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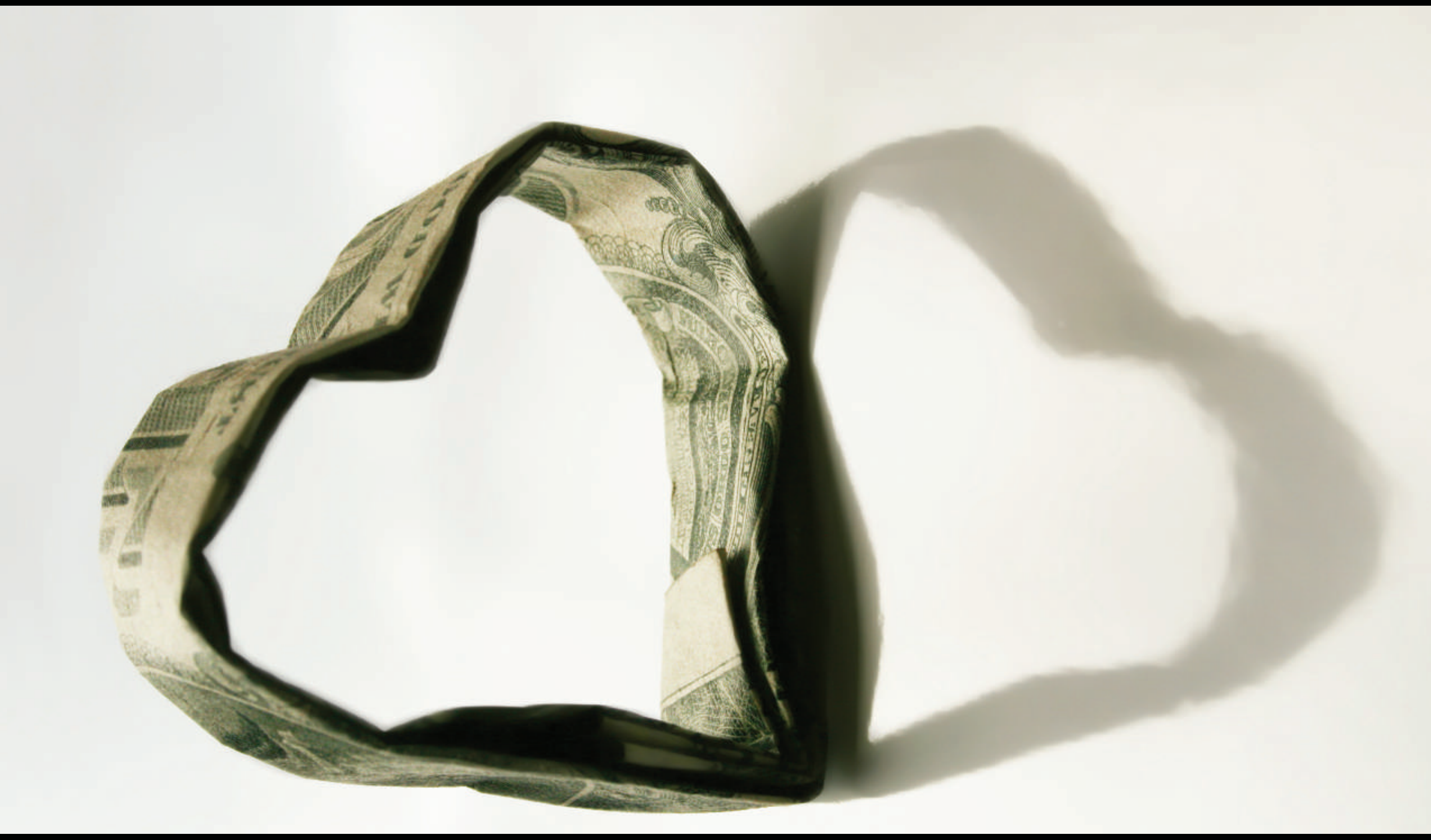
# The HEART of Accounting™



John W. Day, MBA

*A 4-hour course for non-accountants!*

Real Life Online Seminars
Presents

# The HEART of Accounting™

*A 4-Hour Step-By-Step Course That Teaches How to Prepare Financial Statements Using the Double-Entry Method of Accounting*

*Including a Bonus Section of 100 Practice General Journal Entries Related to Sole Proprietorships, Partnerships, Corporations, and Non-Profit Organizations*

Written by John W. Day, MBA
Author of *Real Life Accounting for Non-Accountants* – A 20-hour online course in accounting basics.
www.reallifeaccounting.com

*The HEART of Accounting*

First Edition



Real Life Online Seminars
20235 Sommette Drive
Sonora, CA 95370
E-mail: jday@reallifeaccounting.com
Phone: 209-532-7005
Fax: 209-532-7917
Website: www.reallifeaccounting.com

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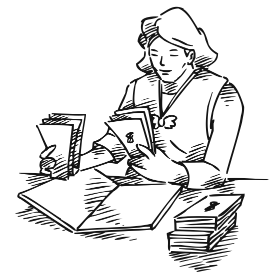
# Introduction



Welcome to **The HEART of Accounting™**, a four-hour course designed for non-accountants. You are about to embark on a brief journey into the world of accounting. You will be traveling into the "heart" of the double-entry accounting system. I like the use of the word "heart" because what you will be learning are the essential elements that make accounting work.

It makes no difference whether it is the smallest business or the largest multinational corporation, both business entities require and use these core accounting concepts to organize and prepare their financial statements. This is the "heart" of accounting and serves no less important function than the heart in a human being.

You must set aside your preconceived ideas and open your mind to a new kind of logic, i.e., accounting logic. It is a new way of thinking about financial events that have occurred in a business. In the beginning, just as learning a new card game, you have to trust that there are good reasons behind the rules. After you've played a few hands, you'll get the hang of it and it will all make sense. That's when the fun starts.

The beauty of "double-entry" accounting is that everything has to balance. This means there are no loose ends and messy finishes. Everything gets tied up in nice, neat little packages so that you experience a satisfactory sense of completion. There is a good and rewarding feeling when the "books" are done. Folks often wonder why some people just love accounting. They don't realize that accountants are like detectives. They solve mysteries constantly. They have their bag of tools, a set of clues, and off they go. It is intriguing to watch how the mind makes connections from bits and pieces of information as it moves closer to a solution.

Don't believe me? Okay, then let's put together a little mystery with this short-course and perhaps you will get a taste of what I mean. It will be best if you can find a quiet place where you will not be interrupted. You are going to need a pencil and a calculator. Look in the Forms Section and make several copies of the blank General Journal pages before you begin. The course is short enough to do in one setting. If you can, it's best to do it this way so you don't have to interrupt your train of thought.

At the end, I have provided a course questionnaire for you to complete and send back to me if you will. I would appreciate any feedback from you because it will help me to continuously improve the course.

After you have completed the course you will have an opportunity to hone your General Journal entry writing skills. Look for the 100 Practice Journal Entries in the Bonus Section.

Before we get started let's do a quick "preconception test". Do you have any preconceived ideas about accounting? Many people do, and they can hamper your ability to learn. Let's identify the main culprits. Here are some typical examples as to how the mind tries to make learning accounting unnecessarily difficult:

- Complicated – I would guess that the biggest obstacle is the presumption that accounting is complicated and therefore hard to learn. If you start with that presumption, you will likely not believe that the concepts could be as simple as they are being presented. Your mind will be looking for something that doesn't exist. This is a frustrating experience.

- Impatience – If you are impatient and jump ahead in the text without learning the concepts in the preceding study sections, you can end up chasing yourself around in circles. In accounting, it is best to walk slowly along the path and leave no stone unturned. Accountants know that this is the fastest way to the finish line. Having to retrace your steps to find mistakes from carelessness is time-consuming and tedious.

- Skepticism – There are certain people who have the type of mind that challenges the whys and wherefores of any field of knowledge. In almost every seminar I have taught there will be at least one person who can't accept why a certain accounting rule or principle was chosen. There is nothing wrong with this other than it takes a while for the individual to trust that there is a solid basis for the rule. For instance, why are the words "debit" and "credit" used? We could spend hours debating the pros and cons of this issue, but then we are no longer learning how to prepare financial statements.

- Self-doubt – Instead of concentrating on how to understand a simple concept being presented, you find yourself listening to that little voice inside your head that is saying, "It's too hard," "I'm not smart enough," "I'm no good with numbers," "Everybody is smarter than I am," "I'll just hold back everybody in the group," "I'm going to embarrass myself if I ask a question that everybody else knows," etc. Focusing your thoughts on self-doubt instead of learning accounting is like trying to drive a car down the road when you are not paying attention to the road. This, of course, becomes a scary, difficult proposition!

- False Confidence – Some people think they know more about accounting than they really do. Yet, when someone asks them how to write a general journal entry for an accounting transaction, they still have to guess whether it's a debit or a credit. It's best for them to swallow their pride and start at the beginning, even though they are familiar with "some" of the accounting rules.

You may or may not fit into any of these categories. But, if you do, usually just being aware of them will help to counteract any negative influences that may potentially obstruct the learning process. So if any of these negative influences or tendencies arise in your mind, don't identify with them. Simply tell them that they don't apply in this situation and that you will be happy to discuss their concerns "after" you are finished with the course.

Time to begin.

# The Language of Business is Accounting

## Part 1: Double-Entry Accounting

As you know, there are several types of business operations such as: Retail; Wholesale; Service; and Manufacturing. In addition, there are various types of business entities:

- Sole Proprietorships
- Partnerships
- C & S Corporations
- Limited Liability Companies
- Non-Profit Organizations

Because sole proprietorships are the easiest of the business entities to understand, I have chosen a small sole proprietorship, retail store called Tommy's T-Shirts, as the practice example for this course. The example I use is oversimplified because I want to make it easy for you get a feel for how double-entry accounting is used to prepare a financial statement. To begin, you must first become familiar with what is called the "Accounting Framework".

The two most common financial statements in accounting are a Balance Sheet and a Profit & Loss Statement (P&L Statement). There are three primary sections to a Balance Sheet and two primary sections to the P&L Statement that make up five primary sections. For example:

### Balance Sheet:

(1) Assets
(2) Liabilities
(3) Equity

### P&L Statement:

(4) Income
(5) Expense

There are only five. There are not fifteen or fifty sections, just five. This is important to remember. Nothing complicated so far. Let's move on to the next accounting concepts you need to learn. These are called the "Accounting Equations".

There is an accounting equation for the Balance Sheet and one for the P&L Statement. These equations establish the function of the five sections. If you know how to add and subtract then you will have no problem understanding the nature of the equations.

## Balance Sheet:

(1) **Assets – Liabilities = Equity (restated) Assets = Liabilities + Equity**

| | |
|---|---|
| **or** | **or** |
| **4 – 2 = 2** | **4 = 2 + 2** |

You might be surprised by the fact that you are already familiar with this equation if you have ever purchased a home. For example:

| | | | |
|---|---|---|---|
| **House** | **(Asset)** | = | **$150,000** |
| **Mortgage** | **(Liability)** | = | **<100,000>** |
| **Home Equity** | **(Equity)** | = | **$ 50,000** |

**$150,000 – $100,000 = $50,000**

Notice that the house asset is stated at its purchase price. When you sell your home, the mortgage is paid off first and the rest goes to you. In other words, the difference between the Assets and the Liabilities is what is yours. This is called your Equity. This all may seem very obvious, but don't overlook this most important concept:

**The Balance Sheet balances because it *has to*.**

It is the same with the P&L equation:

(2) **Income – Expense = Net Profit or <Loss>**

| | | | | | | |
|---|---|---|---|---|---|---|
| **Income** | = | **$10,000** | | **Income** | = | **$ 7,000** |
| **Expense** | = | **< 7,000>** | **or** | **Expense** | = | **<10,000>** |
| **Net Profit** | = | **$ 3,000** | | **Net Loss** | = | **$<3,000>** |

If you generated $10,000 from sales, but had to spend $7,000 to do it, then all you have left is the difference of $3,000. Or, if you generated $7,000 from sales, but you had to spend $10,000 to do it, then you are short $3,000 and therefore have sustained a loss. It's simple arithmetic:

**4 – 2 = 2 or 2 – 4 = –2**

So far this is second grade math that should not be difficult. Let's expand this concept to include a "ledger page". What is a ledger page? It is nothing more than a blank page with a big T drawn on it.

| L | R |
|---|---|

Note that I have placed the letters L and R on either side of the middle line. L stands for Left Side and R stands for Right Side. There are only two sides of the ledger page, left and right. This brings us to another rule in accounting:

**The Left side of the ledger <u>must</u> always equal the Right side of the ledger.**

## Review

This concludes Part 1 of the course. **Review** what you just learned by answering the following questions:

1. What are the names of the two most common financial statements?

2. Name the five primary sections that make up the accounting framework of the financial statements.

3. State the two accounting equations.

4. Why does a Balance Sheet balance?

5. What is a ledger page?

6. How many sides to a ledger page and what are they called?

7. What is the rule regarding a ledger page?

If you have difficulty answering any of the above questions, I highly recommend that you review Part 1, before continuing on with the course.