Introduction to Accounting

Text File

Slide 1 Introduction to Accounting

Welcome to SBA's online training course, Introduction to Accounting.
This program is a product of the agency's Small Business Training Network and is championed by the Office of Entrepreneurial Development.

Slide 2 Introduction

This is a self-paced training program designed to provide an overview of accounting. The course is easy to follow and the subject matter is indexed for quick reference and easy access. It will take about 30 minutes to complete. Additional time will be needed to review included resource materials and to complete the suggested next steps at the end of the course.
When you complete the course, you will have the option of receiving a printed Certificate of Completion from the SBA.
Click the forward button below to get started.

Slide 3 Course Objectives

The course has three key objectives:
• Define and describe accounting;
• Explain the importance of accounting principles; and,
• Provide detailed explanations about different types of accounting scorecards or financial statements.

Slide 4 Course Outline

There are multiple sections within the course. Each section covers a different aspect of accounting. Together they tell a story that will help you understand why accounting is important to the success of a small business.

Slide 5 Course Outline

You will notice a button in the top right section of each slide that says Course Outline. Clicking on that button will bring you to this page – which will give you quick access to any section of the course.
Let's get started………

Slide 6 What is accounting?
The first thing we need to do is define what accounting is.
Accounting is the language of business. It is how a business "keeps score." It tells whether a business is profitable or not. In terms of a formal definition, it's the art of recording, classifying, and summarizing the financial events of a business.

Slide 7 Why is it important?

Accounting is called the "language of business" because it deals with interpreting and communicating information about a company's operations and finances.
Accounting is extremely important to any company because the financial information allows entrepreneurs to make informed business decisions. Economic events are measured and described by financial processes. We all work with and use accounting principals, whether we are managing a business, investing money, or just deciding how to spend our paycheck.

Slide 8 Why is it important?

It's easy to just say, "I'm a craftsperson and I know my craft and that's all I need to know. I'll just hire someone to take care of the numbers for me."
The bottom line is this: Whoever is making the decisions for the business needs to understand the basics of accounting and what each of the financial reporting statements mean.
If you are going to let the person taking care of your numbers make all of the decisions then you'll be fine.
But let's face it. You are most likely the one who's going to make many of the critical decisions facing the business. This is probably why you got into business in the first place—to call the shots.
Therefore, you need to at least understand the numbers even if you let someone else keep the books for you.

Slide 9 Keeping Accurate Books

Here's a few reasons why you have to keep accurate books, and you'll notice that tax reporting is at the bottom of the list. Keeping accurate books will help you: Price your products accurately.
Know if you're making or losing money—in general and on specific jobs.
Know your cash flow – both in the short and long term. Work with bankers and investors.
Let the tax agencies know how you're doing.

Slide 10 General Ledger

A business usually uses a general ledger to organize all of its accounting transactions so they can be easily found and understood. A general ledger is a moment by moment record of everything that happens in the business.
Today, and this is important, most small businesses use an automated financial software package that runs on a computer to keep track of their general ledger.

Slide 11 Double Entry Accounting

There are two different entry accounting systems.
They are the double entry accounting system and the single entry accounting system. A double entry system is when you make a transaction entry to one side and then make a second entry to the other side of the general ledger, scorecard or financial statement. This helps to keep it equal or balanced.
A single entry accounting system is typically associated with using an automated accounting system enabled by a computer. After entering the first entry, the computer program will make the second entry for you. You will still need to remember the double entry system so you will know what is going on behind the scenes.

Slide 12 Money Flows

When you think about it, there are really only a few different ways that money flows through a business. There is money coming in, money going out, money owed to the business, and money the business or you owe to others.
Let's take a look at each of these scenarios.

Slide 13 Money Coming In

There are several ways in which money can come into your business:
You can sell products or services, Receive money from the proceeds of a loan, or Receive money from a new investor or current owner.

Slide 14 Money Going Out

Money can exit a business in the following ways:
Purchase assets such as equipment or inventory, Pay expenses incurred from being in business, Make payments to satisfy a loan or liability, or distribute some of the business earnings to the owners.

Slide 15 Money Owed To The Business

In certain instances you may decide to offer "credit" to your customers.
Basically, this means that the customer receives your product or service now but agrees to pay you at a later date.
Why would you do such a thing? One reason is simple: giving your customer flexibility in making payments can increase the sale of your products and services. It's as simple as that.
Certain kinds of customers such as businesses usually request such payment terms to help them balance the flow of money coming into and going out of their businesses.

Slide 16 Money The Business Owes

In certain instances, you might be able to purchase merchandise from your supplier on account, also called on credit.
Buying and receiving products or services which are to be paid at a later date is called "accounts payable." Such accounts represent money you owe to someone else. Therefore, these amounts will appear on the right side of your scorecard.

Slide 17 The Balance Sheet

The Balance Sheet is a snapshot of your business.
It outlines the financial condition of your business at a specific point in time.
The balance sheet provides a financial perspective, highlighting the stuff you have and who owns it.
Let's take a look at this, broken-down in simple terms.

Slide 18 Simplified Terms

To better understand how money moves in and out of your business, you need a scorecard or financial statement that shows two things: STUFF YOU HAVE and WHO OWNS IT.

Slide 19 Simplified Terms Cont.

When creating a balance sheet, you need to make sure that both sides of the scorecard are equal. An important rule in accounting is that **the left side will always equal the right side**. If they do not equal ---- then you have made a mistake. It is that simple.

Slide 20 The Stuff You Have

Accountants like to categorize things. So we will describe two categories for the stuff your business owns. These categories are called, Current Assets and Fixed Assets.
So why the two names?
In accounting terms, Current Assets are cash or other assets that can be converted into cash within one year. Fixed Assets are property and equipment owned by your business—things not normally intended for sale, which are used over and over again.

Slide 21 Who Owns It

Now, on the right side of the balance sheet grouped under the "Who Owns It" column you essentially still have two major categories: what you owe to others and what's yours.
When you owe someone else you could say that you are "liable" to that person or company. Therefore, we will call these amounts "liabilities." For the share of the business that you or other partners own, we'll call this category, "Owner's Equity," which is the part of the assets that the owner or owners have claims to after all the liabilities are paid.

Slide 22 Sample Balance Sheet

Here is a sample balance sheet. You will notice that it has broken down the "stuff you have" into assets with the two categories of current assets and fixed assets. "Who owns it" has been broken down into liabilities and equity with the two categories of liabilities and owner's equity.

Slide 23 The Balancing Equation

Using the new accounting labels with what you know about your balance sheet scorecard, it should be easy to see that the stuff you have (assets) is always equal to what you owe to others (liabilities) plus what's yours (equity).
This is called the "accounting equation." It's what makes your balance sheet always equal on both sides.
The equation is this: Assets = Liabilities + Owner's Equity

Slide 24 The Income Statement

A second scorecard or financial statement is used to track sales and expenses.
We call this scorecard your income scorecard. In accounting terms, this scorecard is called an "Income Statement." An income statement, sometimes called a profit and loss statement (P&L), is a financial document which shows income *earned* and expenses *incurred*.

The resulting difference between your income and your expenses is called your *net profit*—what is often referred to as the "bottom line." This statement tells you if your business is profitable or not.

Slide 25 Income Statement Format

The income format is as followed:
Income minus cost of sales equals gross margin, gross margin minus fixed operating expenses equals net profit. Let's now break each of these down.

Slide 26 Income

An income statement begins with money that you have earned from selling something. There are several different names given to the money you make selling stuff. Some companies call it "revenue", "sales," or "income." The important thing to remember is that it is not in all cases cash in hand. Sales are monies you have earned but not necessarily collected if you offer any kind of credit to your customer.

Slide 27 Cost of Sales

After the sales for your business are presented, the income statement details the cost of those sales. These costs are called "variable expenses". Variable expenses represent the costs of *doing* business and might include direct labor, materials, and shipping. They usually increase with sales since they are the direct costs of delivering your products and services.

Slide 28 Gross Margin

The next number your income statement produces is the gross margin, sometimes called gross profit. This is the number you get when you take your sales for a given period and subtract your cost of sales. The gross margin is important for any business for it's the money you have left over to pay for any expenses of being in business and for making a profit. Many accountants look at this number as a percent of sales.

Slide 29 Expenses

After the gross margin is presented, your income statement shows your business expenses, sometimes called fixed expenses. Fixed expenses are the costs of *being in* business. These might include salaries, insurance, rent, advertising, utilities, and interest payments. They usually do not vary with the sales level of your business. This is why they are called fixed expenses.

Slide 30 Net Profit

Once you total all of your fixed business expenses, these are then subtracted on your income statement to produce your net profit. Net profit is the money left over after all expenses are accounted for and subtracted from the sales of your business. By aligning the sales of a business with it's relative expenses, it shows the profitability of a business and the amount of earnings made over a period of time.

Slide 31 Investment Costs

The entire goal of your income scorecard is to align your sales with your respective costs to tell if you are making any money or not—your net profit. But sometimes you make an investment in a large asset such as a building or piece of equipment that costs a lot of money.
If you would subtract the cost of this asset all at once, it would be impossible to tell if you are profitable or not. The reason for this is simple: These large assets produce value across a long period of time. This period of time is known as the “useful life” of the asset.

Slide 32 Figuring “depreciation”…

Taking a large cost such as that of a piece of expensive equipment and expensing it across it’s useful life is called “depreciation.” Depreciation is known as the reduction in the cost of your equipment due to wear and tear over the passage of time. Once you expense depreciation on your income statement and you remove the amount from your earnings over time, then you need to reduce the value of this asset.

Slide 33 Walking through the numbers…

Let’s take a look at a very basic example.
Sales are represented in the money in the money you earned. This equals $51.00. You will then subtract the Cost of Sales which equals $20.20. This will equal to the Gross Profit of $30.80. You will then add up the expenses of the business and subtract the number from the Gross Profit. This will equal to the Net Profit of $24.00.

Slide 34 Profitability over time…

It is important to remember that your income statement presents sales and expense activities over a *period* of time as opposed to your balance sheet which shows your financial condition at a *point* in time.

Slide 35 The Cash Flow Statement

Until you start offering credit to your customers and using credit with your suppliers, things are pretty simple. Cash comes in. Cash goes out.
Credit changes everything! The timing between your sales and purchases and your cash are different. Sales are flowing through your business at one rate and cash is flowing through the business at another. In order to keep track of your cash, you need one last scorecard—one that keeps track of the cash flowing through your business. A scorecard that explains the cash balance on your first scorecard. We’ll call this new scorecard your cash scorecard.
In accounting, this is called the “Cash Flow Statement,” or the “Statement of Cash Flows.” A cash flow statement is the financial document that presents income actually *received* and expenses actually *paid*. This statement (usually modified for a small business) usually shows beginning cash balances, cash inflows, cash outflows, and ending cash balances.

Slide 36 Cash Inflow

The cash flow statement details any *sources* of cash coming into the business.
When you think about it, there are only a few primary sources of cash: Cash collected from selling stuff, Cash collected that was owed on account, Loans made to the business, or new ownership equity placed into the business by a partner or investor.

These cash inflows get added together to produce the total sources of cash for the time period the statement covers.

Slide 37 Cash Outflow

The cash flow statement next lists any uses of cash by your business. This is cash leaving the business. There are a few primary ways in which cash flows out of a business: Purchasing some asset such as equipment, turning cash into inventory, paying for expenses generated by the business, making payments to satisfy any liabilities of the business, or distributing earnings to the owners of the business.

These cash outflows get added together to produce the total uses of cash for the time period the statement covers.

Slide 38 The ending cash balance

The ending cash balance on any cash flow statement is carried over as the cash balance to your balance sheet. This number is calculated by taking the beginning cash balance for the accounting period, adding any sources of cash, and then subtracting any uses of cash. This statement is simply the difference between your cash inflows for the period and your cash inflows.

Slide 39 The Format

In its simplest form, a cash flow statement is presented in the following format:
Beginning cash balance
Plus cash inflows
Minus cash outflows
Equals ending cash balance.
Let us now take a look at an example of a cash flow statement.

Slide 40 The movements and flow of cash…

For this example, the beginning cash balance is zero since you just started your business. You will then add in all the cash inflows which will equal $96.00. We will then subtract all the cash outflows which equal $84.80. This will total to your ending cash balance of $11.20.

Slide 41 Other Formats

Sometimes the cash flow statement is presented in a format a little different from the one we just reviewed.
Some statements begin with the earnings of the business (Profits) and then add and subtract any changes in cash not figured in on the income statement. This format breaks down cash provided by operating, financing, and investing activities. Let’s take a look at another example.

Slide 42 Statement of Cash Flows…

Here is another cash flow statement presented differently. You will notice that the beginning cash balance is now at the bottom of the statement. In its place is the cash flows divided into the three categories of operating, financing, and investing activities.

Look carefully at each category. The numbers in parentheses are those being subtracted. Again, the total cash flow will **always** be the same as the ending cash balance.

Slide 43 Some Basic Rules

While the income statement may have a negative net profit or "bottom line number," a cash flow statement should never have a negative ending cash balance.
If you have a negative ending cash balance it means you are in essence bankrupt or out of cash.
More than 51 percent of all businesses that file for bankruptcy protection in the U.S. are "profitable" on their income statements, but because they could not collect on their sales (through accounts receivable) or because they didn't plan their cash needs, they find themselves without any cash and out of business.
For these reasons, the cash flow statement is one of the most important documents in managing a small business.

Slide 44 Don't Be Afraid

The important thing in accounting is to not let the terms and formatting of the financial information scare you.
All you need to remember is that you have three basic financial statements for keeping track of your money.
The balance sheet shows your business at a particular point in time. It gets its cash and earnings balances from the other two statements.
The income statement shows your earnings over a period of time. And, the cash flow statement shows cash coming in and going out and what the net result is over a period of time.

Slide 45 Next Steps

Now that you have completed the course, take the next steps. Put what you have learned into action.

Step 1) Use the automated financial statement templates at the end of this course to prepare updated or new financial statements for your business.
Step 2) Discuss your financial statements and any accounting questions you have with a business mentor, coach, banker or other seasoned business advisor.

Slide 46 Additional Assistance

Many resources are available to assist you. The following resources can help you build a foundation in government contracting.
• Procurement Technical Assistance Centers, located at various locations around the country, help businesses understand and succeed in government contracting markets.
•SBA has over 60 district offices located throughout the country to help you start and grow your business.
•There are more than **1,000 Small Business Development Center** locations around the country. **SBDC's** provide management assistance to current and prospective small business owners.
•SCORE is a powerful source of free and confidential small business advice to help build your business. More than 10,000 SCORE volunteers are available to share their wisdom and lessons learned in business.
•The Small Business Training Network is a powerful virtual campus.

•And finally, **Women's Business Centers** assist women in achieving their dreams by helping them start and run successful businesses. Some 90 WBCs are located around the country.
Click on these resources to learn more and access their assistance.

Slide 47 Other Resources

Use these automated financial statement templates to help you better understand accounting principals and the financial performance of your business.
Knowledge is power. Use these resources to help you.

Slide 48 Have a Question?

This course has covered a great deal of material. And, there is much to learn and understand about preparing accounting. If you have questions about the financial aspects of running your business or another business issue, contact SBA or one of our resource partners. We will help you.
Use the 800 number or referenced hyperlinks to contact us directly.

Slide 49 Course Completion Certificate

CONGRATULATIONS ON COMPLETING THIS COURSE.
WE HOPE IT WAS HELPFUL AND PROVIDED A GOOD WORKING
KNOWLEDGE OF NEW TECHNOLOGIES CAN BENEFIT SMALL BUSINESSES.
YOU EARNED A CERTIFICATE OF COMPLETION FROM THE SBA.
THANK YOU FOR PARTICIPATING IN THIS COURSE. WE WISH YOU THE VERY BEST IN THE FUTURE. CLICK THE PRINT BUTTON TO RECEIVE YOUR CERTIFICATE.