So, you want to learn Bookkeeping!

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Lesson 1

The Bookkeeping Language

In order to discuss your business with your accountant, bookkeeper, banker, or other business associates you need to understand the language. Think back to when you were first learning to read and write. Hopefully for you it's not as long ago as it is for me. You began learning your **ABC's**. After mastering your alphabet and doing a little off key singing, you moved on to learn to use these letters to make words. You then proceeded to learn to make sentences from words and then on to paragraphs, documents, and even term papers. This tutorial is going to use this same approach for introducing you into the world of bookkeeping.

Learning definitions and terminology is about as much fun as watching grass grow, but it is necessary to the understanding of bookkeeping. All I can say is hold your nose, take your medicine, and swallow. After completing the lesson, if you need to, take two aspirin and go to bed.

Your **ABC's** for this lesson are the terminology and definitions used in the Bookkeeping Language. No not ALL of them; just the ONES that you need for this tutorial and those that will enable you to PARTICIPATE and UNDERSTAND when you are discussing financial matters concerning your business. If you're anything at all like me, you like things simple. People also don't need to dazzle and impress me with their wealth of knowledge by using big words that I don't understand. I don't think I'm one that could dazzle you even if I wanted to. Some of the definitions and terminology you will be presented will have a formal and an informal definition. The formal definition is a definition you would find in an accounting textbook or formal course. The informal definition is my attempt to simplify. In addition, in instances where additional clarification is needed, I'll try to provide an example(s) that you can relate to that will help you attach this term to one of your many brain cells. If you were paying attention, you will have noticed that I did say **many**. Even though you don't know bookkeeping **yet**, I'm sure you're a smart gal or guy.

First, let's start with the **Major Categories** that are used to organize our financial information.

Assets
Formal Definition:The properties used in the operation or investment activities of a business.

Informal Definition:All the good stuff a business has (anything with value). The goodies.

Additional Explanation: The good stuff includes tangible and intangible stuff. Tangible stuff you can physically see and touch such as vehicles, equipment and buildings. Intangible stuff is like pieces of paper (sales invoices) representing loans to your customers where they promise to pay you later for your services or product. Examples of assets that many individuals have are cars, houses, boats, furniture, TV's, and appliances. Some examples of business type assets are cash, accounts receivable, notes receivable, inventory, land, and equipment.

Liabilities
Formal Definition:Claims by creditors to the property (assets) of a business until they are paid.

Informal Definition:Other's claims to the business's good stuff. Amounts the business owes to others.

Additional Explanation: Usually one of a business's biggest liabilities (hopefully they are not past due) is to suppliers where a business has bought goods and services and charged them. This is similar to us going out and buying a TV and charging it on our credit card. Our credit card bill is a liability. Another good personal example is a home mortgage. Very few people actually own their own home. The bank has a claim against the home which is called a mortgage. This mortgage is another example of a personal liability. Some examples of business liabilities are accounts payable, notes payable, and mortgages payable.

Owner's Equity also called Owner's Capital
Comment: Both terms may be used interchangeably. In my tutorial lessons, I may refer to both terms or just use one or the other.

Formal Definition:The owner's rights to the property (assets) of the business; also called proprietorship and net worth.

Informal Definition:What the business owes the owner. The good stuff left for the owner assuming all liabilities (amounts owed) have been paid.

Additional Explanation:Owner's Equity (Capital) represents the owner's claim to the good stuff (assets). Most people are familiar with the term equity because it is so often used with lenders wanting to loan individuals money based on their home equity. Home equity can be thought of as the amount of money an owner would receive if he/she sold their house and paid off any mortgage (loan) on the property.

Revenue (Income), Expenses, Investment, and Draws
Revenues, expenses, investment, and draws are sub categories of owner's equity (capital). Think of owner's equity as a mom named Capital with four children to keep up with (I know she's only got one clinging to her leg but she left Expense, Investment, and Draws at home). The kids are named Revenue, Expense, Investment, and Draws and each kid has one job that they are responsible for in order to earn their allowance. **Kid Revenue** is responsible for keeping track of increases in owner's equity (Ma Capital) and **Kid Expense** is responsible for keeping track of decreases in owner's equity (Ma Capital) resulting from business operations. **Kid Draws** has the job of keeping up with decreases in owner's equity (Ma Capital) resulting from owner withdrawals for living expenses and other personal expenses. **Kid Investment** has the job of keeping up with increases in owner's equity (Ma Capital) resulting from additional amounts invested in the business.

Revenue also called Income
Formal Definition:The gross increase in owner's equity (capital) resulting from the operations and other activities of the business.

Informal Definition:Amounts a business earns by selling services and products. Amounts billed to customers for services and/or products.

Additional Explanation:Individuals can best relate by thinking of revenue as their earnings/wages they receive from their job. Most business revenue results from selling their products and/or services.

Expense also called Cost
Formal Definition:Decrease in owner's equity (capital) resulting from the cost of goods, fixed assets, and services and supplies consumed in the operations of a business.

Informal Definition:The costs of doing business. The stuff we used and had to pay for or charge to run our business.

Additional Explanation:Some examples of personal expenses that most individuals are familiar with are utilities, phone, clothing, food, gasoline, and repairs. Some examples of business expenses are office supplies, salaries & wages, advertising, building rental, and utilities.

Owner's Investments
Formal Definition: Increase in owner's equity (capital) resulting from additional investments of cash and/or other property made by the owner.

Informal definition: Additional amounts, either cash or other property, that the owner puts in his business.

Additional Explanation:Although these amounts can be kept up with as a separate item, they are usually recorded directly in the Owner's Capital Account. In other words, immediately put into Ma Equity's purse.

Owner's Drawing
Formal Definition: Decrease in owner's equity (capital) resulting from withdrawals made by the owner.

Informal definition: Amounts the owner withdraws from his business for living and personal expenses.

Additional Explanation:The owner of a sole proprietorship does not normally receive a "formal" pay check from the business, but just like most of the rest of us needs money to pay for his house, car, utilities, and groceries. An owner's draw is used in order for the owner to receive money or other "goodies" from his business to take care of his personal bills.

OK you've now been served the meat or as I like to refer to them, "The Big Three and Equity's Kids", so get ready for the potatoes. Personal examples were used to help clarify the terms, but from here on out it's all business terminology and concepts. All the definitions in **red** in this lesson will receive additional attention in later lessons.

Types of Assets

Cash-Monetary items that are available to meet current obligations of the business. It includes bank deposits, currency & coins, checks, money orders, and traveler's checks.

Accounts Receivable-Business claims against the property of a customer arising from the sale of goods and/or services on account.

Notes Receivable-Formal written promises given by customers or others to pay definite sums of money to the business at specified times.

Inventory-Expenditures for items held for resale in the normal course of a business's operations.

Office Supplies-Expenditures for maintaining a supply of on hand supplies such as typewriter, copier, and computer paper, pens, pencils, and special forms.

Land-Expenditures for parcels of the earth. It includes building sites, yards, and parking areas.

Buildings-Expenditures for structures erected on land and used for the conduct of business.

Equipment-Expenditures for physical goods used in a business, such as machinery or furniture. Equipment is used in a business during the production of income.

Furniture includes items needed in a business office such as tables, desks, chairs, and cabinets.

Types Of Liabilities

Accounts Payable-Creditor's claims against the business's property arising from the business's purchase of goods and/or services on account.

Notes Payable-Formal written promises to pay definite sums of money owed at specified times.

Mortgage Payable-Notes payable which are secured by a lien on land, buildings, equipment, or other property of the borrower (your company).

Types of Revenue (Income)

Sale of Products-Amounts earned from the sale of merchandise.

Sale Of Services-Amounts earned from performing services.

Rental Income-Amounts earned from renting properties.

Interest Income-Amounts earned from investments.

Types of Expenses

Supplies-Expenditures for incidental materials needed in the conduct of business, such as office supplies.

Salaries-Expenditures for work performed by employees.

Payroll Taxes-Expenditures for taxes based on wages paid to employees.

Advertising-Promotional expenditures, such as newspapers, handbills, television, radio and mail.

Utilities-Expenditures for basic services needed to function in the modern world, such as water, sewer, gas, electricity and telephone. Most businesses track the amount spent for each type of utility service.

Building Rental-Expenditures paid to an owner of property (building) for use of the property. A rental agreement called a lease contains the terms.

Maintenance & Repairs-Expenditures paid to repair and or maintain buildings and/or equipment.

Other Terms Necessary for Understanding and Learning Bookkeeping

Accounting Equation-mathematical expression of the relationship of property and property rights. Also called the Balance Sheet Equation.

The equation may be expressed in three forms:

- Abbreviated or Simple Version:
  Property = Property Rights
- Expanded Version:
  Assets = Liabilities + Owner's Equity (Capital)
- Fully Expanded Version:
  Assets = Liabilities + Beginning Owner's Equity (Capital) + Additional Owner Investments + Revenues - Expenses - Draws

Transaction-Any event or condition that must be recorded in the books of a business because of its effect on the financial condition of the business, such as buying and selling. A business deal or agreement.

Single Entry-Type of "informal" accounting/bookkeeping system where a user of this system makes only **one entry** to enter a business financial transaction. It generally includes a daily summary of cash receipts and a monthly record of receipts and disbursements (worksheets).

Double Entry-Type of accounting/bookkeeping system that requires every transaction to be recorded in at least two places (accounts) using a debit and a credit. Every transaction is recorded in a "formal" journal as a debit entry in one account, and as a credit entry in another account. Periodically, usually monthly, the summarized balances from the journals are posted (transferred) to a formal business record called the general ledger.

Cash Method (Basis) of Accounting-method of accounting that recognizes revenues (earnings) in the period the cash is received and expenses in the period when the cash payments are made.

Accrual Method (Basis) of Accounting-method of accounting that records income in the period earned and records expenses and capital expenditures such as buildings, land, equipment, and vehicles in the period incurred.

Debit-

- An entry in the financial books of a firm that increases an asset, draw or an expense or an entry that decreases a liability, owner's equity (capital) or income.

- Also, an entry entered on the left side (column) of a journal or general ledger account.

Let's combine the two above definitions into one complete definition.
An entry (amount) entered on the left side (column) of a journal or general ledger account that increases an asset, draw or an expense or an entry that decreases a liability, owner's equity (capital) or revenue.

Credit-

- An entry in the financial books of a firm that increases a liability, owner's equity (capital) or revenue, or an entry that decreases an asset, draw, or an expense.
- Also, an entry entered on the right side (column) of a journal or general ledger account.

Let's combine the two above definitions into one complete definition.
An entry (amount) entered on the right side (column) of a journal or general ledger account that increases a liability, owner's equity (capital) or revenue, or an entry that decreases an asset, draw, or an expense.

Don't worry double entry, debits, and credits are discussed and explained in future lessons. I only wanted to introduce and make you aware of these terms because they are critical terms for understanding the double entry bookkeeping system.

Posting-Process of transferring balances from bookkeeping records called journals to a "final" bookkeeping record called the general ledger.

T-Account-a skeleton outline of an account which provides the same basic data as a formal ledger account. Used as a teaching aid.

Account-a separate record for each type of asset, liability, equity, revenue, and expense used to show the beginning balance and to record the increases and decreases for a period and the resulting ending balance at the end of a period.

Contra Account-an account which offsets and reduces or offsets the balance of another account.

- A contra-asset account has a credit balance and offsets and decreases the debit balance of the related asset account. An example account is Accumulated Depreciation which reduces the equipment account to arrive at the equipment's net value.
- A contra-liability account has a debit balance and offsets and decreases the credit balance of the related liability account. An example accounts is the bond discount account that reduces the bonds payable account to arrive at the bond's net value.

Balance Sheet Account-a type of account that is included in the Balance Sheet; namely the Assets, Liabilities, and permanent Equity Accounts.

Permanent or Real Account-another term used to refer to the balance sheet accounts.

Income Statement Account-a type of account that is included in the Income Statement; namely the Revenue and Expense Accounts.

Temporary Account-another term used to refer to the income statement accounts. The accounts are called temporary due to the fact that their balances are set to zero when the books are closed.

Closing the Books-process of transferring the balances from the temporary income statement accounts (revenues and expenses) to the permanent balance sheet equity account(s).

Profit-amount a business's revenues exceed (greater than) expenses. In other words, the amounts we earned were greater than our expenses.

Loss-amount a business's expenses exceed (greater than) revenues. In other words, we earned less than we spent.

Property-is another term for assets. In future lessons the term property and assets both mean the same thing-all the good stuff a business has.

Current Asset-cash and other assets normally expected to be converted to cash or used up usually within a year.

Current Liability-amounts owed (liabilities) that need to be paid or settled usually within a year.

Working Capital-net difference between current assets and current liabilities.
Working Capital = Current Assets - Current Liabilities

Major Types of Accounting & Bookkeeping Records and Documents

General Ledger-A book containing the accounts and balances for all of a business's assets, liabilities, equity, revenue, and expense accounts.

Chart Of Accounts-A coded listing of all the accounts in the general ledger.

Journals-A preliminary record where business transactions are first entered into the accounting system. The journal is commonly referred to as the book of original entry.

Specialized Journals-Journals used to initially record special types of transactions such as sales, cash disbursements, and cash receipts in their own journal.

Trial Balance-A worksheet listing of all the accounts appearing in the general ledger with the dollar amount of the debit or credit balance of each. Used to make sure the books are "in balance" -total debits and credits are equal.

Subsidiary Ledgers-A separate record set up to record the individual items relating to a single general ledger account (control account). Examples include an accounts receivable and accounts payable ledger.

Worksheets-Forms which are used to summarize all the information necessary to complete the end-of-period financial reports and prepare other financial analysis.

Invoice-a business document showing the names and addresses of the buyer and the seller; the date and terms of the sale; the description, quantity, unit price, and total price of goods purchased or sold and the method of delivery.
Selling business refers to this document as a Sales Invoice.
Buying business refers to this document as a Supplier Invoice.

Receiving Report-A document originated by the buying business listing the quantities and condition of the goods and/or services received from a supplier.

Sales Order-A documented originated by the seller listing the goods and/or services ordered by a customer and other information such as prices and delivery dates.

Purchase Order-A document originated by the purchaser (buyer) requesting the supplier to ship goods or perform services.

Check Book-Formal record of all checks written, deposits, bank charges, and miscellaneous charges and credits.

Check-A written order directing a bank to pay cash from the account of the writer (drawer) of the check.

Bank Reconciliation-The process of bringing the checkbook and bank statement balances into agreement.

Bank Statement-A copy of the bank's record of the business's account showing the balance of the account at the beginning of the month, the deposits and withdrawals (mostly checks) made during the month, service charges, and the balances at the end of the month.

Financial Statements-Accounting reports prepared periodically to inform the owner, creditors, and other interested parties as to the financial condition and operating results of the business. The four basic financial statements are:

Balance Sheet-The financial statement which shows the amount and nature of business assets, liabilities, and owner's equity (capital) as of a specific point in time. It is also known as a Statement Of Financial Position or a Statement Of Financial Condition.

Income Statement-The financial statement that summarizes revenues and expenses for a specific period of time, usually a month or a year. This statement is also called a Profit and Loss Statement or an Operating Statement.

Capital Statement-The financial report that summarizes all the changes in owner's equity (capital) that occurred during a specific period.

Statement of Changes in Financial Position-The financial statement that reports the sources and uses of cash or working capital for a specific period of time, normally a year.

The definitions and terminology presented in this lesson are by no means all the terminology that is used in the field of accounting, but are some of the major terms that you might encounter and are needed to complete this tutorial. If curious or wanting to know the meaning of other financial or accounting terms check out these sites that provide bookkeeping and accounting definitions.

Let's see if you need to take two aspirin and go to bed. Nothing difficult here, just a few matching and anagram (jumbled word) exercises that review bookkeeping terms.

Matching Terms Quiz 1
Matching Terms Quiz 2
Matching Terms Quiz 3
Matching Terms Quiz 4
Matching Terms Quiz 5
Anagram Terms Quiz

Don't worry if you don't understand every definition that has been presented in this lesson. I tossed you in the water to get you wet, but I'm not going to let you drown. Swimming instructions will be provided in other lessons and your lifeguard (me) will be watching out for you. The lessons that follow will clear up some of the more complex definitions and concepts with examples and additional discussions. All the definitions in **red** in this lesson will receive additional attention.

OK, that's enough of having fun watching the grass grow, let's move on.

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