

# Basic Accounting for Micro-Entrepreneurs



A workshop designed to expose basic accounting principles to future micro-entrepreneurs in the Philippines.

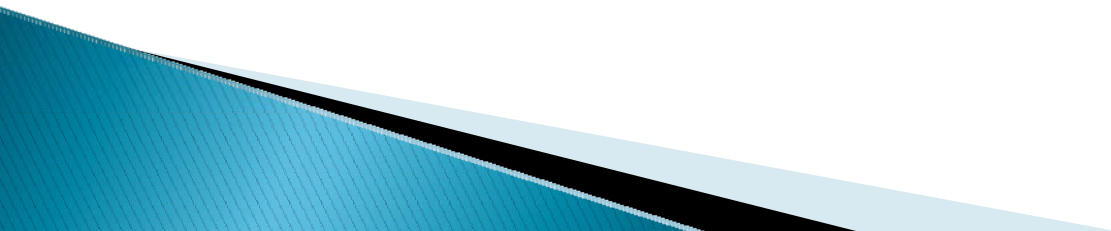
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December 18, 2007

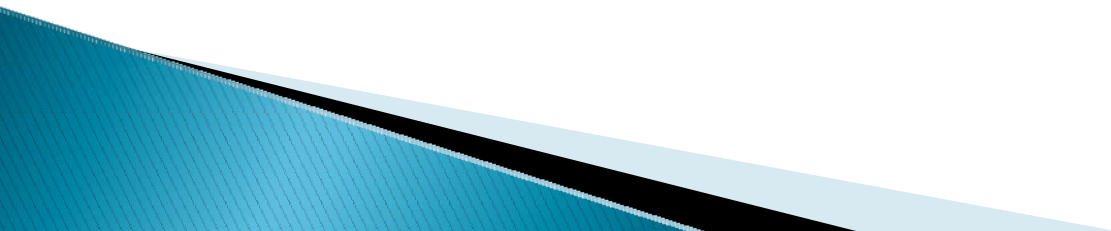
# Basic Accounting Principles

- ▶ Objectives of this module
    - Develop understanding of basic accounting vocabulary, principles and concepts.
    - Apply principles and concepts to coffee-shop exercise.
    - Discover accounting issues/problems for micro-entrepreneurs
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# Vocabulary

- ▶ **Accounting** – measurement of financial information; otherwise known as “the language of business”.
  - ▶ Different types of accounting, ie.
    - Financial Accounting – information describing the financial resources, obligations and activities of the firm.
    - Management Accounting – development and interpretation of information for managers of the firm.
    - Tax Accounting – planning and preparation of tax returns for the firm.
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# Vocabulary

- ▶ **Balance Sheet Accounts** – Assets, Liabilities and Equity, accounts used to track changes in value of things the business owes or owns.
    - **Assets** – group of things owned by the business
    - **Liabilities** – group of things on which the business owes money
    - **Equity** – net worth; assets – (minus) liabilities
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# Accounting

- ▶ Why is Accounting important?
  - Describes the financial condition of an company
    - Any company that participates in buying/selling activity needs to be able to describe their financial condition.
  - Measurement of profit or loss
    - Is the company making money or losing money?
    - Where is the money being spent?
    - What financial decisions should be made in the future?
    - Can the firm attract additional investments?

# Balance Sheet Accounts

- ▶ Balance Sheet is the 'statement of financial position'. It describes what the company looks like at a specific date.
- ▶ Balance Sheet is set up as an equation:  
$$\text{Assets} = \text{Liabilities} + \text{Equity}$$
- ▶ In order for correct accounting, this equation must always be followed –  $A = L + E$

# Balance Sheet example

## Manila Deaf Coffee Shop

### Statement of Financial Position

December 31, 2007

#### Assets

Cash	\$10
Supplies	\$75
Land	\$1000
<u>Equipment</u>	<u>\$125</u>

Total                      \$1210

#### Liabilities & Equity

Rent Expense	\$100
Notes Payable	\$900
Salary	\$100
<u>Retained Earnings</u>	<u>\$110</u>

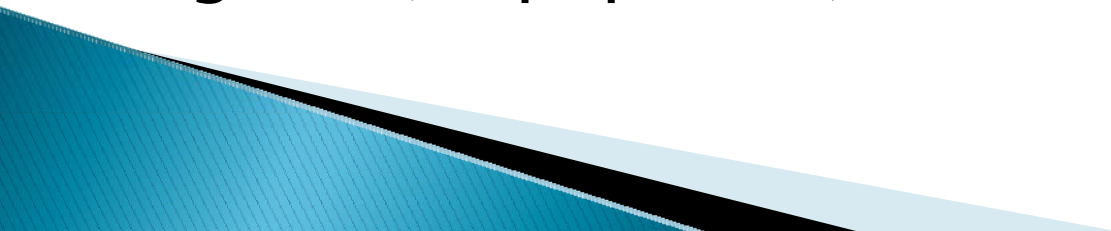
Total                      \$1210

# Balance Sheet – Assets

- ▶ Assets – the lifeblood of your business. If you have no assets, you have no business.

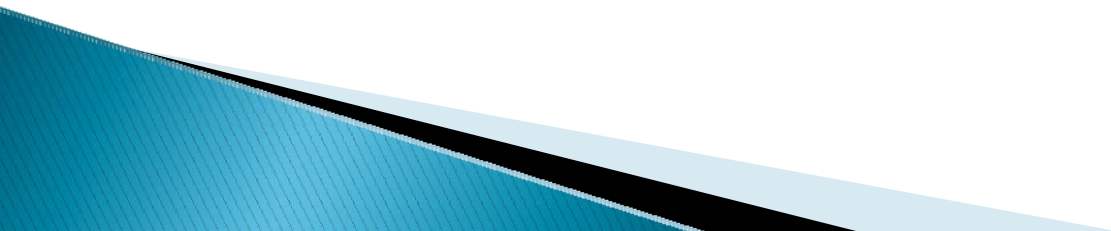
Assets are not just money, but also intangible things like your skills or knowledge, people who help your business, goods or equipment used to operate your business.

For this discussion, we are focused on assets that can be accounted for, ie. Cash, property, goods, equipment, etc.

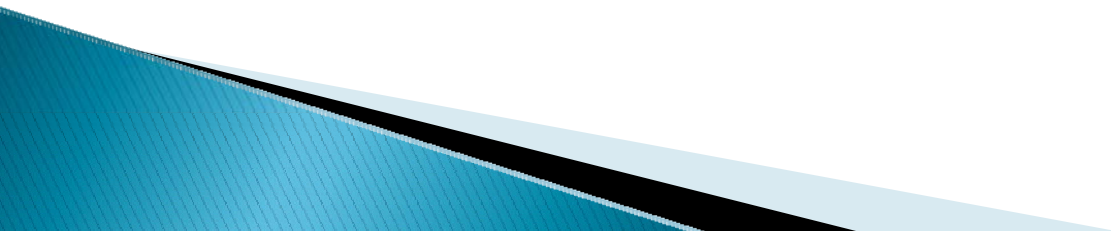




# Balance Sheet – Liabilities

- ▶ Liabilities – the opposite of assets, the obligations of one company to another
  - ▶ Liabilities allow you to operate your business with the least amount of capital possible.
  - ▶ Liabilities in this exercise include rent and materials expense, salaries and notes payable.
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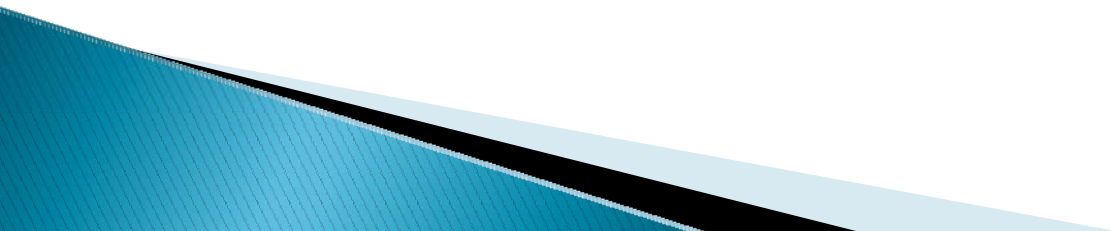
# Balance Sheet – Equity

- ▶ Equity – net worth. The amount left over after subtracting liabilities from assets.
  - ▶ Equity consists of Owners Capital and Retained Earnings.
  - ▶ Equity is the value of a business due to operations over a period of time. Equity can be positive or negative.
  - ▶ Positive equity is what all business owners are seeking. It allows you to sell the business to another company, person or to borrow more money from the Bank.
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# Balance Sheet – Review

- ▶ We have identified the 3 important parts of the Balance Sheet. They are:
  - Assets
  - Liabilities
  - Equity

Let's discuss how they function and what they mean to the balance sheet. Next step is putting these concepts to work.



# Accounting – Debit & Credit

- ▶ Balance Sheet discussion reviewed the following:  $\text{Assets} = \text{Liabilities} + \text{Equity}$
- ▶ How do we make this work by recording it? We use a ledger system of entries called “Debits” and “Credits”. This is the backbone of any accounting system.
- ▶ Every entry in each of the accounts includes a debit and credit, if not, then your balance sheet is out of balance.

# Debits and Credits

<u>Account</u>	<u>Debit</u>	<u>Credit</u>
Assets	Increases	Decreases
Liability	Decreases	Increases
Equity	Decreases	Increases

For every increase in debit, there is an decrease in credit and vice versa.



# Debits and Credits

- ▶ Debit and Credit entries are made in a T-Account for example:

Cash

Left side or Debit side	Right side or Credit side
Increase	Decrease

=

Expenses

Left Side or Debit side	Right side or Credit side
Decrease	Increase

# Debits and Credits

- ▶ Debit and Credit entries are made in a T-Account for example:

Cash		=	Expenses	
Left side or Debit side	Right side or Credit side		Left Side or Debit side	Right side or Credit side
\$100	Decrease		-\$100	Increase

# Debits and Credits

- ▶ Debit and Credit entries are made in a T-Account for example:

Cash

Left side or Debit side	Right side or Credit side
Increase	-\$100

=

Expenses

Left Side or Debit side	Right side or Credit side
Decrease	+ \$100



# Debits and Credits

Key Points: All debits and credits are recorded and journalized.

End of Month – Prepare Balance Sheet

Balance Sheet is the statement of the firm's financial position, ie.

$$\text{Assets} = \text{Liabilities} + \text{Owner's Equity}$$

# Balance Sheet

- ▶ We start with Journalizing Entries, then prepare a balance sheet.
- ▶ We start with \$2,000 in Owner's Equity or Capital.
  - This Results in the following Equation
  - |        |   |           |   |               |
|--------|---|-----------|---|---------------|
| Assets | = | Liability | + | Owners Equity |
| 2,000  | = |           |   | 2000          |

# Journalizing Entries

	2000 = 0	+	2000
Buy Goods	-200 + 200 Asset = 0	+	
	1800 Cash + 200 Asset = 0		2000 Capital
Buy Equipment	- 100 + 100 Asset = 0	+	
	1700 Cash + 300 Asset = 0 Liability		2000 Capital
Sell Goods	300 - 100 Asset =		200 Capital
	2000 Cash + 200 Asset =		2200 Capital
Purchase Land			
Finance Part	-500 + + 1000 Asset = +500 liability		
	1500 Cash + 1200 Asset = +500 Liability		2200 Capital
Total	\$2700 = \$2700		

# Balance Sheet

<u>Assets</u>		<u>Liabilities &amp; Owners Equity</u>	
Cash	1 500	Liability	
		Land Note Payable	500
Goods	100		
Equipment	100		
Land	1 000	Owner's Capital	2 200
	\$2 700		\$2 700

# Balance Sheet Examples

## Assets

Food supplies

Equipment

Land/Building

Transport (bike/car)

More Examples:

## Liabilities

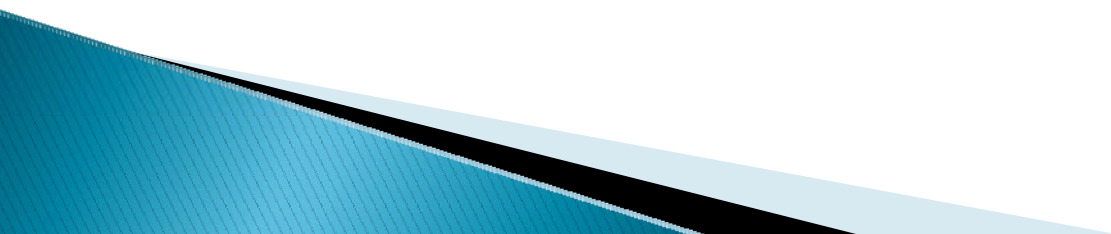
Expenses:

Salary

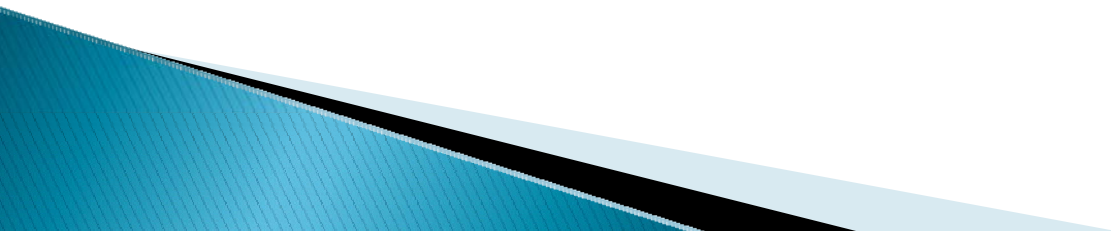
Fare

Gas

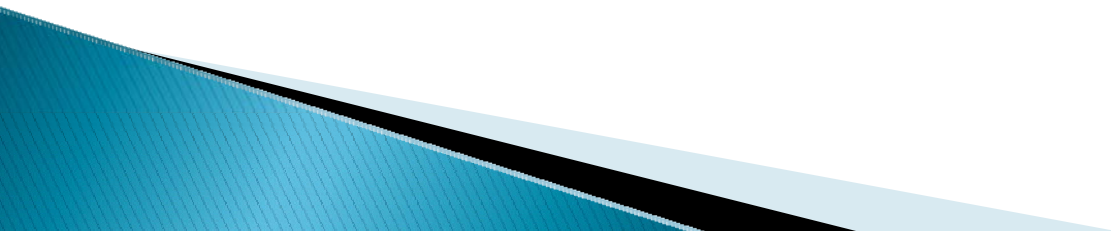
Electricity



# Balance Sheet

- ▶ Example shown is simple form.
  - ▶ Can be expanded to include more entries.
  - ▶ Key is journal entries, then consolidating all entries to make 1 balance sheet.
  - ▶ From Balance Sheet, you can create Income Statement and Statement of Cash Flow
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# Income Statement

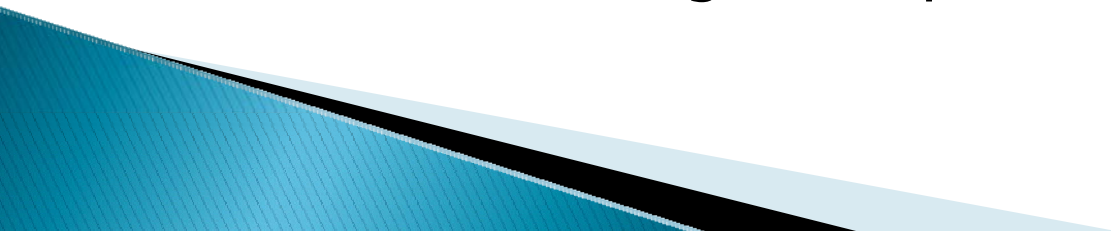
- ▶ Revenue – Expenses = Net Income
  - ▶ Income Statement can be used for 1 month period, 3 months, 6 months or 1 year.
  - ▶ It is depending on the preference of the business owner. Month to month is more accurate and allows for adjustment.
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# Statement of Cash Flow

- ▶ Statement of Cash flow is the result of the following:
  - Operating Activities
  - Investing Activities
  - Financing Activities

The Ending Cash Balance may be positive or negative.

It is simply a picture of the current cash flow. It is possible to have net profit, but negative cash flow due to Investing and Operating activities.





# Conclusion

- ▶ Basis of accounting is the Balance Sheet – the result of journal entries to indicate the following equation:

$$\text{Assets} = \text{Liabilities} + \text{Owner's Equity}$$

Journal Entries consist of Debit/Credit on both sides of the accounting equation

Once Balance Sheet is made, one can create a Income Statement and Statement of Cash–Flow

# Sources:

Text: 14<sup>th</sup> Edition – Financial & Managerial  
Accounting

Authors: Williams, Haka, Bettner and Carcello

Publisher: McGraw Hill

