The Fundamentals of Accounting

VIFM
Virginia Institute of Finance and Management

Learning Objectives

Understand the role and importance of the financial statements.

Define various financial statement terms.

Explain the format of the income statement, balance sheet, and cash flow statement.

Record financial statement transactions.

Understand how transactions move through the financial statements.

Prepare simple financial statements.

The Balance Sheet

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Balancing the balance sheet

We make sure the balance sheet always balances by ensuring:
Assets = Liabilities + Equity

Every accounting transaction entered must always balance.

We use a system called double-entry accounting (i.e., double-entry bookkeeping).

Accounts

Debits (DR)

Assets

Cash
Accounts Receivable
Prepaid Insurance
Capital Assets
- Vehicles
- Equipment
- Buildings
- Land

Credits (CR)

Liabilities

Accounts Payable
Unearned Revenue
Notes Payable

(CR) , (DR)

EquitQ

Revenue ------------------ CR
Share capital ---------- CR

Expenses ---------------- DR
Dividends ---------------- DR

Recording Transactions

Let's imagine that a company engages in the following transactions:

- Issued shares for 100,000 in cash
- Took out a four-year bank loan for 50,000
- Bought equipment and machinery for 80,000
- Bought inventory for 6,000
- Sold all the inventory for 10,000
- Paid salaries for 7,000
- Paid interest for 500

How would each of these transactions be recorded in the accounting records?

Issuing Shares

Let's start by looking at what happens when a company issues shares for 100,000 in cash.

Assets	
Current assets Cash	↑ 100,000
Non-current assets	
Total	↑ 100,000

Liabilities & Shareholder's Equity	
Current liabilities	
Non-current liabilities	
Shareholders equity Commom stock	↑ 100,000
Total	↑ 100,000

	Debit	Cíedit
Cash	100,000	
Shareholder’s equity		100,000

Taking out a Four Year Bank Loan

Now let's see what happens when the company takes out a four-year bank loan for 50,000.

Assets	
Current assets Cash	↑ 150,000
Non-current assets	
Total	↑ 150,000

Liabilities & Shareholder's Equity	
Current liabilities	
Non-current liabilities Loan Payable	↑ 50,000
Shareholder's equity Common stock	100,000
Total	↑ 150,000

	Debit	Cíedit
Cash	50,000	
Loan payable		50,000

Taking out a 4-year bank loan

Now let's see what happens when the company takes out a four-year bank loan for 50,000.

Assets	
Current assets Cash [100,000 = 50,000|	↑ 150,000
Non-curremt »ssets	
Total	↑ 150,000

Liabilities & Shareholder's Equity	
Current liabilities	
Non-current liabilities Loan payable	↑ 50,000
Shareholder's equity Commom stock	100,000
Total	↑ 150,000

Buying machinery & Equipment

Let’s see what happens when a company uses its own resources to buy 80,000 of equipment.

Assets	
Current assets Cash [150,000 – 80,000]	↓ 70,000
Non-current assets Equipmemt	↑ 80,000
Total	150,000

Liabilities & Shareholder’s Equity	
Current liabilities	
Non-current liabilities Loan payable	50,000
Shareholder’s equity Commom stock	100,000
Total	150,000

	Debit	Cíedit
Equipmemt	80,000	
Cash		80,000

Buying Inventory

The next thing this company needs to do is to buy 6,000 of inventory to sell.

Assets	
Current assets	
Cash [70,000 - 6,000]	↓ 64,000
Inventories	↑ 6,000
Non-current assets	
Equipment	80,000
Total	150,000

Liabilities & Shareholder's Equity	
Current liabilities	
Non-current liabilities	
Loan payable	50,000
Shareholder's equity	
Commom stock	100,000
Total	150,000

	Debit	Cíedit
Inventory	6,000	
Cash		6,000

Buying Inventory

The next thing this company needs to do is to buy 6,000 of inventory to sell.

Assets	
Current assets Cash [70,000 - 6,000] Inventory	 ↓ 64,000 ↑ 6,000
Non-current assets Equipmemt	80,000
Total	150,000

Liabilities & Shareholder's Equity	
Current liabilities	
Non-current liabilities Loan payable	50,000
Shareholder's equity Commom stock	100,000
Total	150,000

Adjustments & Balances

Effect of making adjustments related directly to the main balance sheet.

The company is adding Equity & Liability

Several Adjustment to our current & non-current assets

We normally record transactions related to income and expenses on the income statement, but it is important to understand how they impact the balance sheet.

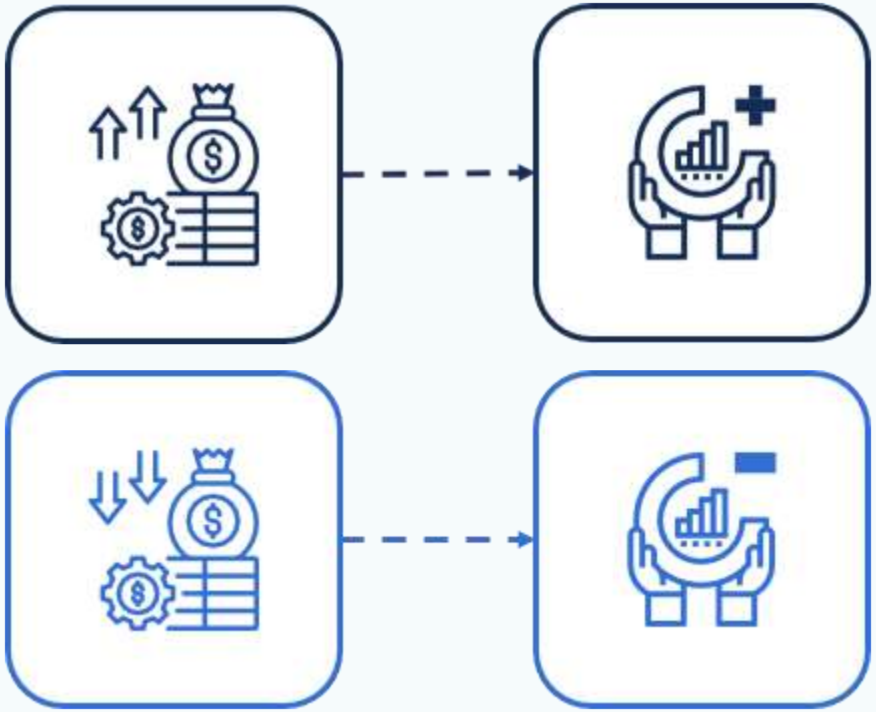
Adjustments & Balances

When we got to the equity section, you will remember we had a few different accounts that had different balances.

Equity ----→ Credit (CR)

Revenue ------------ CR
share capital ------ CR

Expenses ----------- DR
Dividends ---------- DR



Selling All Inventory

Let's see what happens when the company sells all the inventory for 10,000.

Assets	
Current assets	
Cash [64,000 + 10,000]	↑ 74,000
Inventory [6,000 - 6,000]	↓ 0
Non-current assets	
Equipmemt	80,000
Total	↕ 154,000

Liabilities & Shareholder's Equity	
Current liabilities	
Non-current liabilities	
Loan payable	50,000
Shareholder's equity	
Common stock	100,000
Retained earnings	↑ 4,000
Revenue	↑ 10,000
Cost of goods sold	↓ (6,000)
Total shareholder's equity	104,000
Total	↕ 154,000

	Debit	Credit
Cash	10,000	
Revenue		10,000
Cost of Goods Sold	6,000	
Inventory		6,000

Paying Salaries

Next, let's record the company's 7,000 in salaries.

Assets	
Current assets	
Cash [74,000 - 1,000]	↓ 73,000
Inventory	0
Non-current assets	
Equipmemt	80,000
Total	↓ 153,000

Liabilities & Shareholder's Equity	
Current liabilities	
Non-current liabilities	
Loan payable	50,000
Shareholder's equity	
Common stock	100,000
Retained earnings	↓ 3,000
Revenue	10,000
Cost or goods sold	(6,000)
Salaries	↓ (1,000)
Total shareholder's equity	↓ 103,000
Total	↓ 153,000

	Debit	Credit
Salaries Expense	1,000	
Cash		1,000

Paying Interest

Finally, let’s record the 500 of interest the company accrues on the bank loan.

Assets	
Current assets Cash [73,000 – 500]	72,500 0
Non-curremt assets Equipmemt	80,000
Total	152,500

Liabilities & Shareholder’s Equity	
Current liabilities	
Non-current liabilities Loan payable	50,000
Shareholder’s equity Common stock Retained earnings Revenue Cost or goods sold Salaries Interest Total shareholder’s equity	 100,000 3,000 10,000 (6,000) (1,000) (500) 102,500
Total	152,500

	Debit	Credit
Interest Expense	500	
Cash		500

Paying Interest

Finally, let’s record the 500 of interest the company accrues on the bank loan.

Assets	
Current assets	
Cash [73,000 – 500]	72,500
Inventory	0
Non-current assets	
Equipmemt	80,000
Total	**152,500**

Liabilities & Shareholder’s Equity	
Current liabilities	
Non-current liabilities	
Loan payable	50,000
Shareholder’s equity	
Common stock	100,000
Retained earnings	3,000
Revenue	10,000
Cost or goods sold	(6,000)
Salaries	(ľ,000)
Interest	(500)
Total shareholder’s equity	102,500
Total	**152,500**