

Accounting 101

Bookkeeping basics for MYOB customers

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Introduction

Like all small business owners, you went into business with a dream: to sell your unique product or services and make a living for you, your family, and your employees. As your business grows 'beyond the chequebook' your record keeping, reporting and compliance needs also increase. Now you have customers to track, suppliers to pay, sales to record, and a full set of accounts to maintain. You probably also have an accountant who is preparing your taxes for you and your growing business.

But now you find yourself spending more time keeping your books than keeping your customers happy. You understand the importance of having accurate books, but you have a lot of demands on your time, so accounting never seems to get the time it requires. Further, you willingly skipped all those school and uni accounting courses, thinking you weren't "going to be an accountant anyway". Well, surprise! Not only are you an accountant, you are a lawyer, a shipping clerk, a customer service rep and more – all in the pursuit of your dream.

So what can you do to make this work? The first step is to understand what all those accounting terms mean and how they all fit together. At the end of this booklet is a glossary of all the relevant accounting terms that will help you understand the science of accounting. Much like computers, understanding the terminology will help you understand their meaning and their relevance to you and, more importantly, help you analyse and run your small business.

Before we go any further, keep this in mind: you don't have to be an accountant to run MYOB software. All too often small business owners use this line to shun doing any type of record keeping, to their own detriment.

The reality is, I'm not a mechanic, but I can drive my car. I'm also not a plumber, but I can fix an overflowing toilet and I'm certainly not a doctor, but I can put a plaster on my kid's bumps and bruises. All it takes is the will to succeed and the desire to run a successful operation. Will it be easy? I wish I could say yes. Will it be frustrating? I wish I could say no. Will it be invaluable to your business and your long-term success? Certainly! While our goal here is to help you understand the basic concepts of accounting, one of the great things about MYOB software is that it does all the debits and credits for you.

Your daily lives

First, let's start with an overview of how accounting fits into your daily life. Quite simply, every transaction you make results in an entry into your "books". Whether it is a receipt of cash, a sale, a cheque you've written or a deposit from a customer – every transaction gets recorded in your books at some point. The timeliness and accuracy of when and how you record your transaction directly affects your ability to manage your business and your cashflow.

If you think your business is "chequebook-centric", remember that there are plenty of transactions that do not involve cash that should be recorded in your books:

- Anything that affects the things you own (assets) like repairs or purchases, all require a transaction.
- Anything that affects what you owe (liabilities) like GST or payroll taxes requires a transaction to be recorded.
- Anything that affects sales (income), like an invoice or a product-return needs to be recorded.
- And, as you no doubt already know, all your supplier invoices (expenses) are recorded when paid.

Just because cash is not exchanged does not mean there are no entries to record. For example, you probably sell items or services on credit. In this simple example, you record the sales when your invoice is issued, and then subsequently record the cash receipt when your customer pays you.

The golden rules of accounting

Let's discuss the "golden rules" of accounting. They are:

Debits must always equal credits

Don't let the words "debits" and "credits" scare you. They simply refer to the left side and right side of a "T Account", a graphical representation of the amounts recorded into an account (we'll cover this on page 9).

For any transaction you make, total debits always equal total credits. For example, a \$50 cheque to pay for coffee and tea for your office will result in the Kitchen Supplies expense account increasing by \$50 (a debit) and the cheque account, which is an asset, decreasing by \$50 (a credit*).

This table shows the rules to debits and credits

Account type	Increase	Decrease
Assets	Debit	Credit
Liabilities	Credit	Debit
Equity	Credit	Debit
Income	Credit	Debit
Cost of Sales	Debit	Credit
Expenses	Debit	Credit

*You might be wondering why a decrease to your account is considered a credit. Well, when your bank says that they are crediting your account, they are referring to the entry that they will make in THEIR books. Your money in the bank is a liability to the bank (they owe you that money); therefore when they credit your account, they are increasing their liability to you on their books.

The golden rules of accounting

Every transaction you record into your MYOB software is posted to your accounts as a combination of debits and credits — but we take care of it behind the scenes.

Notice how the “Spend Money” window below doesn’t refer to debits or credits. However, it’s actually recording debit and credit entries for you in the background automatically.

The 'Spend Money' window shows a transaction for \$50.00 paid to A-Z Stationery Supplies. The 'Recap Transaction' window shows the resulting journal entry with a debit to Kitchen Supplies and a credit to General Cheque Account.

Spend Money Window:

- Pay from Account: 1-1110 General Cheque Account Balance: \$188,606.56
- Group with Electronic Payments: Tax Inclusive:
- Card: A-Z Stationery Supplies Cheque No.: 108
- Payee: A-Z Stationery Supplies, 5/76 Readen Road, Bondi NSW 2026 Australia
- Date: 1/06/2006 Amount: \$50.00
- Fifty Dollars and 0 Cents
- Memo: A-Z Stationery Supplies Cleanwater Pty Ltd

Acct #	Name	Amount	Job	Memo	Tax
6-6200	Kitchen Supplies	\$50.00			FRE

Total Allocated: \$50.00
Tax: \$0.00
Total Paid: \$50.00
Out of Balance: \$0.00

Recap Transaction Window:

Src	Date	ID#	Account	Debit	Credit	Job
CD	1/06/2006		A-Z Stationery Supplies			
		108	1-1110 General Cheque Account		\$50.00	
		108	6-6200 Kitchen Supplies	\$50.00		

The golden rules of accounting

Increases do not necessarily equal decreases

In the previous example you'll notice that the Kitchen Supplies expense account increases by \$50, while the cheque account decreases by \$50. However, with some transactions there could be two decreases or two increases, or even unequal increases and decreases.

For example, say you write a \$500 cheque to pay a supplier. As a result, the Accounts Payable liability account (which tracks how much you owe to suppliers) will decrease by \$500 (a debit) and your cheque account will also decrease by \$500 (a credit).

Pay from Account: 1-1110 General Cheque Account Balance: \$187,056.56

Supplier: Huston & Huston Packaging Cheque No.: 109
 Payee: Huston & Huston Packaging Date: 1/06/2006
 237 Mason Parade North Sydney NSW 2060 Australia Amount: \$500.00
 Five Hundred Dollars and 0 Cents
 Memo: Payment; Huston & Huston Packaging *Cleanwater Pty Ltd*

Purchase #	Status	Date	Amount	Discount	Total Owed	Amount Applied
00000013	Open	1/03/2005				\$500.00

Total Applied: \$500.00
 Finance Charge: \$0.00
 Total Paid: \$500.00
 Out of Balance: \$0.00

Include Closed Purchases
 Already Printed

Help F1 Print Journal Register OK Cancel



Recap Transaction in Pay Bills

Src	Date	ID#	Account	Debit	Credit	Job
CD	1/06/2006		Payment; Huston & Huston Packaging			
		109	1-1110 General Cheque Account		\$500.00	
		109	2-2000 Trade Creditors	\$500.00		

Help F1 OK

The golden rules of accounting

To further illustrate the point, assume you're making a loan repayment of \$1,000, of which \$250 is an interest repayment. This would normally be entered as a "Spend Money" transaction as shown below.

Pay from Account: 1-1110 General Cheque Account Balance: \$187,056.56
 Tax Inclusive

Card: ABC Bank Cheque No.: 110
 Payee: ABC Bank Date: 1/06/2006 Amount: \$1,000.00
 One Thousand Dollars and 0 Cents
 Memo: ABC Bank - Loan Repayment Clearwater Pty Ltd

Acct #	Name	Amount	Job	Memo	Tax
2-2100	Bank Loans	\$750.00			N-T
6-1135	Interest	\$250.00			N-T

Total Allocated: \$1,000.00
 Tax: \$0.00
 Total Paid: \$1,000.00
 Out of Balance: \$0.00

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Buttons: Help F1, Print, Journal, Register, OK, Cancel

In this case, your cheque account will decrease by \$1,000 (a credit), the Bank Loans liability account, which tracks the principal repayments, will decrease by \$750 (a debit) and the Interest expense account will increase by \$250 (a debit). The debits still equal the credits, but the decreases are greater than the increases, and that's OK.

Recap Transaction in Spend Money

Src	Date	ID#	Account	Debit	Credit	Job
CD	1/06/2006		ABC Bank - Loan Repayment			
		110	1-1110 General Cheque Account		\$1,000.00	
		110	2-2100 Bank Loans	\$750.00		
		110	6-1135 Interest	\$250.00		

Buttons: Help F1, OK

Assets - Liabilities = Equity

This is what's commonly known as the accounting equation. It basically says that what you own less what you owe is what you're really worth. The Balance Sheet follows this rule, and we'll cover that report in detail later.

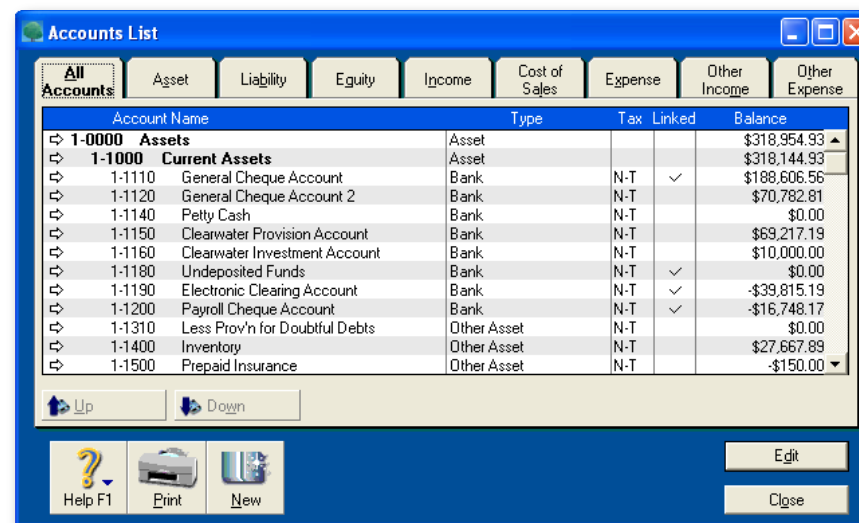
The Accounts List

The Accounts List, or Chart of Accounts, is a list of categories into which all your accounting transactions will be recorded.

In MYOB software each account is defined by a five digit number (eg 1-1000) and an account name. The one-digit prefix designates what type of account it is (and where it will be displayed on your financial statements) and it's followed by a four-digit main account number.

<i>Account number</i>	<i>Account type</i>
1-xxxx	Assets
2-xxxx	Liabilities
3-xxxx	Equity
4-xxxx	Income
5-xxxx	Cost of Sales
6-xxxx	Expenses
8-xxxx	Other Income
9-xxxx	Other Expenses

Here is an example of what the Accounts List could look like in your MYOB software. You have complete control over your account numbers, names and headers.



Account types

Let's drill down on how each account type in the Accounts List actually relates to your business.

Assets

An asset is anything you own in your business. They are the things in your office, your computers, your vehicles, the amounts owed by customers and your cash on hand. Everything you own is considered an asset of the business. Assets are used to generate revenue and purchase other assets. For example, when you buy a new computer, you use one asset (cash) in exchange for another asset (equipment).

Liabilities

Your liabilities are the things you owe, like GST collected on sales but not yet paid to the ATO, or loans payable to your bank. Another example are your credit cards, the money you owe to your credit card company is considered a liability on your books. Liabilities represent claims against your assets.

Equity

The difference between the value of your assets and the total of your liabilities is the value of your company. As the Accounting Equation states: $\text{Assets} - \text{Liabilities} = \text{Equity}$. Depending on the type of taxable entity you created when you first formed your company, the Equity section of your Accounts List and Balance Sheet may have another name.

Income

The income of your company is the total amount of proceeds generated for providing goods and services to your customers. This is typically the total amount of the invoices you generated for your customers.

Cost of Sales

Cost of Sales refers to the total value of the goods and services that were sold to your customers. Typically, this refers to items-based businesses that buy stock for resale or a manufacturer who builds items for resale.

Deduct the cost of sales from your total income and you'll know what your gross profit is.

Expenses

Expenses are the costs you incur to run your business, other than the actual cost of purchasing or building items for resale. Expenses include fixed costs (independent of how much business activity you have, like rent) and variable costs (directly related to how much business activity you have, like electricity).

T accounts and double-entry accounting

Double-entry accounting means that every transaction has at least one debit and one corresponding credit. The total debits always equal the total credits.

A T account, like the one shown here, is a graphical representation of all the debits and credits that have been posted to the account during the period.

All debit amounts posted to an account appear on the left, and all credits on the right. At the end of each month, the closing balance of each account is calculated and recorded as shown, and the balance is then transferred to the relevant financial reports.

Chequebook (1-1100)

1 Sept.	Opening balance	1,000	4 Sept.	Payment (credit)	200
2	Deposit (debit)	100	5	Payment (credit)	100
15	Deposit (debit)	200	18	Payment (credit)	100
27	Deposit (debit)	200	30	Closing balance	<u>1,100</u>
		<u>1,500</u>			<u>1,500</u>
1 Oct.	Opening balance	1,100			

While you'll never encounter T accounts in your MYOB software, it's worth spending a moment on them, as they clearly illustrate how double-entry accounting works.

T accounts and double-entry accounting

Example — ABC Pty Ltd

Assume that on 1 June you started a business called ABC Pty Ltd. The business's financial year runs from 1 July to 30 June.

During the month you performed the following transactions:

June transactions

- 1 You invest \$5,000 cash into the business.
- 2 You buy a desk and pay \$250 cash.
- 3 You buy computer supplies for \$100 with your business credit card.
- 4 You buy 10 Widgets for stock at \$150 each and pay COD.
- 5 You sell 4 Widgets from stock for \$250 each on Net 7 terms.
- 6 You pay your monthly rent of \$800 by cheque.
- 7 You pay your credit card company for your computer supplies.
- 8 Your customer pays for the Widgets they purchased.
- 9 You sell 3 Widgets for \$300 each, in cash.
- 10 You buy 10 Widgets for stock at \$150 each and pay COD.
- 11 You sell 3 widgets for \$350 each and take a \$500 deposit.

To see where all the debits and credits go for each transaction, let's post them to T accounts — remember that each transaction must have at least one debit and one credit. See if you can follow where each transaction's postings go (To keep it simple, we've ignored GST):

<i>Cash (1-xxxx)</i>		<i>DR</i>	<i>CR</i>		
1	Owner's Investment	5,000	2	Furniture and Fixtures	250
8	Debtors	1,000	4	Stock	1,500
9	Sales	900	6	Rent	800
11	Sales	500	7	Credit Card	100
			10	Stock	1,500

<i>Debtors (1-xxxx)</i>		<i>DR</i>	<i>CR</i>		
5	Sales	1,000	8	Cash	1,000
11	Sales	550			

<i>Stock (1-xxxx)</i>		<i>DR</i>	<i>CR</i>		
4	Cash	1,500	5	Cost of Sales	600
10	Cash	1,500	9	Cost of Sales	450
			11	Cost of Sales	450

<i>Furniture and Fixtures (1-xxxx)</i>		<i>DR</i>	<i>CR</i>		
2	Cash	250			

<i>Credit Card (2-xxxx)</i>		<i>DR</i>	<i>CR</i>		
7	Credit Card	100	3	Office Expenses	100

<i>Owner's Investment (3-xxxx)</i>		<i>DR</i>	<i>CR</i>		
			1	Cash	5,000

<i>Sales (4-xxxx)</i>		<i>DR</i>	<i>CR</i>		
			5	Debtors	1,000
			9	Cash	900
			11	Cash	500
			11	Debtors	550

<i>Cost of Sales (5-xxxx)</i>		<i>DR</i>	<i>CR</i>		
5	Stock	600			
9	Stock	450			
11	Stock	450			

<i>Office Expenses (6-xxxx)</i>		<i>DR</i>	<i>CR</i>		
3	Credit Card	100			

<i>Rent (6-xxxx)</i>		<i>DR</i>	<i>CR</i>		
6	Cash	800			

Financial statements

The primary financial statements of any business include the Profit and Loss Statement and the Balance Sheet. Together, they represent the total financial picture of your business. They must be reviewed as a set because collectively they tell you about your business, both in the short term and the long term.

Remember those T accounts? After working out the closing balances of each T account in our ABC Pty Ltd example, we're ready to transfer those final amounts to the appropriate reports.

The Profit and Loss Statement

[Income - Cost of Sales = Gross Profit] - Expenses = Net Profit

The Profit and Loss Statement is one of the primary financial statements. It reflects the total income generated, less the cost of the items that were sold (which equals your Gross Profit), less any other operating expenses (which equals your Net Profit or Loss).

The Profit and Loss Statement's results reflect the performance of your business within a specified 'period of time'. In our example below, the Profit and Loss Statement is showing ABC's performance for the month of June:

ABC Pty Ltd - Profit and Loss Statement for the month ended 30 June

<i>Income</i>	\$
Sales	2,950
<i>less Cost of Sales</i>	<u>(1,500)</u>
Gross Profit	<u>1,450</u>
<i>less Expenses</i>	
Office Expense	100
Rent	<u>800</u>
Total Expenses	<u>900</u>
Net Profit	<u>550</u>

ABC Pty Ltd has made a net profit of \$550. This represents the net increase in the value of the business that has occurred during the current month. Just keep that in mind, we'll come back to it later.

Financial statements

The Balance Sheet

Assets - Liabilities = Net Assets = Equity

The Balance Sheet is another primary financial statement. It reflects your total assets, less total liabilities and the difference, or equity. The Balance Sheet reflects the financial position of your business as at a 'point in time'. In our example below, the Balance Sheet is showing ABC Pty Ltd's financial position as at 30 June.

ABC Pty Ltd - *Balance Sheet as at 30 June*

Assets	\$
Cash	3,250
Debtors	550
Furniture and Fixtures	250
Stock	1,500
Total Assets	<u>5,550</u>
less Liabilities	
Credit Card	<u>0</u>
Net Assets	<u>5,550</u>
Equity	
Owners Investment	5,000
Current Year Earnings	550
Retained Earnings	<u>0</u>
Total Equity	<u>5,550</u>

The Equity section of the Balance Sheet includes a special account called "Current Year Earnings". This account represents the financial year to date net income or loss of your business, which as the Profit and Loss Statement shows, is currently \$550.

At the start of the next financial year the balance of the Current Year Earnings account is transferred to another special account called Retained Earnings. The life to date history of profit and losses for your business is recorded in this account.

In our example, ABC Pty Ltd is brand new, so there are no retained earnings, just current year earnings. On 1 July, the Current Year Earnings account will be \$0 and the Retained Earnings account will be \$550.

Want to know more?

In this guide we've given you a quick overview of the bookkeeping process, from recording individual transactions right through to creating the financial reports at the end of the month or year. Of course, there are lots of other steps involved in the recordkeeping process.

To get a good understanding of what's involved, MYOB Training regularly runs Certificate in MYOB Bookkeeping courses that give you an in-depth introduction to the bookkeeping fundamentals, and it suits those with no bookkeeping or MYOB software experience.

There's also an Advanced Certificate in MYOB Bookkeeping course that takes you right through to preparing the BAS, helps you understand and analyse the relevant tax reports, gives you an overview of the necessary payroll and end-of-financial-year tasks, and much more.

These courses are run in a number of locations around Australia. To find out when they're being held near you, visit www.myob.com.au/training or call **1300 555 151**.

Terminology

Accounts List

(Chart of Accounts): A list of categories or accounts where transactions are recorded.

Asset:

The things a company owns, seen on the Balance Sheet and represented as 1-xxxx accounts in your Chart of Accounts.

Balance Sheet:

The primary financial statement that shows detailed assets, liabilities and equity at a point in time.

Cost of Sales (Cost of Goods Sold):

Represents the cost of items or services sold to customers. These costs are normally kept in the Stock asset account (1-xxxx) until they are sold. Then they are passed over to the Cost of Sales (5-xxxx) account.

Credit:

A credit is one "side" of a transaction. In a T account it's represented or posted to the right-hand side of the account.

Current Year Earnings:

This account represents the year to date earnings, which have not yet been transferred to the Retained Earnings account.

Debit:

A debit is one "side" of a transaction. In a T account it's represented or posted to the left-hand side of the account.

Double-entry accounting:

The principle that every transaction is comprised of at least two entries, a debit and a credit. MYOB products follow this double-entry accounting convention.

Equity (Capital):

The owner's interest in the business, which is the total assets minus the total liabilities of a company, seen on the Balance Sheet and represented in the 3-xxxx accounts in your Accounts List.

Expenses:

Costs incurred in the business, seen on the Profit and Loss Statement and represented in your Accounts List as 6-xxxx accounts.

General Ledger:

An accounting record where all of your accounts are maintained. In MYOB products, when you enter any transaction, the General Ledger accounts are automatically updated.

Gross Profit:

Represents the income from sales of stock or services, less the cost of sales, but does not include overhead expenses.

Terminology

Journals:

With paper-based bookkeeping, a journal is a book or card where each type of transaction is recorded, for example the Sales journal records all income transactions. MYOB products have a number of journals, including General, Disbursements, Receipts, Sales, Purchases and Inventory.

Liability:

The things a company owes in cash or other resources, represented as 2-xxxx in your Accounts List. These are claims against your assets.

Net Profit/Loss:

Total income minus total expenses. The bottom line!

Operating Profit:

The profit before "Other Income" and "Other Expenses" are taken into account.

Overhead Expenses:

Represents the expenses of a business independent of how much revenue is generated. Can also be considered fixed costs — things like rent, salaries, and utilities.

Profit and Loss Statement: The primary financial statement that shows detailed revenues and expenses for a period of time.

Retained Earnings:

Represents the cumulative net income or loss of a business since its inception. When you perform the "Start a New Year" process in your MYOB software, the program will automatically transfer your year-end income or loss (Current Year's Earnings) to this account. This is called a closing entry.

Start a New Year:

The process in MYOB products that closes a financial year, transfers your Current Year's Earnings to Retained Earnings and prepares the accounts for a new financial year. All Income and Expense accounts are reduced to zero to start the new year.

Subsidiary Ledgers:

A record of the individual customer and supplier balances. The totals of each ledger must equal the amount of the Trade Debtors and Trade Creditors accounts.

Trade Creditors:

Money or other obligations owed to creditors for services and materials, a Liability on the Balance Sheet.

Trade Debtors:

Money or other obligations due for services rendered or items sold on terms, an Asset on the Balance Sheet.

Trial Balance:

A list of all your General Ledger accounts that shows whether their current balances are in debit or credit. The total of the debit balances in this report should equal the total of the credit balances.