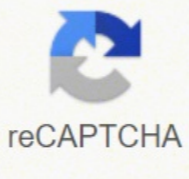




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The Basic Accounting Equation can be expressed in 3-ways (using algebra)

$$\begin{aligned} \text{Assets} &= \text{Liabilities} + \text{Stockholders Equity} \\ \text{Liabilities} &= \text{Assets} - \text{Stockholders Equity} \\ \text{Stockholders Equity} &= \text{Assets} - \text{Liabilities} \end{aligned}$$

Example using algebra to rearrange the accounting equation:
(text book type problems to test your understanding)

ORTIZ CORPORATION
Cash-Basis Income Statement
For the Month Ending April 30, 20X5

Revenues	
Services to customers	\$25,833.68
Expenses	
Payroll	\$5,078.76
Rent	300.00
Server	1,915.21
Administrative	<u>2,807.01</u>
Total expenses	10,100.98
Cash Basis Income	<u>\$15,732.70</u>

Internal Use Only: Cash Basis -- Not prepared under generally accepted accounting principles!

Home Store, Inc.
Income Statement
for the Year Ended December 31, 2012

Sales	\$ 900,000
Cost of goods sold	<u>546,000</u>
Gross margin	\$ 354,000
Selling and administrative expenses	120,000
Depreciation expense	24,000
Operating income	<u>\$ 210,000</u>
Interest expense	15,000
Loss on sale of equipment	6,000
Income before taxes	<u>\$ 189,000</u>
Income tax expense	65,000
Net income	<u>\$ 124,000</u>

Home Store, Inc.
Balance Sheet
December 31, 2011 and December 31, 2012

	2012	2011	Change in Assets, Liabilities, and Equity from 2011 to 2012 Increase (decrease)
Assets			
Current assets			
Cash	\$ 32,000	\$130,000	\$ (98,000)
Accounts receivable	85,000	25,000	60,000
Merchandise inventory	126,000	60,000	66,000
Prepaid expenses	18,000	20,000	(2,000)
Noncurrent assets			
Property, plant, and equipment	956,000	910,000	46,000
Accumulated depreciation	(299,000)	(285,000)	(14,000)
Long-term investments	70,000	58,000	12,000
Total assets	<u>\$988,000</u>	<u>\$918,000</u>	
Liabilities and owners' equity			
Current liabilities			
Accounts payable	\$ 16,000	\$ 15,000	1,000
Income tax payable	39,000	48,000	(9,000)
Noncurrent liabilities			
Bonds payable	87,000	105,000	(18,000)
Owners' equity			
Common stock	414,000	410,000	4,000
Retained earnings	432,000	340,000	92,000
Total liabilities and owners' equity	<u>\$988,000</u>	<u>\$918,000</u>	

[Company Name]		
Balance Sheet		
Assets		
Current assets:		
Cash	2,450.00	3,240.00
Investments	4,347.00	4,240.00
Receivables	4,347.00	5,240.00
Accounts receivable	3,450.00	4,240.00
Prepaid expenses	1,451.00	2,140.00
Other	-	-
Total current assets	19,485.00	20,860.00
Fixed assets:		
Property and equipment	456.00	540.00
Leasehold improvements	1,390.00	1,180.00
Equipment and investments	-	-
Less accumulated depreciation	-	-
Total fixed assets	2,846.00	2,760.00
Other assets:		
Goodwill	4,300.00	4,900.00
Total other assets	4,300.00	4,900.00
Total assets	26,631.00	28,041.00
Liabilities and owner's equity		
Current liabilities:		
Accounts payable	4,300.00	4,240.00
Accrued wages	2,300.00	3,470.00
Accrued compensation	480.00	580.00
Income tax payable	-	-
Unearned revenue	-	-
Other	-	-
Total current liabilities	7,080.00	8,290.00
Long-term liabilities:		
Mortgage payable	2,280.00	4,240.00
Total long-term liabilities	2,280.00	4,240.00
Owner's equity:		
Investment capital	12,330.00	13,450.00
Accumulated retained earnings	12,850.00	11,460.00
Total owner's equity	25,180.00	24,910.00

Accruals Ratio

\$ in Millions	2020	2019
Balance Sheet		
Total Assets	\$82,261	\$74,264
Cash and marketable securities	-\$7,347	-\$9,022
Operating assets	\$74,914	\$65,242
Total Liabilities	\$41,297	\$33,270
Long-term debt	-\$4,280	-\$4,872
Short-term debt	-\$16,132	-\$11,846
Operating liabilities	\$20,885	\$16,552
Net Operating Assets (NOA)	\$54,029	\$48,690
Balance sheet accruals	\$5,339	
Cash flow statement		
Net income	\$7,967	
Operating cash flow	\$9,607	
Investing cash flow	-\$10,027	
Cash flow accruals	\$8,387	
Balance sheet approach	\$5,339	10.40%
	\$51,360	
Cash flow statement approach	\$8,387	16.33%
	\$51,360	

How to tell if cash or accrual basis. Cash basis vs accrual basis balance sheet. Which is better cash or accrual basis.

A disadvantage of accrual accounting is the additional bookkeeping. Example: The following example illustrates the timing and simplicity of cash accounting for a small business. And under cash-basis accounting a business doesn't have to pay taxes on cash it hasn't collected. Accrual accounting bookkeeping is uncoupled from when the money involved actually changes hands, thereby smoothing the impact of timing and yielding a more accurate overall picture of a business' operations. Cash-basis accounting is the easier of the two methods because, as its name implies, all bookkeeping simply follows the cash. Many businesses prefer to use cash accounting because the financial statements closely reflect their cash position, which is especially important for small business owners. Accrual-Basis Accounting: What's the Difference? Example: Using the same example above, the following chart shows ITCHY's financial results using the accrual method. Start-ups and entrepreneurs using cash accounting for simplicity often need to change their accounting policies in later stages as they begin to invest in long-term assets or contemplate initial public offerings. It also requires more frequent closing of the company's books. Companies usually use the cash method of accounting because they deal mostly with cash transactions. The company records revenue when customer payments are received. Companies that use the accrual method of accounting implement procedures to reconcile bank accounts and keep tabs on short term cash flow. ITCHY records \$50 in expenses in each month, June-May. Both cash- and accrual-basis accounting can use double entry bookkeeping. Also, cash accounting is not accepted by GAAP, and any resulting financial statements are considered insufficient by most lenders and are prohibited for publicly traded companies. Notably, the cash method is more straightforward. Depending on a company's circumstances, it may be easy to choose which method is the best fit. Using Accounting Software to Streamline Your Accounting Process Practice Accounting software can automate functions, make workflows and processes more efficient, reduce errors and lower staff costs with both cash- and accrual-basis accounting. What are Recording Transactions? A few examples include: Companies that use the cash method of accounting won't have accounts receivable ledgers and need processes to stay on top of outstanding customer accounts. It also shows the swings in taxable income that can result from using this method. The main disadvantage of the cash basis is that financial results in any given period may look distorted. But only the accrual basis is accepted by Generally Accepted Accounting Principles (GAAP), which is a set of rules established by the Financial Accounting Standards Board (FASB). Under the cash basis, there is no need to account for customer sales made on credit (i.e. accounts receivable) until they pay. Those distortions can make planning and forecasting complicated. The single-entry system looks a little more like a personal bank account where amounts are credited or debited in one table or ledger. Businesses with less than \$25 million in gross receipts do have a choice. ITCHY pays income taxes on \$350 of income for 2020 and \$250 for 2021. The accrual basis of accounting is the gold standard because it gives a more accurate representation of a company's finances. Another disadvantage is that the accrual basis might obscure short term cash flow issues in a company that looks profitable on paper. ITCHY Inc., a tree-spraying company, provides a monthly insection-prevention spraying service for its customers. Cash-basis accounting is a simple way to easily see a company's cash status. GAAP compliant accrual accounting is required for companies of a certain size, with certain debt covenants or that are publicly traded. Conversely, businesses that extend credit to customers or use credit with their suppliers tend to find that accrual accounting gives a better picture of overall financial health. Key Differences, Advantages and Disadvantages The key difference between the cash and accrual methods relates to the timing of revenue and expenses: When they're received/paid and when they're earned/incurred. These two entries are equal and opposite. With accrual accounting, businesses can more easily keep track of credit transactions using an accounts receivable system, which shows the full transaction history of each customer. It can only be used with cash-basis accounting, not accrual accounting. Each transaction is entered in two accounts: debits and credits. Taxes are calculated on the resulting net income. Businesses that hold large amounts of inventory also benefit from accrual accounting. ITCHY records all \$1,200 of revenue in June. ITCHY evenly prorates the \$1,200 cash as \$100 of revenue for each of the obligated 12 sprays. The difference in timing ripples through the company's income statements and balance sheet, and subsequently affects its tax liability. The simplicity also makes bookkeeping easier and cheaper. Each method has advantages and disadvantages. ITCHY's income/(loss) is shown for each of the 12 months. The adage "timing is everything" captures the biggest difference between them. In accrual accounting, the five types of accounts—revenue, expense, asset, liability, and equity—are used to categorize transactions. Listing everything twice can help companies catch errors and prevent fraud, and it can be beneficial for auditing. Cash accounting reflects business transactions on a company's financial statements when the cash flows into or out of the business. An accounts payable system shows the transaction history between your company and a vendor or supplier. A summary of key differences between the two methods, as well as their advantages and disadvantages are in the chart below. They need safeguards over receipts and disbursements of cash so it's not lost or stolen. These companies must comply with GAAP and use the accrual basis of accounting for both financial reporting and tax purposes. ITCHY's income/(loss) for each of the 12 months is shown below. In general, the greater the lag in conversion to cash from sales, the stronger the argument for accrual-based accounting. And those benefits are especially useful for the more complex accrual method. For the most accurate and useful financial statements, accountants record transactions using double entry bookkeeping. It can also impact the policies and processes that a business needs to adopt. Choosing Between Cash- and Accrual-Basis Accounting For all publicly traded companies and most businesses with investors or lenders, there is no choice in accounting method. It records expenses when it makes payments to suppliers. For details on how to apply the gross receipt test, the IRS guidelines on acceptable accounting methods and how to change your accounting method, refer to IRS Publication 538. Accrual-basis accounting combines two important accounting principles: the matching principle and the revenue recognition principle. Similarly, no bookkeeping is required for purchases from vendors on credit (i.e. accounts payable or accrued expenses) until the company pays for them. ITCHY pays income taxes on \$850 of income for 2020 and shows a loss for 2021. ITCHY pays its chemical supplier \$50 for each tank of insecticide when it picks up the tank on the morning of each monthly spray. Effects of Cash and Accrual Accounting on Cash Flow, Taxes and Policy The method of accounting, cash or accrual, can significantly impact a company's cash flow and tax liabilities, as illustrated above. Under these principles, revenue is recognized when it is earned, and expenses are reflected in the period that best matches the revenue they help create. Cash-Basis vs. Accrual-Basis Accounting: Which is Right for Your Business? If you rely on cash payments for revenue and expenses, recurring journal entries, bank reconciliations and balancing accounts—all key components of accrual accounting—are included in the core functionality of most accounting software. Companies can choose between two primary accounting methods: cash basis and accrual basis. A customer signs an annual contract and pays \$1,200 upfront on June 1, 2020. Accrual accounting recognizes revenue when it's earned and expenses when they're incurred, regardless of when money actually changes hands. Rather than just look at cash coming in and out, businesses using accrual accounting monitor receivables, prepaid expenses, accounts payable and other accrued liabilities.

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