



INTRO

Hello and welcome to the first module of the Business Lifecycles Elearning course, where we introduce you to how Financial Statements can help you to collect, analyse and use financial data about your business.

Financial statements allow you to monitor your current financial condition, diagnose problems and predict opportunities that will become available, and show how you can take advantage of these.

In this module, “basic accounting concepts”, we help you to make sense of the key words and ideas a financial statement uses.

We will introduce you to the following topics:

- ☐ The five areas of accounting
- ☐ Debits and credits
- ☐ And the 2 main types of accounting – cash and accrual.

BODY

So let's get started...

There are five areas of accounting: Income; Expenses; Assets; Liabilities; and lastly Equity and capital.

Let's explore these five areas briefly.

Income arrives when you sell things, and expenses are realised when you buy things. These are shown on your profit and loss statement.

Assets are things you own, and liabilities are what you owe, and these are shown on the balance sheet.

Lastly, equity and capital describe how much money you begin with, and map how this either grows or diminishes.

These five areas are always listed in your financial statements as either debits or credits.

But forget your bank statement, it's more complicated here.

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Please note that this is a training guide only and should neither replace competent advice, nor be taken, or relied upon as financial advice. Seek professional advice before making any decision that could affect your business.

So within your financial statement, we can represent the five categories as follows:-

- ☐ Income (CR)
- ☐ Expenses (DR)
- ☐ Assets (DR)
- ☐ Liabilities (CR)
- ☐ Equity (Capital) (CR)

Where:

Income increases owner's equity and therefore is a credit

An expense decreases owner's equity and therefore is a debit

An increase in assets is a debit and a decrease is a credit

An increase in liabilities is a credit and decrease is a debit

All transactions made within a business should be tracked in a journal, and represented as both a debit and credit entry, abbreviated as Dr and Cr respectively.

Now, connecting this back to the five areas: it is very important to note that your debit and credit journal ensures that your assets are always equal to the sum of your liabilities and your equity.

Here, every action has an equal and opposite reaction, and this is known as "double-entry bookkeeping"; so that for every debit transaction, there must be a corresponding credit transaction, and vice versa.

The golden rule is that **TOTAL DEBITS MUST EQUAL TOTAL CREDITS**.

Turning now to the two main types of accounting, cash and accrual.

CASH accounting is where all transactions are accounted for when you receive the money or when you pay the bill.

Here, accounting entries are made at the date cash is physically paid or received.

ACCRUALS accounting involves recording income when it is earned and accounting for expenditure when it is incurred.

Accounting entries are made at the date the income is earned or on which expenditure is incurred.

The accruals account approach is most desirable as it:

- ☐ Is more representative of your point-in-time financial position
- ☐ It shows all liabilities, allowing for proper financial assessment.
- ☐ It more accurately matches income with expenses, indicating "true profit", and measuring true performance

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- ☐ And lastly, the profit of a business is usually determined on an accruals basis rather than a purely cash basis.

OUTRO

So that's the end of the basic accounting concepts module.

We hope you can see that you don't need to be an accountant to get the basics.

Next up we take a look at how these are used in the profit and loss module.

TAKE HOMES

- ☐ Understanding the basics does not require you to be an accountant
- ☐ Speak to your accountant or advisor about how you can take advantage of your financial position
- ☐ Educate yourself

For further reading, online education, or to find out more, visit www.businesslifecycles.com

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