Overview of an Accounting cycle

What is accounting:

Accounting is the process of recording, summarizing, analyzing, and interpreting financial (moneyrelated) activities to permit individuals and organizations to make informed judgments and decisions. By law all businesses must keep account.

3 MAIN ELEMENTS OF ACCOUNTING

ASSETS: items with money value that are owned by a business. Some examples are: cash, accounts receivable (selling goods or services on credit), equipment (office, store, delivery, etc.), and supplies (office, store, delivery, etc.).

LIABILITIES : debts owed by the business. Paying cash is often not possible or convenient, so businesses purchase goods and services on credit. The name of the account used is Accounts Payable. Another type of liability is Notes Payable. This is a formal written promise to pay a specific amount of money at a definite future date.

OWNER'S EQUITY : difference between Assets and Liabilities is Owner's Equity. The can also be called capital, proprietorship, or net worth.

THE ACCOUNTING EQUATION
Assets = Liabilities + Owner's Equity (This equation must always balance!)

1) **Recording Business Transactions**

ACCOUNT. An account is an individual record or form to record and summarize information for each asset, liability, or owner's equity transaction. Each account will have a title and number.

Debit means **left** side. **Credit** means **right** side.

A **"T" ACCOUNT** is so named because it looks like a capital T. Use this form of an account to help you determine whether the amount is placed on the left (debit) or right (credit) side of the account.

Double-entry accounting means that there will be at least two accounts affected by each transaction.

DEBITS MUST ALWAYS EQUAL CREDITS!

Assets	
Debits	Credits
Increase	Decrease
Normal Balance	

Expenses	
Debits	Credits
Increase	Decrease
Normal Balance	

Owner's Drawing	
Debits	Credits
Increase	Decrease
Normal Balance	

Liabilities	
Debits	Credits
Decrease	Increase
	Normal Balance

Revenues	
Debits	Credits
Decrease	Increase
	Normal Balance

Owner's Capital	
Debits	Credits
Decrease	Increase
	Normal Balance

What is cash flow?

Cash flow refers to the movement of money in and out of your business in terms of income and expenditure. Ideally, you want to have a positive cash flow – meaning that more money is coming in to the business than goes out. If you have a positive cash flow, your business will be able to settle its bills and invest in growth. A negative cash flow means you'll need to find an alternative source of income to be able to pay off debts.

What happens if you don't keep on top of your cash flow?

- **Too much stock**. If you suddenly receive high demand for a product, it's tempting to order a high volume of material to service that demand. However, if that demand then changes you could be left with far too much stock and, potentially, debt from ordering the materials. Ordering too much stock might also leave you lumbered with materials that become obsolete and difficult to sell.
- **Long payment terms**. Lengthy payment terms can often leave you with long stretches of time when no money comes in. Any unseen issues, from a fire at the office to replacing a laptop, can then be problematic due to a shortage of cash while you wait for the money to arrive. There's also the possibility of bad debt, which is when customers do not pay at all.
- **Overspending.** It's very tempting to go on a spending spree when you win a new client – snapping up everything from fancy orthopaedic chairs to an office ping pong table. However, you need to remember that you haven't actually got the money until they've paid you. Spending money that you don't have is never the best idea.
- **Overtrading.** Just as with stock, it's easy to get carried away with your business outlook after securing a big order. Employing more staff or expanding to more locations might seem like a good idea to grow your business, but you need to have the cash flow to back this up. While your profits can vary, your rent and salaries won't, meaning that you need to be able to withstand short term pressure on your finances if you want to grow your personnel and premises.

Cash flow statement example

Strauss Printing Services
Statement of Cash Flows
For the Year Ended December 31, 2017

Cash Flow from Operating Activities:		
Cash received from customers	$ 146,000	
Cash paid for expenses	(81,000)	
Cash paid to suppliers	(47,500)	$ 17,500
Cash Flow from Investing Activities:		
Cash paid to acquire additional equipment		(20,300)
Cash Flow from Financing Activities:		
Cash received from investment of owner	$ 10,000	
Cash received from bank loan	50,000	
Cash paid for bank loan – partial payment	(27,000)	

Cash paid to owner – withdrawal	(20,000)	13,000
Net Increase (Decrease) in Cash for the Year		$ 10,200
Add: Cash – January 1, 2017		10,800
Cash – December 31, 2017		$ 21,000

FINANCIAL STATEMENTS

Summaries of financial activities are called financial statements which are prepared on a regular basis at the end of an accounting period. The accounting period typically is one year; however, it can be any length of time for which records are maintained.

There are several financial statements. You are going to prepare the **Income Statement, Statement of Owner's Equity, and Balance Sheet.** These must be completed in that order.
Income Statement. This is a summary of a business's revenue and expenses for a specific period of time. It ONLY shows revenue and expenses. These should be listed in order from largest to smallest. (This should be done in this chapter because accounts are not given account numbers.)

Net Income is realized when revenue exceeds expenses.

Net loss is realized when expenses exceed revenue.

Statement of Owner's Equity. This is a summary of the changes that have occurred in the owner's equity during a specific period of time. This statement will show either an increase or decrease in the capital account.

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Balance Sheet/Statement of Financial Position
This statement is a listing of the firm's assets, liabilities, and owner's equity at a specific point in time. Total Assets must equal the addition of Liabilities and Owner's Equity.

Strauss Printing Services
Income Statement
For the Year Ended December 31, 2017

Service Revenue		$ 160,000
Less: Expenses		
Salaries Expense	$ 40,000	
Supplies Expense	26,100	
Rent Expense	20,500	
Utilities Expense	11,300	
Depreciation Expense	5,000	102,900
Net Income		$ 57,100

Strauss Printing Services
Statement of Financial Position
As of December 31, 2017

ASSETS

Current Assets:		
Cash	$ 21,000	
Accounts Receivable	16,000	
Prepaid Expenses	4,500	$ 41,500
Non-current Assets:		
Property, Plant and Equipment		145,000
Total Assets		$ 186,500

LIABILITIES AND OWNER'S EQUITY

Current Liabilities:		
Accounts Payable	$ 8,400	
Rent Payable	8,000	$ 16,400
Non-current Liability:		
Loans Payable		23,000
Strauss, Capital		147,100
Total Liabilities and Owner's Equity		$ 186,500

Strauss Printing Services
Statement of Owner's Equity
For the Year Ended December 31, 2017

Strauss, Capital	$ 100,000
Add: Additional Contributions	10,000
Net Income	57,100
Total	$ 167,100
Less: Strauss, Drawings	20,000
Strauss, Capital – Dec. 31, 2017	$ 147,100

For list company

PEPPER CORPORATION
Statement of Stockholders' Equity
For the Year Ending December 31, 20X9

	Common Stock, $1 Par	Paid-in Capital in Excess of Par	Retained Earnings	Treasury Stock	Total Stockholders' Equity
Balance on January 1	$20,000,000	$25,000,000	$11,000,000	$(5,000,000)	$51,000,000
Issued shares for cash	3,000,000	12,000,000			15,000,000
Purchase of treasury stock				(2,000,000)	(2,000,000)
Net income			4,000,000		4,000,000
Cash dividends			(1,500,000)		(1,500,000)
Stock dividends	1,150,000	4,600,000	(5,750,000)		
Balance on December 31	$24,150,000	$41,600,000	$ 7,750,000	$(7,000,000)	$66,500,000

What is an 'Accounting Ratio'

Accounting ratios, also known as financial ratios, are used to measure the efficiency and profitability of a company based on its financial reports. They provide a way of expressing the relationship between one accounting data point to another, and are the basis of ratio analysis.

The most cost commonly and top five ratios used in the financial field include:

1. Debt-to-Equity Ratio

The debt-to-equity ratio, is a quantification of a firm's financial leverage estimated by dividing the total liabilities by stockholders' equity. This ratio indicates the proportion of equity and debt used by the company to finance its assets.

The formula used to compute this ratio is

Total Liabilities / Shareholders Equity

2. Current Ratio

The current ratio is a liquidity ratio which estimates the ability of a company to pay back short-term obligations. This ratio is also known as cash asset ratio, cash ratio, and liquidity ratio. A higher current ratio indicates the higher capability of a company to pay back its debts. The formula used for computing current ratio is:

Current Assets / Current Liabilities

3. Quick Ratio

The quick ratio, also referred as the "acid test ratio" or the "quick assets ratio", this ratio is a gauge of the short term liquidity of a firm. The quick ratio is helpful in measuring a company's short term debts with its most liquid assets.

The formula used for computing quick ratio is:

(Current Assets – Inventories)/ Current Liabilities

A higher quick ratio indicates the better position of a company.

4. Return on Equity (ROE)

The return on equity is the amount of net income returned as a percentage of shareholders equity. Moreover, the return on equity estimates the profitability of a corporation by revealing the amount of profit generated by a company with the money invested by the shareholders. Also, the return on equity ratio is expressed as a percentage and is computed as:

Net Income/Shareholder's Equity

The return on equity ratio is also referred as "return on net worth" (RONW).

5. Net Profit Margin

The net profit margin is a number which indicates the efficiency of a company at its cost control. A higher net profit margin shows more efficiency of the company at converting its revenue into actual profit. This ratio is a good way of making comparisons between companies in the same industry, for such companies are often subject to similar business conditions.

The formula for computing the Net Profit Margin is:

Net Profit / Net Sales