

Yes, QuickBooks® Is Accounting!

The QuickBooks® Users' Guide
To Basic Accounting Concepts

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Accounting Made Simple

**Accounting
Made
Simple**



Accounting...Payroll...Support...Training



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Yes, this is Accounting!

Introduction

Today, QuickBooks® helps us with accounting by streamlining or eliminating repetitive tasks. Electronic sorting and matching of data help our data to meet the criteria of the *matching principle*. *Consistency* is maintained by automation or memorization of details. QuickBooks® can even change reports to *cash or accrual basis* with the touch of a button eliminating hours of detailed analysis.

So if software can “do our accounting for us,” why do we need to know about accounting? Consider a more familiar example: Just like your VCR can play, record or even act as a clock; if you don’t understand how to tell it what you want, you may not get the results you expect. Your desire to eliminate the flashing 12:00 determines how quickly you will learn to program your new machine.

Similarly, your commitment to manage your business with QuickBooks® will urge you to learn some correct accounting procedures. QuickBooks® will do much of the work for you, but a foundation of terminology or classifications will prove invaluable when you encounter unfamiliar territory.

These worksheets are designed to be used as a reference to help select appropriate account types, treatments and as general guidelines. This is not meant to replace your accountant or tax preparer. If you have specific concerns not contained here, I urge you to seek the advice of a professional.

Happy Accounting!

Accounting Made Simple, LLC
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Matching Principle

The matching principle of accounting states that expenses should be recorded in the same period as the revenue that created those expenses. Put another way, expenses should be recorded in the same period as the revenue that those expenses generated. This helps you, the reader of financial statements to understand the true profitability of your business or specific project. This is best achieved by using accrual-basis accounting.

Accrual vs. Cash-Basis Accounting

In cash-basis accounting, income is recorded when cash is received and expenses are recorded cash is paid. Accounts receivable and accounts payable are not used in cash-basis accounting. Accrual-basis accounting means that you record income when it is *earned* and expenses when they are *incurred*. The accrual basis is a more accurate tool in management of your business, and should be used if at all possible.

In QuickBooks® reports can be produced in cash or accrual-basis at any time. If you are a cash-basis tax payer, this allows you to manage your finances on the accrual-basis but view your cash-basis net income at any time.

Consistency

One of the hallmarks of correct accounting is the consistency and reliability of the information. Budgeting, financial forecasting, and many other types of financial analyses rely on unvarying accounting information to be useful. Not only does the information need to be consistent within each account and from day to day or month to month, but also year after year.

The backbone of your accounting system (and QuickBooks® file) is the chart of accounts. Immediately QuickBooks® will want to know what type of account you wish to create. Following are some examples of typical account categories and their correlations in QuickBooks®.

Account Categories

Balance Sheet Accounts

Balance sheet The balance sheet is the financial statement that shows a “snapshot” of where the company stands at a single point in time. It shows your position in assets, liabilities and equity currently, or for the date you choose.

Assets

Assets are the resources available to your business to generate revenue. They don’t necessarily have to be 100% debt free (equipment collateralizing a loan) to be considered owned by the business. They also don’t have to be in use, just available for your company to use (vacant land or a currently idle workstation).

Current assets are said to be more *liquid* than long-term assets. Liquidity is a measure of how quickly an asset can be turned into cash. Current or short-term assets are expected to be turned into cash within one (1) year. All the assets in the Current Assets section of the Balance Sheet have *high liquidity*.

Current or short-term assets	
<u>Accounting type</u>	<u>QuickBooks® type</u>
Checking	Bank
Savings accounts	Bank
Accounts receivable	Accounts Receivable
Inventory	Other Current Asset
Employee Advances	Other Current Asset
Prepaid expenses	Other Current Asset
Portfolio investments	Other Current Asset

Long-term assets are expected to last for more than one (1) year. They are not as easily turned into cash as short term assets. The assets in the Long-term section of the Balance Sheet have *low liquidity*. Some long term assets can be intangible or intellectual property as seen below:

Contra accounts are *negative* asset accounts indicated here in (parentheses). They are used to record a reduction in the value of the assets. Examples: allowance for bad debts reduces the value of accounts receivable, or accumulated depreciation or amortization reduce the value of fixed assets.

Long-term assets:

<u>Accounting type</u>	<u>QuickBooks® type</u>
Tangible property	
Land	Fixed Assets
Buildings	Fixed Assets
Equipment and vehicles	Fixed Assets
(Accumulated Depreciation)	Fixed Assets
Long-term receivables	Fixed Assets
Utility Deposits	Other Assets
Long-term investments	Other Assets

Intangible property	
Copyrights	Fixed Assets
Patents	Fixed Assets
Franchises	Fixed Assets
Goodwill	Fixed Assets
(Accumulated Amortization)	Fixed Assets

Remember: Contra account balances should appear negative on financial statements.

Liabilities

Liabilities are debts or claims against the assets of a company. For example, they are created by buying supplies and materials “on account” or from withholding taxes from employee paychecks. Borrowing money from the bank or a line of credit also creates a liability for your company. Like assets, liabilities are divided into short-term and long-term, based on when they are due.

Short-term liabilities are debts that come due within one year. Also called current liabilities, they are expected to be paid in the current accounting period.

Current or short-term liabilities:

<u>Accounting type</u>	<u>QuickBooks® type</u>
Accounts payable	Accounts Payable
Credit card payable	Credit Card
Line of Credit	Other Current liability
Short-term loans	Other Current liability
Taxes payable	Other Current liability
Insurance withholding	Other Current liability

Long-term liabilities are debts that do not come due within one year. Some liabilities for leases should be recorded. For specific guidance, consult your accountant.

Long-term liabilities:

<u>Accounting type</u>	<u>QuickBooks® type</u>
Vehicle loan	Long-term liability
Mortgage payable	Long-term liability
Lease payable	Long-term liability
Notes payable to owners	Long-term liability
Small business loan	Long-term liability

Equity

Equity is what’s left over after subtracting liabilities from assets. Each owner or partner may have a set of equity accounts depending on your business structure. In essence, it is the remainder for the owners of the enterprise.

Paid-in capital or capital contribution is the amount that has been directly invested into the business by an owner or partner for an ownership interest. A corporation can have various **Capital stock** accounts to record what shareholders pay for the stock of the company.

Retained earnings is the cumulative total of all profits (and losses) earned by the company since its inception minus draws or dividends paid. Each owner or partner can have a separate account. The balance of each owner/partner’s retained earnings account (plus investment) relative to the total represents his ownership interest in the company.

Contra Equity Accounts: Distributions, drawings, and dividends are contra accounts, similar to contra accounts we saw in the asset section; again illustrated in (parentheses).

Drawings or distributions are cash amounts taken out by an owner, partner or shareholder from the business profits. Large corporations may pay **Dividends** to their shareholders to distribute earnings to their investors. Keep in mind; these are permanent distributions of the profits, not just loans or repayments. **Owner’s distribution accounts require a manual adjustment in QuickBooks® each year.**

Equity Accounts:

<u>Accounting type</u>	<u>QuickBooks® type</u>
Common stock	Equity
Paid-in capital	Equity
Partner contributions	Equity
Retained earnings	Equity
(Owner's distributions)	Equity
(Partner drawing)	Equity
*Opening bal equity	Equity

***Opening bal equity**” is a special account QuickBooks® creates while setting up your company file. It is designed to hold your beginning balances until you are done with your initial setup. **Once your company is operating, the balance should remain -0-, and the account can be made inactive.**

This account can appear if you fail to give QuickBooks® all the accounting information necessary to complete a transaction. If you have balances in “Opening Bal Equity” it is a sign that your accounting is not complete. Again, for the best assistance, consult you accountant to correct this account.

Profit & Loss Accounts

Profit & loss or income statement The income statement shows what happened during a *period* of time (i.e., month, quarter, year). It tells you what revenue you earned and what expenses you incurred during that period.

Remember, an income statement records *earned* revenue and *incurred* expenses (accrual basis) that generated that revenue (matching principle). A cash basis profit and loss will show income *received* and expenses *paid*.

Revenue or Income Accounts are used to record *earned* income. The income is not necessarily collected yet, just earned. This means that you have provided the product or service for which you are being paid (now or later). You can have dozens of sales, fee or service income accounts or only one.

Revenue accounts:

<u>Accounting type</u>	<u>QuickBooks® type</u>
Sales	Income
Fees	Income
Services provided	Income
Freight charges	Income
(Returns and allowances)	Income

Expenses are costs of doing business. Expense accounts are used to record *incurred* expenses. The expense is not necessarily paid yet, just incurred. This means that you have received the product or service for which you are paying (now or later). In many industries, expense accounts are divided into cost of goods sold (COGS) accounts and general & administrative (G&A) accounts to better analyze direct and overhead costs.

Cost of goods sold expenses are directly related to the selling of your product or service. They can be attributed to a specific sale and become a permanent part of the final product. Examples: direct material, direct labor. Traditionally,

service businesses may not use cost of goods sold accounts

General & administrative expenses cannot be attributed to a specific sale and do not become a permanent part of the final product. G&A are the expenses necessary to run the business, but not related to specific sales. Examples: administrative expenses (office workers), office supplies, general labor (maintenance, janitorial), insurance, taxes, etc. Sometimes G&A expenses are divided into “selling expenses” and “G&A expenses.” Selling expenses are advertising expenses and expenses like customer or community relations and trade show expenses. These preferences are often specific to your industry and help you to compare your company growth to similar businesses.

Expense Accounts:

<u>Accounting type</u>	<u>QuickBooks® type</u>
Cost of goods sold	Cost of Goods Sold
Direct material	Cost of Goods Sold
Direct labor	Cost of Goods Sold

General & administrative

Administrative wages	Expense
Office supplies	Expense
Utilities	Expense
Taxes	Expense
Insurance	Expense
Advertising	Expense
Depreciation expense	Expense

Other income and expenses appear in a section at the end of the income statement or profit and loss. These accounts are for income and expenses that are incidental to your business. Typically, they are either unusual or not part of your ordinary course of business. Examples might include rental income for excess warehouse space, finance charges or gains on the sale of assets.

Other income/expense				
<u>Accounting type</u>	<u>QuickBooks® type</u>		<u>Increase</u>	<u>Decrease</u>
Interest income	Other Income			
Gains on sale of assets	Other Income	Assets	Debit	Credit
Vending machine income	Other Income			
Sales tax allowance	Other Income	Liabilities	Credit	Debit
Casualty loss	Other Expense			
Investment losses	Other Expense	Equity	Credit	Debit

Journal Entries in QuickBooks®

Journal entries are VERY RARELY required in QuickBooks®. Although the software is making the journal entries behind the transaction screens (i.e., invoices, bank deposits, pay bills, etc . . .), you do not need to understand them to use QuickBooks®. If you are having trouble understanding how transactions are affecting your bookkeeping, this section can prove an invaluable diagnostic resource.

The most common use for journal entries in QuickBooks® is to record non-cash transactions, such as depreciation or amortization expenses. Another common use is to record equity transfers at the year end closing. For almost every other transaction we encourage you to use QuickBooks® transaction entry forms to provide you with the most complete information possible.

The Journal report will allow you to see the debits and credits of any transaction screen to help you determine if the transaction is correct.

Holding the Ctrl + Y keys simultaneously will create a transaction journal on the screen for the current transaction in QuickBooks®.

Most Frequently Asked Question:

How do debits and credits affect each of the account types?

Revenue	Credit	Debit
Expenses	Debit	Credit

Remember: Contra accounts work the opposite way.

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