Accounting 101: The Basics

Double Entry Accounting-

This means that every transaction entered into our accounting system will affect two accounts, always. For every debit made, there will need to be a corresponding credit entry.

Example: recording an invoice

Debit: Job Cost

    Credit: Accounts payable

Example: paying the same invoice

Debit: Accounts Payable

    Credit: Cash

Debits and Credits-

Debits and Credits are used to record the accounting entries above.

TYPES OF ACCOUNTS	INCREASES BALANCE	DECREASES BALANCE
Assets	Debit	Credit
Liabilities	Credit	Debit
Revenue	Credit	Debit
Expenses	Debit	Credit
Equity	Credit	Debit

Chart of Accounts-

Chart of Accounts is the heart of the accounting system and lists all of the accounts found in the general ledger.

Assets- 1000 (cash, accounts receivable, investments, cost in excess, PP&E)

Liabilities- 2000 (accounts payable, accrued Items, billings in excess)

Equity- 3000 (retained earnings- past earnings, current year earnings)

Revenue- 4000 (work in progress, this is not billings)

Cost of Sales- 5000 (Job Cost)

Payroll- 6000 (money paid to employees)

General Expenses- 7000 (rent, meals, travel, insurance, etc.)

Other income- 8000 (investment income, interest income, partner company income)

Accrual Accounting-

Records all revenue/income and expenses as they occur, not when cash is exchanged. This is very important to understand as we are required to use accrual method of account vs. cash accounting which records transactions when cash is exchanged.

Equity-

The balance sheet tells the true story of a company, your equity represents your current financial interest in the business and is always equal to assets-liabilities.

Key indicators of a strong financial company:

Liquidity-

liquidity is the amount of cash and easily-convertible-to-cash assets a company owns to manage its short-term debt obligations.

Current Ratio(Working Capital) Ratio: measures a company's ability to pay short-term obligations or those due within one year.

$$\text{Current Ratio} \frac{\text{Current Assets}}{\text{Current Liabilities}}$$

Solvency-

Solvency a company's ability to meet its debt obligations on an ongoing basis, not just over the short term. Solvency ratios calculate a company's long-term debt in relation to its assets or equity.

The debt-to-equity (D/E) ratio is generally a solid indicator of a company's long-term sustainability because it provides a measurement of debt against stockholders' equity, and is, therefore, also a measure of investor interest and confidence in a company.

Operating Efficiency-

Operating Margin is a good measure of operating efficiency. This metric considers a company's basic operational profit margin after deducting the variable costs of producing and marketing the company's products or services. Crucially, it indicates how well the company's management is able to control costs.

Profitability-

Companies can survive for years without being profitable, operating on the goodwill of creditors and investors. But to survive in the long run, a company must eventually attain and maintain profitability.