

## CORE PRINCIPLE

'ASSETS'  
PROBABLE FUTURE ECONOMIC BENEFITS

STUFF THAT A BUSINESS OWNS = STUFF THAT A BUSINESS OWES

'LIABILITIES'

PROBABLE FUTURE SACRIFICES OF ECONOMIC BENEFITS

'EQUITY'

THE RESIDUAL VALUE OF AN ENTITY'S ASSETS AFTER DEDUCTING ALL ITS LIABILITIES

THE NET FUNDS INVESTED INTO A BUSINESS

THIS BALANCES

TO WHO? THIRD PARTIES OWNERS

# ACCOUNTING EQUATION

## ASSETS = LIABILITIES + EQUITY

FOR THIRD PARTIES FOR OWNERS

'INCOME STATEMENT'

A SUMMARY OF A BUSINESS'S REVENUES AND EXPENSES OVER A PERIOD OF TIME

**INCOME STATEMENT**  
FOR THE PERIOD ENDED MMM-DD-YYYY

REVENUE  
COST OF SALES  
GROSS PROFIT/(LOSS)  
OVERHEAD EXPENSES  
OPERATING PROFIT/(LOSS)  
INTEREST EXPENSE  
TAX EXPENSE  
NET PROFIT/(LOSS)

\$

X  
(X)  
X/(X)  
(X)  
X/(X)  
(X)  
(X)  
X/(X)

CAPITAL CONTRIBUTIONS + RETAINED EARNINGS

ACCUMULATED PROFITS - WITHDRAWALS

REVENUE - EXPENSES

KEY TO UNDERSTANDING THE LINK BETWEEN THE BALANCE SHEET AND INCOME STATEMENT  
EXPANDED ACCOUNTING EQUATION

'BALANCE SHEET'

A SNAPSHOT OF A BUSINESS'S ASSETS, LIABILITIES AND EQUITY AT A SINGLE POINT IN TIME

**BALANCE SHEET**  
AS AT MMM-DD-YYYY

### ASSETS

CURRENT ASSETS  
CASH  
ACCOUNTS RECEIVABLE  
INVENTORY  
PREPAID EXPENSES  
SHORT-TERM INVESTMENTS  
TOTAL CURRENT ASSETS  
  
NON-CURRENT ASSETS  
LONG-TERM INVESTMENTS  
PROPERTY, PLANT & EQUIPMENT  
TOTAL NON-CURRENT ASSETS  
  
TOTAL ASSETS

\$

X  
X  
X  
X  
X  
X  
X  
  
X  
X  
X  
X

### LIABILITIES AND EQUITY

LIABILITIES  
CURRENT LIABILITIES  
ACCOUNTS PAYABLE  
SALARIES PAYABLE  
TAXES PAYABLE  
ACCRUED EXPENSES  
TOTAL CURRENT LIABILITIES  
  
NON-CURRENT LIABILITIES  
LONG-TERM LOANS  
TOTAL NON-CURRENT LIABILITIES  
  
TOTAL LIABILITIES  
  
EQUITY  
OWNER'S EQUITY  
RETAINED EARNINGS  
  
TOTAL EQUITY  
  
TOTAL LIABILITIES AND EQUITY

\$

X  
X  
X  
X  
X  
X  
  
X  
X  
X  
X

TOTAL ASSETS ARE ALWAYS EQUAL TO TOTAL LIABILITIES AND EQUITY



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## DOUBLE-ENTRY BOOKKEEPING

EVERY ACCOUNTING ENTRY HAS AN  
OPPOSITE CORRESPONDING ENTRY  
IN A DIFFERENT ACCOUNT

### MISCONCEPTIONS

- #1 DEBITS AND CREDITS ARE  
NEITHER GOOD NOR BAD
- #2 DEBITS AND CREDITS ARE NOT THE  
SAME AS ADDING OR SUBTRACTING

### DEBITS AND CREDITS

ARE WORDS USED TO REFLECT THE  
DUALITY OR DOUBLE-SIDED NATURE  
OF ALL FINANCIAL TRANSACTIONS

### FINANCIAL TRANSACTIONS

INVOLVE A FLOW OF ECONOMIC BENEFIT  
FROM A SOURCE TO A DESTINATION

“ECONOMIC BENEFIT”  
IS THE POTENTIAL  
FOR AN ASSET  
TO CONTRIBUTE EITHER  
DIRECTLY OR INDIRECTLY  
TO THE FLOW OF  
AN ENTITY'S CASH

DESTINATIONS

SOURCES

**DEBITS** ON THE LEFT

ON THE RIGHT **CREDITS**

**DIVIDENDS**  
**EXPENSES**  
**ASSETS**

**EQUITY**  
**LIABILITIES**  
**REVENUE**

**DEALER**

AN ACRONYM  
TO REMEMBER

### AND HERE IS THE PROOF...

THE ACCOUNTING EQUATION STATES THAT

**ASSETS = LIABILITIES + EQUITY**

BUT EQUITY IS MADE UP OF

**EQUITY = OWNER'S EQUITY - DIVIDENDS + RETAINED EARNINGS**

AND SINCE RETAINED EARNINGS ARE 'PROFITS HELD FOR FUTURE USE'

**RETAINED EARNINGS = REVENUE - EXPENSES**

SO EQUITY EXPANDED IS

**EQUITY = OWNER'S EQUITY - DIVIDENDS + REVENUE - EXPENSES**

AND IF WE DROP THIS IN TO THE ACCOUNTING EQUATION WE GET

**ASSETS = LIABILITIES + OWNER'S EQUITY - DIVIDENDS + REVENUE - EXPENSES**

WHICH CAN BE REARRANGED AS

**DIVIDENDS + EXPENSES + ASSETS = LIABILITIES + OWNER'S EQUITY + REVENUE**



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# FINANCIAL ACCOUNTING

THE PROCESS OF IDENTIFYING, RECORDING, SUMMARIZING & ANALYZING AN ENTITY'S FINANCIAL TRANSACTIONS AND REPORTING THEM IN FINANCIAL STATEMENTS TO ITS EXISTING & POTENTIAL INVESTORS, LENDERS AND CREDITORS

CORE PRINCIPLE

STUFF THAT A BUSINESS OWNS = STUFF THAT A BUSINESS OWES

THE ACCOUNTING EQUATION

ASSETS = LIABILITIES + EQUITY  
FOR 3RD PARTIES FOR OWNERS

DOUBLE-ENTRY BOOKKEEPING

EVERY ACCOUNTING-ENTRY HAS AT LEAST ONE OPPOSITE, CORRESPONDING ENTRY IN A DIFFERENT ACCOUNT

JOURNAL ENTRY

DATE	ACCOUNT	DEBIT	CREDIT
MMM-DD-YY	ACCOUNT NAME ACCOUNT NAME DESCRIPTION	X	X

DEBITS AND CREDITS

ARE WORDS USED TO REFLECT THE DUALITY OR DOUBLE-SIDED NATURE OF ALL FINANCIAL TRANSACTIONS

STEP 2  
PREPARE JOURNAL ENTRIES

RECORDS OF FINANCIAL TRANSACTIONS

## ACCOUNTING CYCLE

STEP 8  
POST CLOSING ENTRIES

STEP 1  
IDENTIFY TRANSACTIONS

JOURNAL ENTRIES THAT TRANSFER BALANCES FROM TEMPORARY ACCOUNTS SUCH AS REVENUES, EXPENSES & DIVIDENDS TO PERMANENT ACCOUNTS IN THE BALANCE SHEET

ACCOUNTING REPORTS THAT SUMMARIZE A BUSINESS'S ACTIVITIES OVER A PERIOD OF TIME

STEP 7  
CREATE FINANCIAL STATEMENTS

BALANCE SHEET

A SNAPSHOT OF A BUSINESS'S ASSETS, LIABILITIES & EQUITY AT A SINGLE POINT IN TIME

A SUMMARY OF A BUSINESS'S CASH INFLOWS & OUTFLOWS OVER A PERIOD OF TIME

CASH FLOW STATEMENT

INCOME STATEMENT

A SUMMARY OF A BUSINESS'S REVENUES & EXPENSES OVER A PERIOD OF TIME

CLOSING ENTRY

DATE	ACCOUNT	DEBIT	CREDIT
MMM-DD-YY	REVENUE	X	
	EXPENSES		X
	DIVIDENDS		X
	RETAINED EARNINGS	X OR	X
	DESCRIPTION		

STEP 3  
POST TO GENERAL LEDGER

6 TYPES OF ACCOUNT

DIVIDENDS -  
EXPENSES -  
ASSETS -  
LIABILITIES -  
EQUITY -  
REVENUE -

ACCOUNT

A PLACE WHERE WE RECORD, SORT & STORE ALL FINANCIAL TRANSACTIONS THAT AFFECT A RELATED GROUP OF ITEMS

STEP 4  
UNADJUSTED TRIAL BALANCE

TRIAL BALANCE  
AS AT MMM-DD-YY

STEP 5  
POST ADJUSTING ENTRIES

JOURNAL ENTRIES POSTED AT THE END OF AN ACCOUNTING PERIOD TO BRING A BUSINESS'S BOOKS IN LINE WITH THE ACCRUAL METHOD OF ACCOUNTING

AN ACCOUNTING REPORT SHOWING THE CLOSING BALANCES OF ALL GENERAL LEDGER ACCOUNTS

STEP 6  
ADJUSTED TRIAL BALANCE

EXAMPLES INCLUDE...

- DEPRECIATION
- AMORTIZATION
- PREPAID EXPENSES
- DEFERRED REVENUE
- ACCRUED EXPENSES
- ACCRUED REVENUE

ADJUSTING ENTRY

DATE	ACCOUNT	DEBIT	CREDIT
MMM-DD-YY	ACCOUNT NAME ACCOUNT NAME DESCRIPTION	X	X

ACCRUAL METHOD OF ACCOUNTING

REVENUE IS RECOGNIZED AS IT'S EARNED  
EXPENSES ARE RECORDED AS THEY ARE INCURRED

ALLOWED

ACCOUNTING RULEBOOKS

INTERNATIONAL FINANCIAL REPORTING STANDARDS  
GENERALLY ACCEPTED ACCOUNTING PRINCIPLES

NOT ALLOWED

CASH METHOD OF ACCOUNTING

REVENUE IS RECOGNIZED WHEN CASH IS RECEIVED  
EXPENSES ARE RECORDED AS WHEN CASH IS PAID OUT

DR	ACCOUNT NAME	CR
DEBITS ON THE LEFT		CREDITS ON THE RIGHT

T-ACCOUNT

A VISUAL REPRESENTATION OF AN ACCOUNT

ACCOUNT	DEBIT	CREDIT
CASH	X	
ACCOUNTS RECEIVABLE	X	
INVENTORY	X	
PROPERTY, PLANT & EQUIPMENT	X	
ACCOUNTS PAYABLE		X
SALARIES PAYABLE		X
TAXES PAYABLE		X
OWNER'S EQUITY		X
DIVIDENDS	X	
REVENUE		X
COST OF GOODS SOLD	X	
OVERHEAD EXPENSE	X	
INTEREST EXPENSE	X	
TAX EXPENSE	X	
TOTAL	X	X



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**ACCOUNT**  
THIS IS THE PLACE WHERE WE  
RECORD, SORT AND STORE  
ALL FINANCIAL TRANSACTIONS THAT  
AFFECT A GROUP OF RELATED ITEMS

ACCOUNTS ARE KEPT  
IN THE 'GENERAL LEDGER'

THIS IS THE PLACE WHERE A  
BUSINESS STORES A COMPLETE  
RECORD OF ALL ITS FINANCIAL  
TRANSACTIONS AND ACCOUNTS

## T-ACCOUNT

THIS IS A VISUAL REPRESENTATION OF AN ACCOUNT

A T-ACCOUNT  
LOOKS LIKE THIS

YOU CAN NOTE DOWN  
THESE PROMPTS TO  
HELP YOU REMEMBER

SHORT FOR 'DEBIT'

**DR**

**ACCOUNT NAME**

SHORT FOR 'CREDIT'

**CR**

**DEBITS**  
GO ON THE  
**LEFT**

**CREDITS**  
GO ON THE  
**RIGHT**

'NORMAL DEBIT ACCOUNTS'

INCREASE WHEN DEBITED  
DECREASE WHEN CREDITED

DIVIDENDS  
EXPENSES  
ASSETS

**DEALER**

'NORMAL CREDIT ACCOUNTS'

LIABILITIES  
OWNER'S EQUITY  
REVENUE

INCREASE WHEN CREDITED  
DECREASE WHEN DEBITED

TOTAL AT THE BEGINNING

### CASH ACCOUNT

OPENING BALANCE	100
BILL PAYMENT	(40)
NEW SUPPLIES	(25)
<b>CLOSING BALANCE</b>	<b>35</b>

TOTAL AT THE END

'BALANCE'  
TOTAL AT A POINT IN TIME

### EXAMPLE

#### CASH ACCOUNT

OPENING BALANCE	100		
		BILL PAYMENT	40
		NEW SUPPLIES	25
<b>CLOSING BALANCE</b>	<b>35</b>		

"SAME INFORMATION, DIFFERENT PRESENTATION"

THE MAIN BENEFIT IS THAT  
WE CAN EASILY DISTINGUISH  
BETWEEN THE DEBITS AND CREDITS

'DOUBLE-ENTRY BOOKKEEPING'

EVERY ACCOUNTING ENTRY HAS AN  
OPPOSITE, CORRESPONDING ENTRY  
IN A DIFFERENT ACCOUNT

SO...

EVERY FINANCIAL TRANSACTION  
MUST BE RECORDED IN  
AT LEAST TWO T-ACCOUNTS



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## BOOKKEEPING

THE SYSTEMATIC PROCESS OF  
RECORDING, SORTING AND STORING  
A BUSINESS'S FINANCIAL TRANSACTIONS

*'POSTING DATE'*

THE DATE THE JOURNAL IS POSTED  
IN THE GENERAL LEDGER

AFFECTS THE ACCOUNTING PERIOD  
THE TRANSACTION APPEARS IN

*'DEBITS AND CREDITS'*

TERMS USED TO REFLECT THE  
DOUBLE-SIDED NATURE OF ALL  
FINANCIAL TRANSACTIONS

THESE ARE SEPARATED  
INTO TWO COLUMNS

# JOURNAL ENTRY (JE)

A RECORD OF A FINANCIAL TRANSACTION

*'JOURNAL NUMBER'*

A UNIQUE REFERENCE NUMBER  
USED TO IDENTIFY THE JOURNAL

*'ACCOUNT DESCRIPTIONS'*

NAMES OF THE ACCOUNTS  
IMPACTED BY THE JOURNAL

**JOURNAL NUMBER: 0001**

**DATE**

**ACCOUNT**

**DEBIT**

**CREDIT**

SEP 1ST

CASH

100

CREDIT ENTRIES  
ARE INDENTED

OWNER'S EQUITY

100

INITIAL INVESTMENT

TOTAL DEBITS = TOTAL CREDITS

*'JOURNAL DESCRIPTION'*

A BRIEF DESCRIPTION EXPLAINING  
THE PURPOSE OF THE JOURNAL

## ACCOUNT

THE PLACE WHERE WE  
RECORD, SORT AND STORE  
ALL FINANCIAL TRANSACTIONS THAT  
AFFECT A RELATED GROUP OF ITEMS

*'DOUBLE-ENTRY BOOKKEEPING'*

EVERY ACCOUNTING ENTRY HAS AN  
OPPOSITE, CORRESPONDING ENTRY  
IN A DIFFERENT ACCOUNT

SO...

A JOURNAL MUST AFFECT  
AT LEAST TWO ACCOUNTS

DR	CASH	CR	DR	OWNER'S EQUITY	CR
INITIAL INVESTMENT	100		INITIAL INVESTMENT		100

*'MANUAL JOURNALS'*

- ADJUSTING ENTRIES
- UNIQUE TRANSACTIONS

*'AUTOMATIC JOURNALS'*

- EXIST IN ACCOUNTING SOFTWARE
- POST AUTOMATICALLY
- SAVE TIME

## GENERAL LEDGER

THE DATABASE THAT STORES  
A COMPLETE RECORD OF ALL  
ACCOUNTS AND JOURNAL ENTRIES

*'T-ACCOUNTS'*

ARE VISUAL REPRESENTATIONS  
OF ACCOUNTS



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**ACCOUNT**  
A PLACE WHERE WE RECORD, SORT & STORE ALL FINANCIAL TRANSACTIONS THAT AFFECT A RELATED GROUP OF ITEMS

**IDENTIFY TRANSACTIONS**  
THESE ARE EVENTS THAT HAVE AN IMPACT ON A BUSINESS' FINANCIAL STATEMENTS

**JOURNAL ENTRY**

JOURNAL NUMBER: #####

DATE	ACCOUNT	DEBIT	CREDIT
MMM-DD-YY	ACCOUNT NAME	X	
	ACCOUNT NAME		X
	DESCRIPTION		

**CONTROL ACCOUNT**

AN ACCOUNT IN THE GENERAL LEDGER THAT SHOWS A SUMMARY TOTAL OF THE BALANCES HELD IN A SEPARATE SET OF SUB-ACCOUNTS

MORE DETAIL CAN BE FOUND BY LOOKING AT THE CORRESPONDING SUBLEDGER WHICH CONTAINS THESE SUB-ACCOUNTS

**PREPARE JOURNAL ENTRIES**

A JOURNAL ENTRY IS A RECORD OF A FINANCIAL TRANSACTION

**MANUAL JOURNAL ENTRIES**

THE TRANSACTION IS SUMMARIZED IN A JOURNAL ENTRY AND POSTED DIRECTLY INTO THE GENERAL LEDGER

**AUTOMATIC JOURNAL ENTRIES**

THE TRANSACTION IS ENTERED INTO THE RELEVANT SUBLEDGER

A JOURNAL ENTRY IS AUTOMATICALLY GENERATED BY YOUR ACCOUNTING SOFTWARE AND POSTED INTO THE GENERAL LEDGER

# GENERAL LEDGER

A MASTER DATABASE THAT STORES A COMPLETE RECORD OF ALL ACCOUNTS AND JOURNAL ENTRIES

CASH	ACCOUNTS RECEIVABLE	INVENTORY	PREPAID EXPENSES	PROPERTY, PLANT & EQUIPMENT
X	X	X	X	X
ACCOUNTS PAYABLE	SALARIES PAYABLE	ACCRUED EXPENSES	LONG TERM LOANS	OWNER'S EQUITY
X	X	X	X	X
REVENUE	COST OF GOODS SOLD	OVERHEAD EXPENSES	INTEREST EXPENSE	TAX EXPENSE
X	X	X	X	X

**LEDGER**

A DATABASE THAT YOU REGULARLY RECORD TRANSACTIONS IN  
THE GENERAL LEDGER AND ITS SUBLEDGERS ARE SEPARATE DATABASES THAT INTERACT WITH EACH OTHER  
THEY MUST BE RECONCILED ON A REGULAR BASIS

**SUBLEDGERS**

MINI-DATABASES THAT SUPPORT CONTROL ACCOUNTS IN THE GENERAL LEDGER BY PROVIDING EXTRA DETAIL

WHO OWES THE BUSINESS MONEY?

**ACCOUNTS PAYABLE SUBLEDGER**

SUPPLIER A	SUPPLIER B	SUPPLIER C
X	X	X

**ACCOUNTS RECEIVABLE SUBLEDGER**

CUSTOMER A	CUSTOMER B
X	X



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# FINANCIAL ACCOUNTING

IS THE PROCESS OF RECORDING, SUMMARISING AND ANALYSING AN ENTITY'S FINANCIAL TRANSACTIONS AND REPORTING THEM IN FINANCIAL STATEMENTS TO ITS EXISTING AND POTENTIAL INVESTORS, LENDERS AND CREDITORS.

FINANCIAL STATEMENTS ARE PRODUCED IN LINE WITH...

GENERALLY ACCEPTED ACCOUNTING PRINCIPLES

INTERNATIONAL FINANCIAL REPORTING STANDARDS

WHICH REQUIRE US TO USE THE...

## ACCRUAL BASIS OF ACCOUNTING

REVENUE IS RECOGNISED AS IT'S EARNED AND EXPENSES ARE RECORDED AS THEY ARE INCURRED

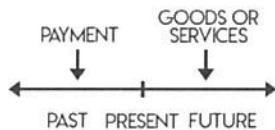
GOODS OR SERVICES  
INVOICE  
PAYMENT

ACCOUNTING PERIOD

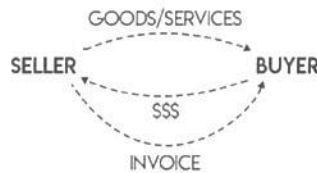
NO ADJUSTMENT NECESSARY!

# ADJUSTING ENTRIES

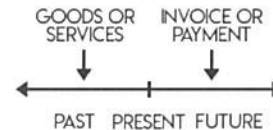
## PREPAYMENTS



'A NORMAL BUSINESS TRANSACTION'



## ACCRUALS



AKA. PREPAID OR UNEARNED REVENUE

AKA. UNBILLED REVENUE

## PREPAID EXPENSE

A FUTURE EXPENSE WHICH HAS BEEN PAID FOR IN ADVANCE

## DEFERRED REVENUE

THE PAYMENTS THAT A BUSINESS RECEIVES IN ADVANCE FOR GOODS OR SERVICES THAT HAVEN'T YET BEEN DELIVERED OR PROVIDED

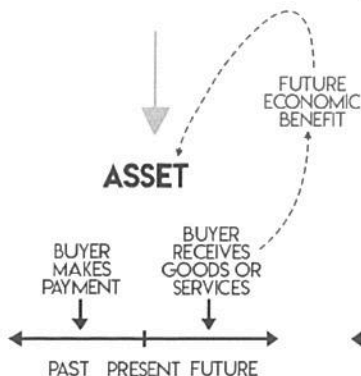
## ACCRUED EXPENSE

A PAST EXPENSE WHICH HASN'T BEEN RECORDED OR PAID FOR YET

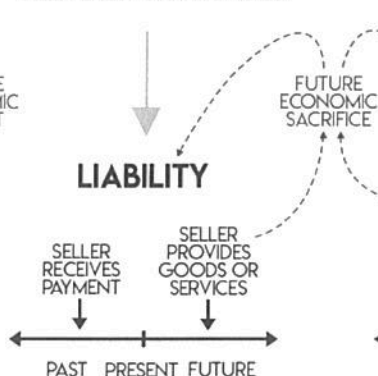
## ACCRUED REVENUE

REVENUE THAT HAS BEEN EARNED BUT NOT INVOICED YET

## ASSET



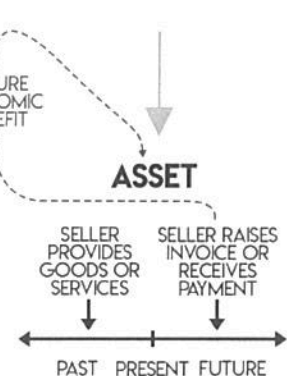
## LIABILITY



## LIABILITY



## ASSET



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PAST  
IT WAS USED TO CHECK THAT...  
TOTAL DEBITS = TOTAL CREDITS

## TRIAL BALANCE (TB)

AN ACCOUNTING REPORT SHOWING  
THE CLOSING BALANCES OF ALL  
GENERAL LEDGER ACCOUNTS

PRESENT  
IT'S AN INTERNAL DOCUMENT  
USED BY ACCOUNTANTS  
TO CHECK FOR ERRORS AND ASSIST IN  
PRODUCING FINANCIAL STATEMENTS

A COMPLETE LIST OF ALL  
GENERAL LEDGER ACCOUNTS

ALTHOUGH...

SOMETIMES ACCOUNTS WITH  
ZERO BALANCES ARE LEFT OUT

# TRIAL BALANCE

FOR THE PERIOD ENDED MMM - DD - YYYY

SEPARATE COLUMNS FOR  
NET TOTALS OF DEBITS AND CREDITS

COLUMN TOTALS MUST MATCH  
EACH OTHER EXACTLY

	ACCOUNT	DEBIT	CREDIT
ASSETS	CASH	X	
	ACCOUNTS RECEIVABLE	X	
	INVENTORY	X	
	PROPERTY, PLANT & EQUIPMENT	X	
LIABILITIES	ACCOUNTS PAYABLE		X
	SALARIES PAYABLE		X
	TAXES PAYABLE		X
EQUITY	OWNER'S EQUITY		X
DIVIDENDS	DIVIDENDS	X	
REVENUE	REVENUE		X
EXPENSES	COST OF GOODS SOLD	X	
	OVERHEAD EXPENSE	X	
	INTEREST EXPENSE	X	
	TAX EXPENSE	X	
	<b>TOTAL</b>	<b>X</b>	<b>X</b>

ERRORS IN A BALANCED TB  
CAN BE CAUSED BY...

- SWITCHING DEBITS AND CREDITS
- POSTING THE SAME JOURNAL TWICE
- NOT POSTING IT AT ALL
- POSTING IT TO THE WRONG ACCOUNTS

HOW TO BUILD A  
TRIAL BALANCE

SEPARATE COLUMNS FOR  
EACH JOURNAL ENTRY

## WORKING TRIAL BALANCE

DEBITS ARE POSITIVE  
CREDITS ARE NEGATIVE

DEBITS ON THE LEFT  
CREDITS ON THE RIGHT

ACCOUNT	1	2	3	4	5	6	7	TOTAL	DEBIT	CREDIT
CASH	X		(X)				(X)	X	X	
ACCOUNTS RECEIVABLE					X			X	X	
INVENTORY				X				X	X	
PROPERTY, PLANT & EQUIPMENT			X					X	X	
ACCOUNTS PAYABLE				(X)	(X)	(X)		(X)		X
SALARIES PAYABLE		(X)						(X)		X
TAXES PAYABLE						(X)		(X)		X
OWNER'S EQUITY	(X)							(X)		X
DIVIDENDS							X	X	X	
REVENUE					(X)			(X)		X
COST OF GOODS SOLD					X			X	X	
OVERHEAD EXPENSE		X						X	X	
INTEREST EXPENSE						X		X	X	
TAX EXPENSE						X		X	X	
<b>TOTAL</b>	-	-	-	-	-	-	-	-	<b>X</b>	<b>X</b>



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'READERS' OF FINANCIAL STATEMENTS ARE EXISTING AND POTENTIAL INVESTORS, LENDERS AND CREDITORS

**DOUBLE-ENTRY ACCOUNTING**  
EVERY ACCOUNTING ENTRY HAS AN OPPOSITE, CORRESPONDING ENTRY IN A DIFFERENT ACCOUNT

PUT SIMPLY...

THE B/S HELPS 'READERS' DETERMINE A BUSINESS'S FINANCIAL HEALTH

**ACCOUNTING EQUATION**  
**ASSETS = LIABILITIES + EQUITY**

STUFF A BUSINESS OWNS = STUFF A BUSINESS OWES

OWNERS

THIRD PARTIES

AKA. STATEMENT OF FINANCIAL POSITION (SOPF)

**BALANCE SHEET (B/S)**  
FINANCIAL STATEMENT PROVIDING A 'SNAPSHOT' OF A BUSINESS'S ASSETS, LIABILITIES AND EQUITY AT A SINGLE POINT IN TIME

# BALANCE SHEET

AS AT MMM-DD-YYYY

ASSETS		\$	LIABILITIES AND EQUITY		\$
SHORT-TERM ASSETS THAT CAN BE CONVERTED INTO CASH WITHIN ONE YEAR	CURRENT ASSETS		LIABILITIES		
	CASH	X	CURRENT LIABILITIES		
	ACCOUNTS RECEIVABLE	X	ACCOUNTS PAYABLE	X	
	INVENTORY	X	SALARIES PAYABLE	X	
	PREPAID EXPENSES	X	TAXES PAYABLE	X	
	SHORT-TERM INVESTMENTS	X	ACCRUED EXPENSES	X	
	TOTAL CURRENT ASSETS	X	TOTAL CURRENT LIABILITIES	X	
LONG-TERM ASSETS THAT CAN'T EASILY BE CONVERTED INTO CASH WITHIN ONE YEAR	NON-CURRENT ASSETS		NON-CURRENT LIABILITIES		
	LONG-TERM INVESTMENTS	X	LONG-TERM LOANS	X	
	PROPERTY, PLANT & EQUIPMENT	X	TOTAL NON-CURRENT LIABILITIES	X	
	TOTAL NON-CURRENT ASSETS	X			
TOTAL ASSETS		X	TOTAL LIABILITIES		X
			EQUITY		
			OWNER'S EQUITY	X	
			RETAINED EARNINGS	X	
			TOTAL EQUITY	X	
			TOTAL LIABILITIES AND EQUITY	X	

SHORT-TERM OBLIGATIONS THAT NEED TO BE SETTLED WITHIN ONE YEAR

LONG-TERM OBLIGATIONS THAT AREN'T EXPECTED TO BE SETTLED WITHIN ONE YEAR

'ASSETS'

PROBABLE FUTURE ECONOMIC BENEFITS OBTAINED OR CONTROLLED BY A PARTICULAR ENTITY AS THE RESULT OF PAST TRANSACTIONS OR EVENTS

'LIABILITIES'

PROBABLE FUTURE SACRIFICES OF ECONOMIC BENEFITS ARISING FROM PRESENT OBLIGATIONS OF A PARTICULAR ENTITY TO TRANSFER ASSETS OR PROVIDE SERVICES TO OTHER ENTITIES IN THE FUTURE AS A RESULT OF PAST TRANSACTIONS OR EVENTS

'EQUITY'

THE RESIDUAL VALUE OF AN ENTITY'S ASSETS AFTER DEDUCTING ALL ITS LIABILITIES

IT REPRESENTS THE NET FUNDS INVESTED INTO A BUSINESS BY ITS OWNERS

**INCOME STATEMENT (I/S)**  
FOR THE PERIOD ENDED MMM-DD-YYYY

REVENUE	X
COST OF GOODS SOLD	(X)
GROSS PROFIT/(LOSS)	X/(X)
OVERHEAD EXPENSES	(X)
OPERATING PROFIT/(LOSS)	X/(X)
INTEREST EXPENSE	(X)
TAX EXPENSE	(X)
NET PROFIT/(LOSS)	X/(X)

'RETAINED EARNINGS'

ARE PROFITS HELD FOR FUTURE USE

THEY ARE 'THE BRIDGE' LINKING THE I/S THROUGH TO THE B/S



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'READERS' OF FINANCIAL STATEMENTS ARE EXISTING AND POTENTIAL INVESTORS, LENDERS AND CREDITORS

THE I/S HELPS 'READERS' DETERMINE A BUSINESS'S FINANCIAL PERFORMANCE

# INCOME STATEMENT (I/S)

FINANCIAL STATEMENT SUMMARIZING A BUSINESS'S REVENUES AND EXPENSES OVER A PERIOD OF TIME

PERIOD OF TIME

THIS COULD BE A WEEK, MONTH, QUARTER OR A FULL YEAR

## BASIC INCOME STATEMENT

FOR THE PERIOD ENDED MMM-DD-YY

REVENUE	\$
EXPENSES	X
PROFIT/(LOSS)	(X)
	<u>X/(X)</u>

PROFIT WHEN REVENUE > EXPENSES  
LOSS WHEN EXPENSES > REVENUE

EXPANDED

DIRECT COSTS

EXPENSES WHICH CAN BE DIRECTLY TRACED THROUGH TO GOODS SOLD OR SERVICES PROVIDED

# DETAILED INCOME STATEMENT

FOR THE PERIOD ENDED MMM-DD-YYYY

TERMS CHANGE WHEN...

SELLING GOODS	\$
PRODUCTS SOLD	X
COST OF GOODS SOLD	(X)
GROSS PROFIT	<u>X/(X)</u>
SELLING SERVICES	\$
SERVICES RENDERED	X
COST OF SERVICES	(X)
GROSS PROFIT	<u>X/(X)</u>

NET PROFITS HELD FOR FUTURE USE ARE STORED IN **RETAINED EARNINGS** IN THE BALANCE SHEET

FINANCIAL RATIO ANALYSIS ACROSS COMPARATIVE PERIODS CAN PROVIDE VALUABLE INSIGHTS ABOUT A BUSINESS'S PROFITABILITY, EFFICIENCY, LIQUIDITY & LEVERAGE

## COMPARATIVE INCOME STATEMENT

FOR THE PERIOD ENDED...

	MMM-DD-YY	MMM-DD-YY	MOVEMENT	COMPARATIVE PERIOD
	\$	\$	\$	A DIFFERENT PERIOD OF TIME
REVENUE	X	X	X	
COST OF GOODS SOLD	(X)	(X)	X	
GROSS PROFIT/(LOSS)	<u>X/(X)</u>	<u>X/(X)</u>	X	
OVERHEAD EXPENSES	(X)	(X)	X	
OPERATING PROFIT/(LOSS)	<u>X/(X)</u>	<u>X/(X)</u>	X	
INTEREST EXPENSE	(X)	(X)	X	
TAX EXPENSE	(X)	(X)	X	
NET PROFIT/(LOSS)	<u>X/(X)</u>	<u>X/(X)</u>	X	

COSTS

TOP LINE

REVENUE

COST OF SALES

GROSS PROFIT/(LOSS)

OVERHEAD EXPENSES

OPERATING PROFIT/(LOSS)

INTEREST EXPENSE

TAX EXPENSE

NET PROFIT/(LOSS)

BOTTOM LINE

INDIRECT COSTS

EXPENSES WHICH CAN'T BE DIRECTLY TRACED THROUGH TO GOODS SOLD OR SERVICES PROVIDED

INDIRECT FIXED

INDIRECT VARIABLE

RENT  
SALARIES  
INSURANCE  
ADMIN  
LEGAL  
ACCOUNTING  
MARKETING  
DEPRECIATION  
AMORTIZATION

ADVERTISING  
COMMISSIONS  
UTILITIES

REVENUE  
COST OF GOODS SOLD  
GROSS PROFIT/(LOSS)  
OVERHEAD EXPENSES  
OPERATING PROFIT/(LOSS)  
INTEREST EXPENSE  
TAX EXPENSE  
NET PROFIT/(LOSS)



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# CASH FLOW STATEMENT

A FINANCIAL STATEMENT THAT SUMMARIZES A BUSINESS'S CASH INFLOWS AND OUTFLOWS OVER A PERIOD OF TIME

COMPARISON VS INDIRECT METHOD  
MORE USEFUL TO EXISTING & POTENTIAL INVESTORS, LENDERS AND CREDITORS

BUT...

HARDER FOR ACCOUNTANTS TO PREPARE

## DIRECT METHOD CASH FLOW STATEMENT

FOR THE PERIOD ENDED MMM-DD-YYYY

CASH FLOW IS NOT THE SAME AS PROFIT!

CASH BASIS OF ACCOUNTING

REVENUE IS RECOGNIZED WHEN CASH IS RECEIVED

EXPENSES ARE RECORDED WHEN CASH IS PAID OUT

MIRRORS AN INCOME STATEMENT PREPARED UNDER THE CASH BASIS

THE PRINCIPLE REVENUE GENERATING ACTIVITIES OF A BUSINESS

THE SALE OR PURCHASE OF NON-CURRENT ASSETS OR INVESTMENTS THAT SIT OUTSIDE OF A BUSINESS'S CORE OPERATIONS

CHANGES IN SHARE CAPITAL OR BORROWINGS FROM A BANK OR THIRD PARTY

CALCULATING THE NET CASH FLOW FOR THE PERIOD THAT IS RECONCILED ABOVE

### CASH FLOW FROM OPERATING ACTIVITIES

CASH RECEIPTS FROM CUSTOMERS  
CASH PAID TO SUPPLIERS  
CASH PAID TO EMPLOYEES  
INTEREST PAID  
TAXES PAID  
NET CASH FLOW FROM OPERATING ACTIVITIES

\$	\$
X	(A)
(X)	(B)
(X)	(C)
(X)	(D)
(X)	(E)
<u>X/(X)</u>	SUM

### CASH FLOW FROM INVESTING ACTIVITIES

PURCHASE OF PLANT, PROPERTY & EQUIPMENT  
CASH RECEIPTS FROM SALE OF PPE  
NET CASH FLOW FROM INVESTING ACTIVITIES

(X)	(F)
<u>X</u>	(G)
X/(X)	SUM

### CASH FLOW FROM FINANCING ACTIVITIES

PROCEEDS FROM LONG-TERM BORROWINGS  
NET CASH FLOW FROM FINANCING ACTIVITIES

<u>X</u>	
X/(X)	SUM

### NET INCREASE/(DECREASE) IN CASH

X/(X) SUM

OPENING CASH AS AT MMM-DD-YYYY

CLOSING CASH AS AT MMM-DD-YYYY

### NET INCREASE/(DECREASE) IN CASH

X/(X) DIFF

### WORKINGS

CASH FLOWS ARE CALCULATED BY COMPARING OPENING & CLOSING AMOUNTS IN BALANCE SHEET WITH CORRESPONDING REVENUE EARNED OR EXPENSES INCURRED IN THE INCOME STATEMENT

### 'T ACCOUNTS'

ARE VISUAL REPRESENTATIONS OF ACCOUNTS

ACCOUNTS RECEIVABLE	
B/S OPENING SALES	X
I/S CLOSING	X
	CASH RECEIPTS X (A)
DEALER	

SALARIES PAYABLE	
(C) CASH PAID	X
	OPENING SALARIES EXP X B/S
	CLOSING X B/S
DEALER	

INTEREST PAYABLE	
(D) CASH PAID	X
	OPENING INTEREST EXP X B/S
	CLOSING X B/S
DEALER	

ACCOUNTS PAYABLE	
(B) CASH PAID	X
	OPENING INV PURCHASES X B/S
	CLOSING X B/S
DEALER	

TAX PAYABLE	
(E) CASH PAID	X
	OPENING TAX EXP X B/S
	CLOSING X B/S
DEALER	

PPE	
B/S OPENING	X
(F) PURCHASE PPE	X
B/S CLOSING	X
	DEPN EXP X I/S
	SALE OF PPE X (G)
DEALER	

INVENTORY	
B/S OPENING	X
B/S CLOSING	X
	INV PURCHASES X
	COGS X I/S
DEALER	

ASSUMING...  
1. NO ACCUMULATED DEPRECIATION  
2. NO GAIN / LOSS ON DISPOSAL  
3. ALL CASH HAS CHANGED HANDS

DEBITS	CREDITS
DEA	LER
TXS	TQE
VPS	AUV
IEE	BIE
DNT	BITN
ESS	LYE
NDS	ITIE
S	ES



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MOST LARGE BUSINESSES  
USE THIS METHOD

ACCURAL BASIS OF ACCOUNTING

REVENUE IS RECOGNIZED  
AS IT'S EARNED

EXPENSES ARE RECORDED  
AS THEY ARE INCURRED

CASH FLOW IS NOT THE  
SAME AS PROFIT!

THE PRINCIPLE REVENUE  
GENERATING ACTIVITIES  
OF A BUSINESS

THE SALE OR PURCHASE OF  
NON-CURRENT ASSETS OR  
INVESTMENTS THAT SIT  
OUTSIDE OF A BUSINESS'S  
CORE OPERATIONS

CHANGES IN SHARE CAPITAL  
OR BORROWINGS FROM  
A BANK OR THIRD PARTY

CALCULATING THE NET  
CASH FLOW FOR THE PERIOD  
THAT IS RECONCILED ABOVE

## CASH FLOW STATEMENT

A FINANCIAL STATEMENT THAT SUMMARIZES A BUSINESS'S  
CASH INFLOWS AND OUTFLOWS OVER A PERIOD OF TIME

COMPARISON VS DIRECT METHOD

LESS USEFUL TO EXISTING & POTENTIAL  
INVESTORS, LENDERS AND CREDITORS

BUT...

EASIER FOR ACCOUNTANTS TO PREPARE

# INDIRECT METHOD CASH FLOW STATEMENT

FOR THE PERIOD ENDED MMM-DD-YYYY

### CASH FLOW FROM OPERATING ACTIVITIES

NET PROFIT / (LOSS)

\$  
X/(X)

\$

→ STEP 1

ADD BACK NON-CASH EXPENSES

DEPRECIATION

X

AMORTIZATION

X

(GAIN) / LOSS ON SALE OF NON-CURRENT ASSETS

(X)/X

→ STEP 2

ADJUST FOR MOVEMENT IN WORKING CAPITAL

(INCREASE) / DECREASE IN INVENTORY

(X)/X

(INCREASE) / DECREASE IN RECEIVABLES

(X)/X

INCREASE / (DECREASE) IN PAYABLES

X/(X)

→ STEP 3

NET CASH FLOW FROM OPERATING ACTIVITIES

X/(X) SUM

### CASH FLOW FROM INVESTING ACTIVITIES

PURCHASE OF PLANT, PROPERTY & EQUIPMENT

(X)

CASH RECEIPTS FROM SALE OF PPE

X

← IDENTICAL TO  
DIRECT METHOD

NET CASH FLOW FROM INVESTING ACTIVITIES

X/(X) SUM

### CASH FLOW FROM FINANCING ACTIVITIES

PROCEEDS FROM LONG-TERM BORROWINGS

X

NET CASH FLOW FROM FINANCING ACTIVITIES

X/(X) SUM

← IDENTICAL TO  
DIRECT METHOD

### NET INCREASE/(DECREASE) IN CASH

X/(X) SUM

OPENING CASH AS AT MMM-DD-YYYY

X/(X)

CLOSING CASH AS AT MMM-DD-YYYY

X/(X)

← PRIOR PERIOD  
BALANCE SHEET

← CURRENT PERIOD  
BALANCE SHEET

### NET INCREASE/(DECREASE) IN CASH

X/(X) DIFF

## WORKINGS

THREE STEP PROCESS TO CALCULATE CASH FLOW FROM OPERATING ACTIVITIES  
UNDER THE INDIRECT METHOD

### STEP 1

INDIRECT METHOD BEGINS WITH 'NET PROFIT / LOSS' FROM THE INCOME STATEMENT

### STEP 2

ADD BACK ALL NON-CASH EXPENSES THAT APPEAR ABOVE 'NET PROFIT / LOSS' IN THE INCOME STATEMENT  
THESE DON'T REPRESENT CASH OUTFLOWS AND NEED TO BE REVERSED OUT

### STEP 3

ADJUST FOR MOVEMENT IN WORKING CAPITAL

WORKING CAPITAL = CURRENT ASSETS - CURRENT LIABILITIES

LIABILITIES THAT NEED TO BE SETTLED  
WITHIN ONE YEAR FROM NOW

ASSETS THAT ARE TYPICALLY CONVERTED  
INTO CASH WITHIN ONE YEAR



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**CREATE FINANCIAL STATEMENTS**  
ACCOUNTING REPORTS THAT  
SUMMARIZE A BUSINESS'S ACTIVITIES  
OVER A PERIOD OF TIME

CLOSING ENTRIES ARE THE FINAL STEP  
IN THE ACCOUNTING CYCLE

THEY ARE POSTED AFTER  
CREATING FINANCIAL STATEMENTS

**DEALER**  
NORMAL DEBIT ACCOUNTS  
DIVIDENDS  
EXPENSES  
ASSETS  
NORMAL CREDIT ACCOUNTS  
LIABILITIES  
EQUITY  
REVENUE

**RED ALE**  
TEMPORARY ACCOUNTS  
REVENUE  
EXPENSES  
DIVIDENDS  
PERMANENT ACCOUNTS  
ASSETS  
LIABILITIES  
EQUITY

# CLOSING ENTRIES

JOURNAL ENTRIES POSTED AT THE END OF AN ACCOUNTING PERIOD TO RESET  
TEMPORARY ACCOUNTS TO ZERO

THE BALANCES ARE TRANSFERRED TO A PERMANENT ACCOUNT  
CALLED RETAINED EARNINGS

TEMPORARY ACCOUNT

THE CLOSING BALANCE AT THE END  
OF AN ACCOUNTING PERIOD ALWAYS  
NEEDS TO BE RESET TO ZERO

TRIAL BALANCE

AN ACCOUNTING REPORT  
SHOWING THE CLOSING BALANCES  
OF ALL GENERAL LEDGER ACCOUNTS

PERMANENT ACCOUNT

THE CLOSING BALANCE AT THE END  
OF AN ACCOUNTING PERIOD IS ALWAYS  
CARRIED FORWARD INTO THE NEXT ONE

## ADJUSTED TRIAL BALANCE

## POST CLOSING TRIAL BALANCE

	ACCOUNT	DEBIT	CREDIT	DEBIT	CREDIT
ASSETS	CASH	X		X	
	ACCOUNTS RECEIVABLE	X		X	
	ACCRUED REVENUE	X		X	
	PROPERTY, PLANT & EQUIPMENT	X		X	
LIABILITIES	ACCOUNTS PAYABLE		X		X
	SALARIES PAYABLE		X		X
	ACCRUED EXPENSES		X		X
	DEFERRED REVENUE		X		X
EQUITY	LONG TERM LOANS		X		X
	SHAREHOLDER'S EQUITY		X		X
DIVIDENDS	RETAINED EARNINGS*		X		X
	DIVIDENDS	X			
REVENUE	REVENUE		X		
	COST OF GOODS SOLD	X			
EXPENSES	OVERHEAD EXPENSES	X			
	INTEREST EXPENSE	X			
	TAX EXPENSE	X			
	<b>TOTAL</b>	<b>X</b>	<b>X</b>	<b>X</b>	<b>X</b>

## LONG WAY

**STEP 1**  
CLEAR REVENUE TO INCOME SUMMARY

**STEP 2**  
CLEAR EXPENSES TO INCOME SUMMARY

**STEP 3**  
CLEAR INCOME SUMMARY TO RETAINED EARNINGS

**STEP 4**  
CLEAR DIVIDENDS TO RETAINED EARNINGS

INCOME SUMMARY ACCOUNT

A SPECIAL TEMPORARY ACCOUNT  
THAT ONLY EXISTS WHILE POSTING  
CLOSING ENTRIES

## HOW TO POST CLOSING ENTRIES

JOURNAL ENTRY

A RECORD OF A  
FINANCIAL TRANSACTION

## SHORT WAY

**STEP 1**  
CLEAR ALL TEMPORARY ACCOUNTS  
TO RETAINED EARNINGS

## ADJUSTING ENTRY

JOURNAL NUMBER: #####

DATE	ACCOUNT	DEBIT	CREDIT
MMM-DD-YY	DIVIDENDS		X
	REVENUE	X	
	COST OF GOODS SOLD		X
	OVERHEAD EXPENSES		X
	INTEREST EXPENSE		X
	TAX EXPENSE		X
	RETAINED EARNINGS*		X
	DESCRIPTION		

RETAINED EARNINGS\*

PROFITS HELD FOR FUTURE USE



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## ACCOUNTING METHODS

THE BASIC RULES A BUSINESS FOLLOWS WHEN REPORTING  
IT'S REVENUES AND EXPENSES IN FINANCIAL STATEMENTS

### PROS

- ▶ EASIER TO IMPLEMENT AND MAINTAIN
- ▶ EXPLICITLY TRACKS CASH FLOWS
- ▶ GREAT FOR SIMPLE, CASH-BASED BUSINESSES

### PROS

- ▶ PROFITS CAN BE ACCURATELY RECORDED
- ▶ FINANCIAL POSITION CAN BE TRACKED IN A DETAILED BALANCE SHEET

	CASH BASIS	ACCRUAL BASIS
REVENUE IS RECOGNIZED	WHEN CASH IS RECEIVED	AS IT'S EARNED
EXPENSES ARE RECORDED	WHEN CASH IS PAID OUT	AS THEY ARE INCURRED

### CONS

- ▶ HARD TO ACCURATELY MEASURE PROFIT
- ▶ TOO SIMPLE FOR MORE COMPLEX BUSINESSES THAT REQUIRE A DETAILED BALANCE SHEET

### CONS

- ▶ HARDER TO IMPLEMENT AND MAINTAIN
- ▶ CASH FLOWS NEED TO BE TRACKED SEPARATELY

## WHAT THIS MEANS FOR RECORDING A SALE...

PERIOD 1

PERIOD 2

PERIOD 3

### CASH BASIS

REVENUE RECOGNIZED  
EXPENSE RECORDED

$$\frac{(X)}{(X)}$$

LOSS

TIMING DIFFERENCES  
CAN ARISE WHEN USING  
THE CASH BASIS

X

X

PROFIT

### ACCRUAL BASIS

REVENUE RECOGNIZED  
EXPENSE RECORDED

$$\frac{X}{X/(X)}$$

NET PROFIT  
OR LOSS

CASH PAID OUT

GOODS SOLD OR  
SERVICES PROVIDED

CASH RECEIVED

### REVENUE RECOGNITION PRINCIPLE

REVENUE IS RECOGNIZED AS IT'S EARNED  
NOT WHEN CASH IS RECEIVED.

### MATCHING PRINCIPLE

REVENUE AND ALL RELATED EXPENSES ARE  
RECOGNIZED IN THE SAME ACCOUNTING PERIOD

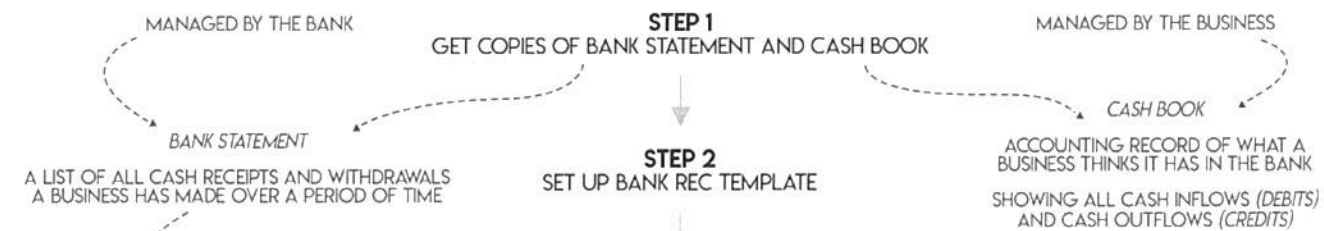
APPLIES BOTH OF  
THESE PRINCIPLES...



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# BANK RECONCILIATION

AS AT MMM-DD-YYYY

## BANK STATEMENT

UNADJUSTED CLOSING BALANCE

### TIMING DIFFERENCES

ADD DEPOSITS IN TRANSIT  
DEDUCT OUTSTANDING CHEQUES

AKA. UNRECORDED DEPOSIT

ADD/DEDUCT BANK ERRORS

ADJUSTED CLOSING BALANCE

UNRECONCILED AMOUNT

\$  
X/(X)

X  
(X)

X/(X)

X/(X)

X/(X)

## CASH BOOK

UNADJUSTED CLOSING BALANCE

### OMISSIONS

ADD MISSING RECEIPTS  
ADD INTEREST RECEIVED  
DEDUCT BANK FEES  
DEDUCT BOUNCED CHEQUES  
ADD/DEDUCT CASH BOOK ERRORS

ADJUSTED CLOSING BALANCE

\$  
X/(X)

X  
X  
(X)  
(X)

X/(X)

X/(X)

## STEP 3

TICK ALL MATCHING TRANSACTIONS

ALL MATCHING TRANSACTIONS THAT HAVE BEEN CORRECTLY RECORDED IN THE BANK STATEMENT AND THE CASH BOOK CAN BE IGNORED WHEN DOING A BANK RECONCILIATION

NEED TO BE FIXED BY NOTIFYING THE BANK (LESS LIKELY) OR THROUGH CORRECTING JOURNAL ENTRIES (MORE LIKELY)

## STEP 4

CALCULATE ADJUSTED BANK STATEMENT BALANCE

### TIMING DIFFERENCES

TRANSACTIONS RECORDED IN THE BANK STATEMENT AND CASH BOOK IN DIFFERENT ACCOUNTING PERIODS

### ERRORS

CAN OCCUR IN THE BANK STATEMENT (LESS LIKELY) OR THE CASH BOOK (MORE LIKELY)

## STEP 5

CALCULATE ADJUSTED CASH BOOK BALANCE

NO JOURNAL ENTRIES REQUIRED SINCE THESE NATURALLY CORRECT THEMSELVES IN FUTURE ACCOUNTING PERIODS

### OMISSIONS

TRANSACTIONS RECORDED IN THE BANK STATEMENT THAT HAVEN'T YET BEEN RECORDED IN THE CASH BOOK

## STEP 6

CHECK THAT ADJUSTED TOTALS MATCH

IF THEY DON'T THEN REPEAT THE PREVIOUS STEPS

POST TO GENERAL LEDGER ON LAST DAY OF ACCOUNTING PERIOD TO UPDATE 'TRUE CASH BALANCE'

## STEP 7

PREPARE THE NECESSARY JOURNAL ENTRIES

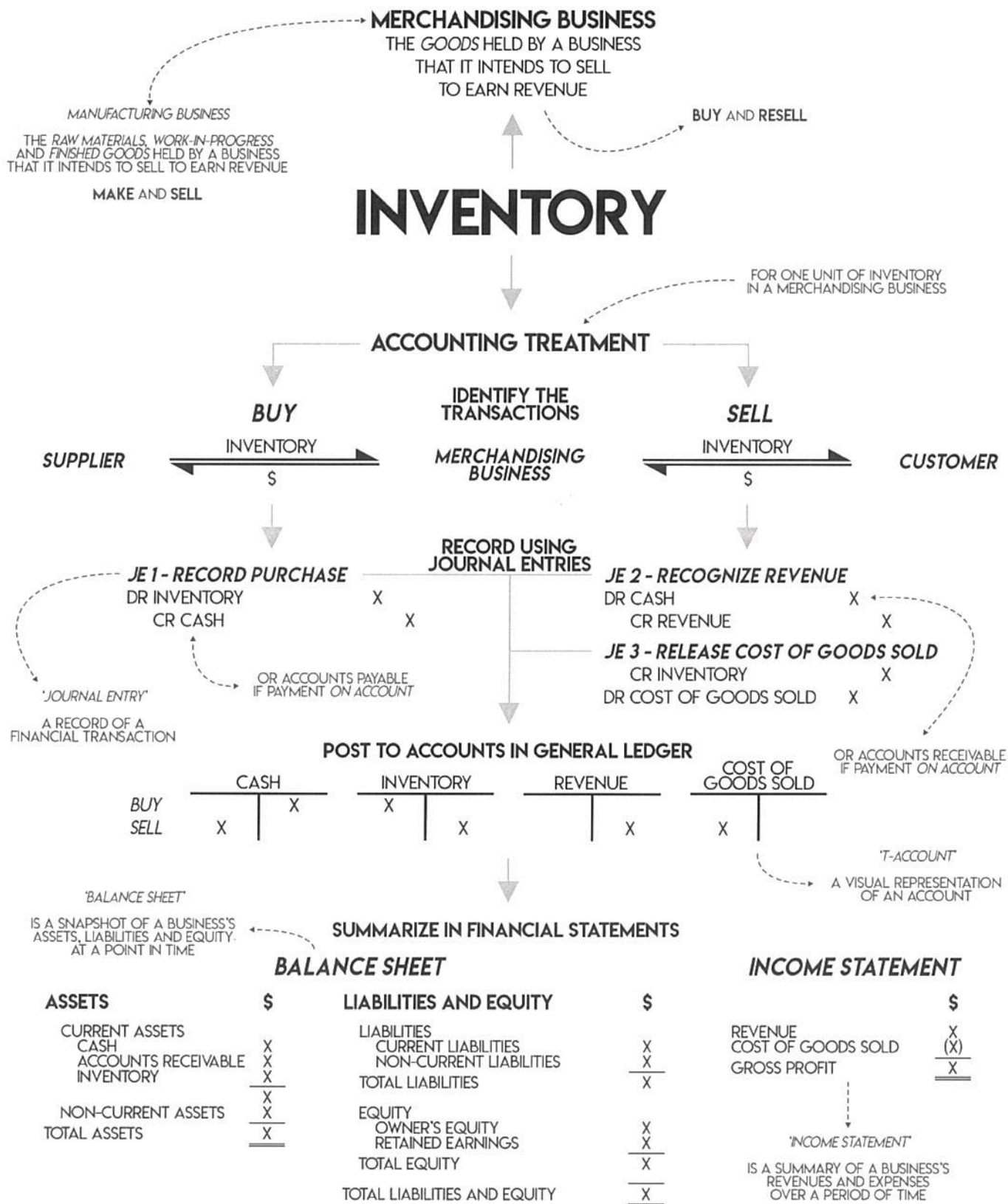
DATE	ACCOUNT	DR	CR
MMM-DD-YYYY	ACCOUNT #1	X	
	ACCOUNT #2		X

AS MANY JOURNAL ENTRIES AS NECESSARY TO COMPLETE THE BANK RECONCILIATION



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# PERPETUAL INVENTORY CALC

OPENING INVENTORY  
ADDITIONS  
COST OF GOODS AVAILABLE FOR SALE  
COST OF GOODS SOLD  
CLOSING INVENTORY

\$
X
X
X
X
(X)
X

**STEP 4**  
INVENTORY UPDATES IN REAL-TIME

**STEP 3**  
RECOGNIZE REVENUE AND COST OF GOODS SOLD  
AS SALES TAKE PLACE

**STEP 2**  
RECORD ADDITIONS IN INVENTORY ACCOUNT

**STEP 1**  
LAST PERIOD'S CLOSING INVENTORY  
BECOMES THIS PERIOD'S OPENING INVENTORY

DURING PERIOD

**STEP 3**  
DR CASH (OR A/R)  
CR REVENUE

**STEP 3**  
DR COGS  
CR INVENTORY

**STEP 2**  
DR INVENTORY  
CR CASH (OR A/P)

INVENTORY			
STEP 1	OPENING	X	
STEP 2	ADDITIONS	X	
STEP 3			COGS X
STEP 4	CLOSING	X	

**PROS**  
REAL-TIME INVENTORY UPDATES  
IMPROVED INVENTORY TRACKING

**PERPETUAL**  
UPDATES INVENTORY ACCOUNT CONTINUOUSLY

**CONS**  
HIGH SET UP COSTS  
NOT ALWAYS RELIABLE

# INVENTORY SYSTEMS

**PROS**  
RELATIVELY SIMPLE  
LOW SET UP COSTS

**PERIODIC**  
UPDATES INVENTORY ACCOUNT AT REGULAR INTERVALS

**CONS**  
DELAYED INVENTORY UPDATES  
LESS CONTROL

DURING PERIOD

**STEP 1**  
LAST PERIOD'S CLOSING INVENTORY  
BECOMES THIS PERIOD'S OPENING INVENTORY

**STEP 2**  
RECORD ADDITIONS IN PURCHASES ACCOUNT

**STEP 3**  
RECOGNIZE REVENUE AS SALES TAKE PLACE

INVENTORY COUNT  
AFTER PERIOD END

**STEP 4**  
CLEAR TOTAL PURCHASES TO INVENTORY ACCOUNT

**STEP 5**  
UPDATE CLOSING INVENTORY  
AND CALCULATE COST OF GOODS SOLD

INVENTORY			
STEP 1	OPENING	X	
STEP 4	TOT. PUR	X	
STEP 5A	CLOSING	X	
			COGS X

PURCHASES			
STEP 2	ADDITIONS	X	
STEP 4			TOT. PUR X

**STEP 2**  
DR PURCHASES  
CR CASH (OR A/P)

**STEP 3**  
DR CASH (OR A/R)  
CR REVENUE

**STEP 4**  
DR INVENTORY  
CR PURCHASES

**STEP 5**  
DR COGS  
CR INVENTORY

# PERIODIC INVENTORY CALC

OPENING INVENTORY  
ADDITIONS  
COST OF GOODS AVAILABLE FOR SALE  
CLOSING INVENTORY  
COST OF GOODS SOLD

\$
X
X
X
X
(X)
X



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## THE PROBLEM

WHEN INVENTORY COST PRICES ARE CHANGING  
HOW MUCH COST SHOULD FLOW TO *COST OF GOODS SOLD*  
AND HOW MUCH SHOULD BE RETAINED IN *CLOSING INVENTORY*?

RULES THAT ESTIMATE THE  
COST FLOW FROM INVENTORY  
TO *COST OF GOODS SOLD*  
WHEN A SALE TAKES PLACE

## THE SOLUTION

# COST FLOW ASSUMPTIONS

**FIFO**  
FIRST IN FIRST OUT

**LIFO**  
LAST IN FIRST OUT

**AVCO**  
AVERAGE COST

**STEP 1**  
DRAW A COST FLOW TABLE

MATCHES CURRENT REVENUES  
AGAINST WEIGHTED AVERAGE COSTS

MATCHES CURRENT REVENUES  
AGAINST PAST COSTS

MATCHES CURRENT REVENUES  
AGAINST CURRENT COSTS

**STEP 2**  
ENTER WHAT YOU KNOW

**STEP 3**  
FILL IN THE BLANKS

**STEP 3**  
FILL IN THE BLANKS

**STEP 3**  
FILL IN THE BLANKS

IGNORE COST PER UNIT FOR  
'COGAFS', 'COGS' AND 'CLOSING INVENTORY'

**STEP 4**  
CALCULATE COST OF GOODS SOLD  
AND CLOSING INVENTORY

CALCULATE WEIGHTED AVERAGE COST PER UNIT  
FOR 'GOODS AVAILABLE FOR SALE' AND 'GOODS SOLD'

$$\text{WEIGHTED AVERAGE COST PER UNIT (\$/UNIT)} = \frac{\text{TOTAL COST OF GOODS AVAILABLE FOR SALE (\$)}}{\text{TOTAL UNITS AVAILABLE FOR SALE (UNITS)}}$$

### INVENTORY CALCULATION

OPENING INVENTORY  
ADDITIONS  
COST OF GOODS AVAILABLE FOR SALE  
COST OF GOODS SOLD  
CLOSING INVENTORY

\$  
X  
X  
X  
X  
(X)  
X

### COST FLOW TABLE

DATE	DESCRIPTION	QUANTITY (UNITS)	COST PER UNIT (\\$/UNIT)	TOTAL COST (\$)
MM-DD-YY	OPENING INVENTORY	X	X	X
MM-DD-YY	ADDITIONS	X	X	X
MM-DD-YY	GOODS AVAILABLE FOR SALE	X	?	X
MM-DD-YY	GOODS SOLD	(X)	?	(?)
MM-DD-YY	GOODS AVAILABLE FOR SALE	X	?	X
MM-DD-YY	ADDITIONS	X	X	X
MM-DD-YY	GOODS AVAILABLE FOR SALE	X	?	X
MM-DD-YY	GOODS SOLD	(X)	?	(?)
MM-DD-YY	CLOSING INVENTORY	X	?	?



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**NON-CURRENT ASSETS**  
LONG TERM ASSETS TYPICALLY HELD FOR MORE THAN ONE YEAR  
THAT ARE USED IN OPERATIONS TO GENERATE PROFITS

### INTANGIBLE ASSETS

YOU CAN'T TOUCH THEM  
E.G. INTELLECTUAL PROPERTY,  
PATENTS,  
ROYALTY RIGHTS,  
TRADEMARKS,  
AND COPYRIGHT

### AMORTIZATION

THE PROCESS OF REDUCING THE  
BOOK VALUE OF AN INTANGIBLE ASSET

**TANGIBLE FIXED ASSETS**  
YOU CAN TOUCH THEM  
E.G. PLANT, PROPERTY & EQUIPMENT

# DEPRECIATION

THE PROCESS OF REDUCING THE BOOK VALUE OF A TANGIBLE FIXED ASSET  
DUE TO USE, WEAR AND TEAR, THE PASSING OF TIME, OR OBSOLESCENCE

CONTRA ASSET

### CALCULATING DEPRECIATION

STEP 1

WRITE DOWN WHAT YOU KNOW

STEP 2

BUILD A DEPRECIATION SCHEDULE THAT  
FITS THE DEPRECIATION METHOD

STEP 3

CALCULATE THE DEPRECIATION EXPENSE,  
ACCUMULATED DEPRECIATION  
& BOOK VALUES FOR EACH PERIOD

ASSET DESCRIPTION:  
DEPRECIATION METHOD:  
ASSET COST:  
RESIDUAL VALUE:  
USEFUL LIFE:  
DEPRECIATION RATE:  
DEPRECIABLE COST:

DESCRIPTION  
SL/DDB/SYD/UOP  
OBV<sub>1</sub>  
CBV<sub>N</sub>  
"N" YEARS  
SEE BELOW  
SEE BELOW

STEP 1

DEPRECIATION EXPENSE	
EXP <sub>N</sub>	X
INCOME STATEMENT	

NON-CURRENT ASSETS		ACCUMULATED DEPRECIATION	
OBV <sub>1</sub>	X	ACC <sub>N</sub>	X
BALANCE SHEET			

## DEPRECIATION SCHEDULE

YEAR	OPENING BOOK VALUE (\$)	DEPRECIATION EXPENSE (\$)	ACCUMULATED DEPRECIATION (\$)	CLOSING BOOK VALUE (\$)
20X1	OBV <sub>1</sub>	EXP <sub>1</sub>	ACC <sub>1</sub>	CBV <sub>1</sub>
20X2	OBV <sub>2</sub>	EXP <sub>2</sub>	ACC <sub>2</sub>	CBV <sub>2</sub>
20X3	OBV <sub>3</sub>	EXP <sub>3</sub>	ACC <sub>3</sub>	CBV <sub>3</sub>
...	...	...	...	...
20XN	OBV <sub>N</sub>	EXP <sub>N</sub>	ACC <sub>N</sub>	CBV <sub>N</sub>

STEP 2 → STEP 3

OBV<sub>N</sub> = CBV<sub>N-1</sub>

ACC<sub>N</sub> = EXP<sub>1</sub> + EXP<sub>2</sub> + EXP<sub>3</sub> + ... + EXP<sub>N</sub>

CBV<sub>N</sub> = OBV<sub>N</sub> - EXP<sub>N</sub>

### STRAIGHT LINE

A FIXED COST DEPRECIATION METHOD WHERE THE  
EXPENSE IS SPREAD EVENLY OVER ITS USEFUL LIFE

$$\text{DEPRECIATION EXPENSE} = \frac{\text{STRAIGHT LINE DEPRECIATION RATE}}{\text{USEFUL LIFE}} \times \text{DEPRECIABLE COST}$$

DEPRECIABLE COST = ASSET COST - RESIDUAL VALUE

### DOUBLE-DECLINING BALANCE

AN ACCELERATED VARIABLE COST DEPRECIATION METHOD  
WHERE THE EXPENSE IS HIGHER IN EARLY YEARS

$$\text{DEPRECIATION EXPENSE} = 2 \times \frac{\text{STRAIGHT LINE DEPRECIATION RATE}}{\text{USEFUL LIFE}} \times \text{OPENING BOOK VALUE}$$

### SUM OF THE YEAR'S DIGITS (SYD)

AN ACCELERATED VARIABLE COST DEPRECIATION METHOD  
WHERE THE EXPENSE IS HIGHER IN EARLY YEARS

$$\text{DEPRECIATION EXPENSE} = \text{SYD DEPRECIATION RATE} \times \text{DEPRECIABLE COST}$$

SYD DEPRECIATION RATE =  $\frac{\text{REMAINING USEFUL LIFE}}{\text{SYD}}$

SYD =  $\frac{\text{USEFUL LIFE} \times (\text{USEFUL LIFE} + 1)}{2}$

DEPRECIABLE COST = ASSET COST - RESIDUAL VALUE

### UNITS OF PRODUCTION

A VARIABLE COST DEPRECIATION METHOD WHERE THE  
EXPENSES MIRROR ACTUAL PHYSICAL USE OF ASSET

$$\text{DEPRECIATION EXPENSE} = \text{DEPRECIATION PER UNIT} \times \text{UNITS PRODUCED}$$

DEPRECIATION PER UNIT =  $\frac{\text{DEPRECIABLE COST}}{\text{USEFUL UNITS}}$

DEPRECIABLE COST = ASSET COST - RESIDUAL VALUE



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