

Accounting: Learn in 1 Day

By Krishna Rungta

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Chapter 1: What is accounting and why do we need it?

If you're like most people out there, just hearing the word "accounting" probably sends your brain off to sleep. You probably think accounting is hard. And boring. And for old people.

Well, the good news is, that's not entirely true. Accounting can actually be extremely interesting. In fact, a large part of accounting is basically learning about how to make more money. And most people find making money a lot of fun J.

What is accounting?

Accounting can be defined as the production of financial information.

What this means is accounting allows us to see things like how much money you are earning, how much you are worth, how much money you spend and where you can improve to make even more money! The reason we need to know this is so we can make **decisions**.

Consider this scenario:

You run a bakery and you bake the best cream cake in the country. It is world famous and you receive orders for your legendary cake from every continent!

My Bakery!



However, one night a fanatic customer who believes you have a magic oven breaks into your bakery and steals it. You go ballistic.

You need \$10,000 to buy a new oven. You decide to go to the bank and ask for a loan.

You ask the bank for a \$10,000 loan. The thing is, you don't even have an accountant, so you do not have any **financial information** about your bakery.

The loan officer is a pretty lady named Anne.



Anne asks how much profit you made this year. You don't know so you guess. You say it was maybe \$30,000.

She asks you how much your assets are worth. You have no idea. She asks how much debt you have. You're not sure.

She asks what your cash flow is each month. You don't even know what that means.

Because you have no financial information, Anne says no.

Now let's say you go and find an accountant, who prepares some financial records for you. You return to the bank with the following information. You have \$5,000 of cash in the bank.

- You have sold \$52,000 worth of cakes this year.
- This year you made a profit of \$27,000, and profit has been increasing at an average rate of 6% per year for the last 3 years. Your operating expenses are
- \$25,000 this year. The largest is wages at \$11,000 per year. The next largest is advertising at \$7,500 per year. The smallest is telephone expenses at \$600 per year.

- ♦ Your bakery has net assets of \$122,000 and no debt.
- ♦ Your bakery had a net positive cash flow of \$13,000 this year.

Now you can tell Anne the loan officer exactly how much money you make, how much you spend, what you spend it on, how much you owe, how much you have in the bank, and how much your assets are worth.

Because she now has **information**, she is able to make a **decision** to loan you the money. This is because she knows how much money you make each month and can be confident you will be able to repay the loan.

Now, don't worry if you don't understand all the fancy terms up there like **"cash flow"** and **"net assets"**. We'll be learning what all that means very soon.

So, what does accounting do for us? I'm sure you already know that when you're in business, you need to know whether you're making money or not. Well, accounting helps you determine exactly that!

And remember, it's important for the people you do business with (like the loan officer) to know that too.

Even if you're not in business, chances are you work for somebody that is. Whether you fix the computers, write advertisements or makes sales over the phone, your role is designed to help your employer achieve one key objective – making a profit. Your ability to understand financial information makes you that much more valuable, not only to your employer but to your clients and customers too. By understanding accounting, you have the ability to understand how a business makes money, making you a more

complete professional and connecting you with your employer, your clients and their goals.

We also cannot forget the benefits of good personal finance. Accounting is as much a personal tool as it is a business one. Money is a big problem for many people all over the world. Perhaps you are finding it difficult to make ends meet, or maybe you're trying to save for a vacation but can't seem to figure out where all your money goes. Accountancy provides you with the skills you need to manage your money, where you can trace and categorise your expenses and effectively budget your income. This allows you to determine exactly how much you spend on non-essentials such as movies and fancy dinners, while also ensuring the important stuff such as rent and food for the family is always paid on time.

Chapter 2: Assets and Liabilities

The words “asset” and “liability” are two very common words in accounting.

Some people simply say an asset is something you own and a liability is something you owe. In other words, assets are good and liabilities are bad. That’s not wrong, but there’s a little more to it than that. Let’s look at a more complete definition.

Assets

Assets are something that your business uses to help generate a profit.

To make your famous cream cake, you need your oven. These two things are examples of **assets**.

To be an asset it has to satisfy 3 requirements:

- ♦ It’s something you have control over
- ♦ You have control as a result of a past event It has a
- ♦ future economic benefit

Now, let’s say after you got your loan of \$10,000, you went out and bought a new oven. But not just any oven. You bought the latest and greatest model. You bought the Bakemaster X Series 3000.



Let's see if your new Bakemaster fits the requirements of an asset.

Something you have control over?

You paid for it didn't you? You can keep it, you can sell it, you can even bake your shoes in it if you want to! Yep, it's definitely in *your control*.

As a result of a past event?

In this case, going to the store and handing over your cash will constitute a *past event*.

Has a future economic benefit?

With your new Bakemaster, you're definitely going to be baking some serious cream cakes which customers are going to pay top dollar for. That's definitely a *future economic benefit*.

Because your new oven meets above 3 requirements, it's definitely an asset.

Now let's take a look at an example, where something might not fit the definition of an asset.

Example B

A customer calls your store and says he had a dream about your cakes. He says he's coming in tomorrow to spend \$1,000 in your bakery on every lemonade butter cream flavoured treat he can find.

You think the \$1,000 should be recorded as an asset in your records.

Let's see if it fits the definition of an asset.

Something you have control over?

Sorry, you don't have the \$1,000 yet. You can't spend it. You can't even touch it! *Definitely not in your control*.

As a result of a past event?

The event needed for you to gain control of that cash will be when he comes in and hands it to you. Hasn't happened yet though! So in this case, *no event has taken place*.

Has a future economic benefit?

\$1,000 can buy a lot of things. Of course it has a future economic benefit.

Sorry, but this time you're only 1 for 3. The \$1,000 holds a future benefit, however you do not have control of the money and the past events needed for you to gain control have not occurred yet. Therefore, **the \$1,000 is not an asset.**

Another example:

Your friend lets you borrow his car as a delivery vehicle. However, one night the road is slippery and your driver crashes into a tree.

The car is completely damaged and is no longer drivable. Let's see if the car is an asset:

Something you have control over?

The car doesn't belong to you. It was lent to you by a friend, and you didn't sign a lease or contract giving you any rights to the car.

Therefore, *the car is not in your control*.

As a result of a past event?

The event needed for you to gain control of the car is you signing an agreement and paying to purchase the car or rent it. Sorry, but *no such event has taken place*.

Has a future economic benefit?

The car is completely damaged and cannot be driven. *It won't be providing a future economic benefit for anyone.*

Sorry, but this time you're 0 for 3. The car is definitely not an asset.

Hopefully that gives you an understanding of assets and when you recognize them. But what about liabilities?

Let's take a look.

Liability

A liability requires 3 things:

- ♦ Presents the business with an obligation
- ♦ Obligation is a result of past events
- ♦ Settling the obligation will require an outflow of valuable resources

Remember when Anne decided to give you that loan? Well, before you walked out of the bank she said to you, "You're going to need to pay \$1,000 each month until the whole \$10,000 is paid back!"

Liabilities are stressful



Let's see if the loan from Anne fits the definition of a liability.

Presents the business with an obligation?

You took the money. Now you're required to pay it back! Definitely presents *an obligation*.

As a result of past events?

You signed the loan agreement. The obligation comes as a result of this *past event*.

Requires an outflow of valuable resources?

Paying back the loan requires the outflow of money. Money is valuable! That's certainly an *outflow of valuable resources*.

Bingo! The loan satisfies all the requirements, so we'll be recording it in our books as a liability.

Example B:

The sink in your store is leaking. One of your staff takes a look at it and tells you that you'll definitely need a plumber to come in and fix it, which will cost you around \$200. You want to list the \$200 as a liability in your records.

Let's see if the \$200 fits the definition of a liability. Presents the business with an obligation?

You are not obliged to pay anybody at this stage. The leaking sink is simply an inconvenience which you can either choose to fix or not to fix. Therefore there's no obligation to the business...yet.

As a result of past events?

You'll need to actually call the plumber and receive the \$200 invoice before any liability can be recognised. This event hasn't occurred yet!

Requires an outflow of valuable resources?

With no obligation to pay anybody just yet, no outflow of resources should be expected.

Luckily for you, the \$200 doesn't fit the requirements for a liability. You can keep this one off your records!

Activity:

Below is a list of everyday thing you come across. Classify them as Asset, Liability or perhaps neither. Try hard before you [Check Your Answer](#)

	Assets	Liability	Neither
Bank			
Loan			
Building			
Hired furniture			
Rented property			
Mortgage			
Car			
Lawyer's fees			
Bank account			
Credit Debit Card			
Investments			
Bonds			
Job			
Unpaid bills			

House			
Hire purchase contracts			
Future bills			
Computer			
Cellphone			
Past bills			
Television			
Furniture			

=== End of Chapter ===

Answer Key

Assets	Liability	Neither
Bank	Loan	Hired furniture
Building	Mortgage	Rented property
Car	Credit Debit Card	Lawyer's fees
Bank account	Unpaid bills	Job
Investments	Hire purchase contracts	Future bills
Bonds		Past bills
House		

Computer		
Cellphone		
Television		
Furniture		

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