remove sold inventory from inventory account

Here cost of goods sold is an expense so it is a debit. Inventory is an asset that has decreased so it is a credit.

Inventory costing methods

If you sell inventory, you need to decide how to account for the cost when you sell inventory.

Specific identification method:
This is when each inventory is tracked with its own cost. This method usually is applicable to businesses with few inventory or specific models of inventories such as cars.

First-in, first-out (FIFO) method:
This is when the first inventory comes in, it is sold first in the order purchased. Because inventory purchase prices change, this method is done this way: say you buy inventory on November 1 at $10, then you purchase more inventory on November 15 at $12, when you sell inventory, you will sell all of the $10 inventory before selling the $12 inventory.

Last-in, first-out (LIFO) method:
This method is the reverse of the FIFO method. The last inventory that is purchased is considered sold first. Using the same example, the company would deem the $12 inventory being sold first before the $10 inventory. Because inventory purchase price typically increases over time, LIFO method usually produces a lower gross margin than the FIFO method.

Weighted average cost:
This method uses the average cost for the year.

Lower of cost or market (LCM)

At the end of the year, a company needs to compare its inventory cost on the books with the market value. If the market value is lower than the inventory cost on the books, the inventory needs to be written down to the market value. On the other hand, if the market value is higher than the inventory cost on the books, then no adjustment is required.

Capital assets

Every business needs to buy capital assets, also known as fixed assets or property, plant, and equipment.

Capital assets include:

- Land
- Buildings
- Office equipment (desks, chairs, etc.)
- Computers
- Computer software
- Vehicles
- Leasehold improvements

Generally, capital assets are required for the business to earn income. They are an asset rather than an expense because they enable the business to earn income over multiple years rather than a one-time expense.

Each capital asset should have its own account class. A different account should be used for each type of capital asset, so when it's time to do the corporate tax return, the information is more easily and readily found because each class of capital asset has a prescribed depreciation rate for taxes by the government.

Most capital assets, with the exception of land, depreciate over time meaning its useful life decreases over the years.

Depreciation of capital assets

Depreciation can be calculated at month-end or year-end.

Example. Your business purchases a computer with a cost of $600 that has a useful life of 3 years.

Dr. Computer 600
Cr. Cash 600
To record purchase of computer

If your business uses the **straight-line method** - which means each year the depreciation is the same - each year there will be depreciation of $600/3 years = $200/year.

Dr. Depreciation expense 200
Cr. Accumulated amortization - computer 200
To record depreciation for the year

Notice that the credit is to an account called "accumulated amortization – computer", which is an asset account that goes along with the computer asset account. At the end of the first year, the computer has book value of 400 on the balance sheet, which is 600 minus 200.

If your business uses the declining balance method, a percentage of depreciation is applied every year.

Example. Your business has equipment worth $1,000, and it depreciates at 20% a year.

Year	% depreciation	Book value	Depreciation
1	20%	1,000	200
2	20%	800	160
3	20%	640	128
4	20%	512	102
5	20%	410	82

Note that using the double declining method the depreciation is highest in the 1st year ($200), and decreases over time ($160, $128, etc).

Sale of an asset

When you sell an asset, you will remove the asset from the balance sheet.

Example. Using the above example, you sell the equipment after the end of the second year. You receive cash of $650 from the buyer.

The cost of the equipment is $1,000, and the accumulated amortization is 200 + 160 = $360.

You will record this journal entry:

Dr. Cash	650	
Dr. Accumulated amortization – equipment	360	
Cr. Equipment		1,000
Cr. Gain on sale of equipment		10

To record sale of equipment

The net book value of the equipment is $640, but you received $650 from the buyer. You received $10 more than the equipment's book value, so you record a gain on the income statement. If you received less than the book value, you would record a loss on the income statement.

Shareholder loans – shareholder pays out of pocket

Sometimes the owner or shareholder of a small business pays for an expense out of pocket on behalf of the company.

Example. The owner pays for a business meal out of his own pocket.

Dr. Meals expense 20
Cr. Shareholder loan 20
To record a meal expense paid by the owner out of pocket

The owner did not use the company funds to pay for the meal, so the credit is not to cash. The credit is to shareholder loan which is a liability account because the company now owes the owner $20.

Example. Later, when the company reimburses the owner for the meal, the following happens.

Dr. Shareholder loan 20
Cr. Cash 20
To record the company reimbursing the owner for expense paid out of pocket

Shareholder loans – company pays on behalf of shareholder

Another common situation is when the company pays a personal expense for a shareholder.

Example. The company pays for a personal vacation for a shareholder.

Dr. Shareholder loan 1,000
Cr. Cash 1,000
To record company paying for a personal vacation for shareholder

Here, the shareholder loan is in a debit position like an asset because it will receive in the future the money owed to the company by the shareholder. The shareholder will have to pay back the company later.

Example. The owner pays back the company for the personal vacation.

Dr. Cash 1,000
Cr. Shareholder loan 1,000
To record shareholder reimbursing company for personal vacation

Year-end closing

Most accountants and bookkeepers are busy at month-end or year-end because they need to make adjusting journal entries such as depreciation, and close the books. When you close the books, the amounts accumulated in the income statement are closed out into the retained earnings of the balance sheet. The income statement is reset to zero to start the next year.

Example. Your company's year-end is December 31 and you need to close the books. The company had annual revenue of $100,000 and expenses of $80,000.

To close the books, the following journal entry is done.

Dr. Revenue	100,000	
Cr. Expenses		80,000
Cr. Retained earnings		20,000

To close out revenues and expenses into retained earnings at year-end

Retained earnings are usually a credit amount if the company has been profitable. Retained earnings represent the profits or loss that has accumulated in the business to date.

Final thoughts

This was just a snapshot into the exciting world of bookkeeping. Bookkeeping is one of the fastest growing industries out there and Forbes, Entrepreneur and INC named it as one of the top small businesses to start.

As an instructor, nothing lights me up more than seeing students that I have taught in the past succeed, who started with absolutely no experience find meaningful work as an accountant and bookkeeper after taking the course. I still keep in touch with some of them. I am truly happy to hear stories of their success and that I was able to accompany them on their journey to success.

Bookkeeping is definitely in my opinion one of the most valuable skills out there and you can utilize it to find meaningful employment as a bookkeeper or accountant or to start your own profitable online business, or BOTH! You can also change career paths whenever you want from being a bookkeeping employee to starting your own business and enjoy the excitement and freedom that comes with it. It is also high paying and profitable. The sky is the limit.

One of my passions is teaching, and I couldn't have asked for more fun teaching at Schulich School of Business, Canada's top MBA program. However, I knew I wanted to have more impact and more reach. I knew with the power of the Internet, I could reach many more students and have much more impact.

When I looked at current offerings on the Internet, I was frustrated at how expensive online courses were. Some were charging for $2,000 or MORE, creating a BARRIER to entry for students such as yourself that wanted to learn bookkeeping.

I was also disappointed at how these courses focused only on the online marketing aspect and not enough on the technical foundations of bookkeeping. You need both to be successful in being a bookkeeper or building a profitable bookkeeping business.

Frustrated with the current status, I decided to launch online courses with all the material I taught at the school PLUS much more. These courses are designed to take you from zero bookkeeping experience to take control of your finances in your business or as a bookkeeper in a company or have your own bookkeeping business.

I personally get to know every student in my courses whether online or offline and I am here to support you.

I hope you will continue learning with me.

About the Author

Calvin K. Lee, MBA, CPA, CA, CPA (Illinois) is an accountant, author, consultant, and teacher. His biggest passion is inspiring and helping others achieve their goals. He has launched 7 online courses on bookkeeping, accounting, investing, and time management, and more than 65,000+ students have enrolled in his courses from 178 countries.

He is a Certified Public Accountant (CPA) in the U.S.A. and a Chartered Professional Accountant, Chartered Accountant (CPA, CA) in Canada. He also holds a Double MBA degree from two of the world's top business schools.

In addition to his successful career in accounting, he has also taught Master of Accounting classes at York University, taught accounting modules at the CPA Professional Education Program, and enjoys being a mentor to younger accountants. He has served as President of the MBA Ambassadors during his MBA studies and as Chair of the Young Professionals Forum at the CPA Association.

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