

The Full Contact Accounting “Accounting Primer”

The truth is, you don't need to be an accounting whiz to use QuickBooks effectively. But it certainly doesn't hurt! The more you know about accounting, the more insight you'll be able to get into your business. If you want to know enough just to get by, this primer is for you!

I compiled as much accounting information as I could into one easy to read, concise document. It's the type of document that you should keep hanging on the wall near your desk or in your top desk drawer because you'll want to refer to it time after time. But be careful, you might actually start to understand some of this stuff!

Financial Statements – There are 3 main statements that make up a “set of financial statements”

Balance Sheet

A financial statement that shows the company's assets, liabilities and equity as of one particular date. A “snapshot” of the company's financial position.

Assets – Things the company owns, such as bank accounts, inventory, equipment and accounts receivable

Liabilities – Things the company owes such as accounts payable, bank loans, payroll withholdings

Equity – The net worth of the company. Can be defined as Assets minus Liabilities. Common stock, additional paid-in capital and retained earnings are found in this section of the Balance Sheet

Profit & Loss

A financial statement that shows the company's income and expenses for a certain period of time. Also referred to as the “P&L” or “Income Statement”.

Income – Sometimes referred to as “Revenue”. The results of the company's sales. Can be from selling a physical product or performing a service.

Cost of Goods Sold – The cost of purchasing the items that the company has sold. Other expenses can be grouped into this section such as labor related to selling the goods, modifying the goods and shipping them.

Expenses – Any costs not directly associated with the production of goods such as rent, non-direct payroll, office supplies, travel, bank charges, etc.

Statement of Cash Flows

A financial statement that presents the company's activity in terms of cash in and cash out. It provides a link between the Balance Sheet and Profit & Loss reports. It begins with Net Income from the P&L and works its way down to the cash balance that appears on the Balance Sheet.

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Account Types

Each account in the Chart of Accounts fits into one of 2 groups. Every account is either a Balance Sheet account or a P&L account.

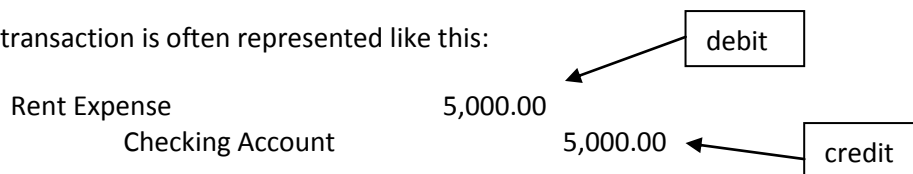
Balance Sheet	P&L
Bank	Income
Accounts Receivable	Cost of Goods Sold
Other Current Asset	Expense
Fixed Asset	Other Income
Other Asset	Other Expense
Accounts Payable	
Credit Card	
Other Current Liability	
Long Term Liability	
Equity	

Balance Sheet accounts maintain a continuously running balance that carries over from year to year. P&L accounts maintain a running balance for one year and then start over again at zero at the beginning of the next year. For example, on December 31 you may have total sales for the year of \$100,000. Then the very next day, on January 1 you start over again at total sales of \$0. But your bank account balance does not zero out at the end of every year, it keeps on going.

Debits and Credits

In the double-entry accounting system that we use there are debits and credits. Every transaction has them and the one rule that you have to remember is that **debits must always equal credits**. This also means that every transaction has to affect at least two accounts (yes, you could debit and credit the same account in a transaction, but that wouldn't really make any sense). Let's take your rent check as an example. When you record a check to pay the rent you are debiting rent expense and crediting your checking account for the same amount. This has the effect of lowering the balance in your checking account and increasing the balance in the rent expense account. It's kind of like an equal and opposite reaction. For every debit, there is a corresponding credit.

An accounting entry or transaction is often represented like this:



The dollar amount on the left is a debit and the one on the right is the credit. In this entry we are debiting Rent Expense and crediting the Checking Account.

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Debits and credits affect different accounts in different ways. Here’s a chart of how debits and credits affect the major account types:

Account Type	Debits	Credits
Assets	Increase	Decrease
Liabilities	Decrease	Increase
Equity	Decrease	Increase
Income	Decrease	Increase
Cost of Goods Sold	Increase	Decrease
Expenses	Increase	Decrease

Natural State of Being

Each major account type has a “natural state of being”. It is either normally a debit balance or normally a credit balance. For example, asset accounts normally have a debit balance. You can think of debits as pluses or positive numbers and credits as negative numbers. Assets normally have a positive (debit) balance. For example, your bank account should normally have a positive balance. It’s possible to have a credit balance in an asset account but it is usually a case where an adjustment should be made to correct the situation.

Liabilities and Equity accounts are normally credit balances. Think of a bank loan sitting on your Balance Sheet. It is not a good thing to owe people money. It’s not a positive situation, it’s a negative to your company. That negative equates to a credit balance (if you think of credits as negative numbers).

Income accounts are normally credit balances while the Cost of Goods Sold and Expense accounts are normally debit balances.

Believe it or not, that’s about all the accounting that you really need to know! There are of course, many finer points and nuances that I did not cover here (that’s why it takes 4 years of college to get an accounting degree), but this should be enough to understand most of what’s going on.

In my opinion, really good accountants and bookkeepers think in terms of debits and credits. Kind of like in my favorite movie, The Matrix. When the characters start to see the world inside the matrix in green, flowing code instead of an actual physical world. That’s how I look at transactions in QuickBooks. When I look at an “Enter Bills” screen I know that it’s going to credit the Accounts Payable account and debit whatever account is selected at the bottom of the window. This causes Accounts Payable to increase (credits increase that account).

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I know that when money is being deposited into the bank account, it is a debit. Therefore the other side of that entry must be a credit. It doesn't matter if it's a credit to Sales on the P&L or a credit to Additional Paid-In Capital on the Balance Sheet, but it's got to be a credit to some account.

When you write a check, you are crediting (decreasing) the checking account and debiting some other account.

That's how I see things. I break everything down to the most basic unit of measure that there is in accounting – debits and credits. It has served me well over the years and I think that if you can become familiar enough with how debits and credits interact with the accounts that it becomes second nature, you will be a much better bookkeeper.

I hope you have found some valuable pieces of information in this “accounting primer”. I wish you the best of luck in your business and especially with your QuickBooks.

-Mike Debyah
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