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Accounting 101

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What is Accounting?

- Accounting is the process of recording, summarizing, analyzing, and reporting financial transactions to provide insights into a business's financial health and performance. It involves organizing and interpreting financial data to help stakeholders, such as managers, investors, and creditors, make informed decisions.

Types of Accountants:

Financial Accountant

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Purpose & Focus

- Financial accounting is focused on external reporting
- Provides an accurate snapshot of a company's financial position
- Ensures transparency and consistency for outside stakeholders

Recording & Summarizing

- Tracks and documents all financial transactions
- Ensures that data is organized and compliant with accounting standards (e.g., GAAP)

Financial Statements Produced

Generates key reports:

- Balance Sheet (assets, liabilities, equity)
- Income Statement (revenues and expenses)
- Cash Flow Statement (inflows and outflows)

External Stakeholders

Reports are used by:

- Investors
- Creditors
- Regulators
- Tax authorities

Why It Matters to You

- Financial accounting gives a clear picture of the company's overall performance
- Provides a foundation for business planning, funding, and compliance

Managerial (Cost) Accountant

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Purpose & Focus

- Managerial (or cost) accounting supports internal business decisions
- Helps leadership plan, direct, and control operations

Goal: Improve efficiency and profitability

Cost Tracking & Measurement

- Identifies and monitors expenses tied to business activities
- Tracks both fixed and variable costs
- Focuses on the cost of producing goods or services

Decision Support

Informs choices about:

- Pricing
- Production levels
- Budgeting
- Profit planning

Analysis & Reporting

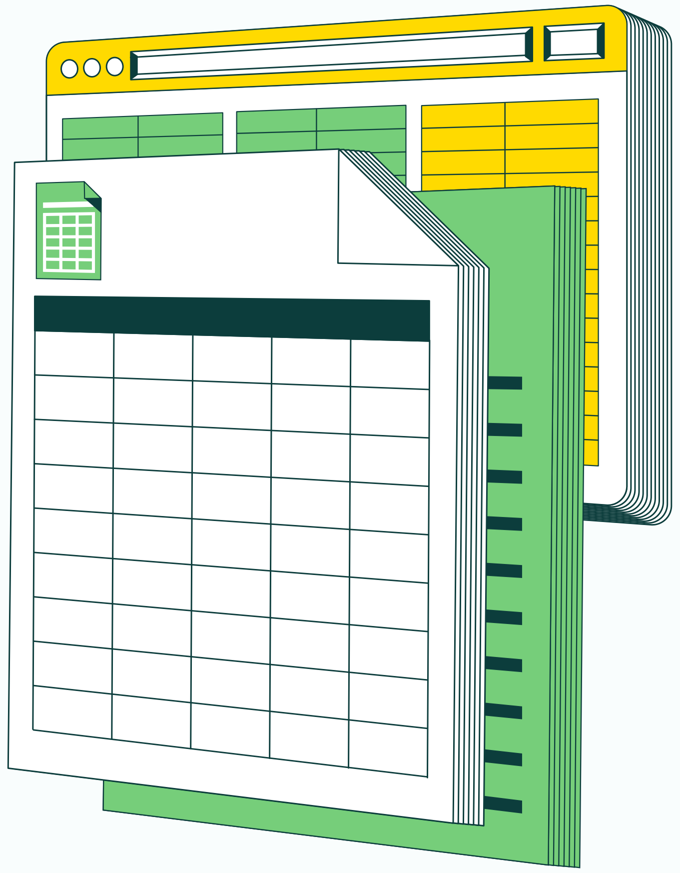
- Records, analyzes, and summarizes operational costs
- Turns cost data into actionable insights
- Helps explain where money is going and why

Why It Matters to You

- This is the most relevant type of accounting for your role
- Also referred to as cost accounting
- Directly impacts day-to-day business operations

What is a Balance Sheet?

A balance sheet (BS) is a financial statement that provides a snapshot of a company's assets, liabilities, and equity at a specific point in time.



THE ACCOUNTING EQUATION
Assets = Liabilities + Equity

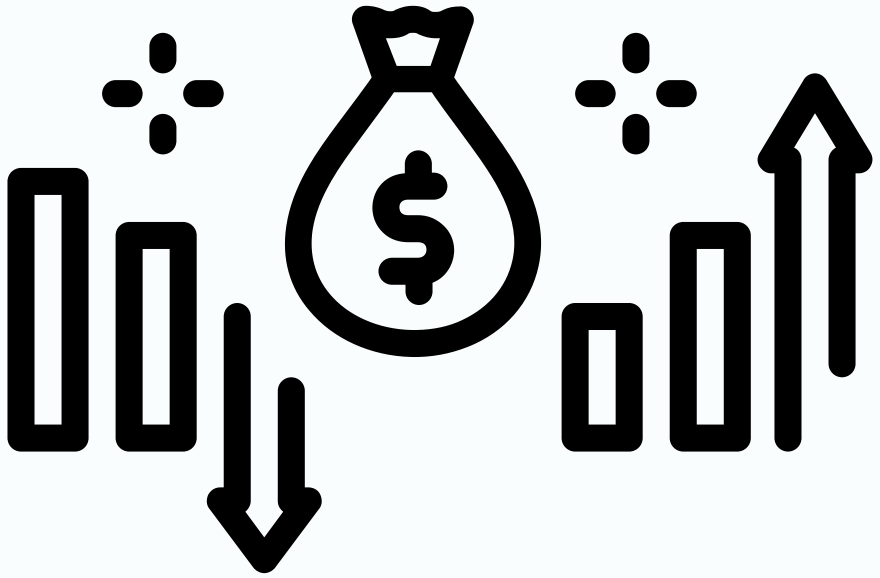
Assets: What the company owns
Liabilities: What the company owes
Equity: The owners' stake in the business

Begins with the first transaction, often cash received for company stock sold

Ends the day the company goes out of business

What is a Profit & Loss Statement?

A profit and loss (P&L) statement, also known as an income statement, is a financial document that summarizes a company's financial performance over a specific period (e.g., a month, quarter, or year). It details the company's revenues, expenses, and resulting profit or loss.



The P & L begins on the first day of a company's new business year – can be calendar or fiscal year.

The P & L ends on the last day of the company's calendar or fiscal year end.

The P & L then closes and rolls into the balance sheet, increasing or decreasing the Shareholders Equity portion of the B/S known as Retained Earnings.

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Is there any other key financial statement for a company?

Cash Flow Statement

This statement tracks the movement of cash both into and out of a company over a period of time. It categorizes these cash flows into operating, investing, and financing activities, providing insight into how the company generates and uses cash.

CONCLUSION

These three statements are interconnected and provide a comprehensive view of a company's financial health.

How do you build a set of financial statements?

- Collect all relevant financial documents like bank statements, invoices, expense reports, and tax returns.
- Determine the accounting standards you will follow (e.g., US GAAP, IFRS).
- This framework will dictate how transactions are recorded and reported.

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Why do I care?

Chances are none of you will ever have to “Build a set of Financial Statements”. But you will complete an expense report, purchase a fixed asset for your company (example a truck for the company use) or purchase an expense item (example purchasing a pallet of copier paper).

There is a good chance someone may ask you “what **GL Code** do I apply to that purchase”?

General Ledger (GL Codes) codes are the building blocks of financial statements.

GL Codes - Example:

A Typical GL Code for a $50,000,000 company with multiple profit and cost center can look like these: 1-78-1650 and 3-22-7110

1 - **78** - **1650**

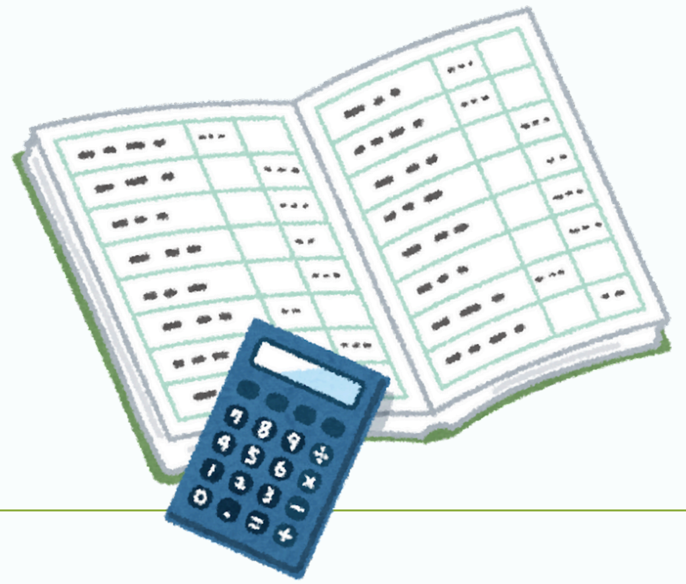
- The first number refers to the company within the larger company that the purchase is accounted for. (Not all companies have more than one company)
- The second number refers to the division within the company, let's say the hydraulic power unit shop.
- The last number is the actual type of expense.

1-78-1650 – Tells Accounts Payable (A/P)

o Company 1, Warehouse Division, Purchased a Vehicle

3-22-7110 – Tells A/P

o Company 3, Hydraulic Shop, Purchased Shop Supplies



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GL Codes continued...

You will never have to come up with these GL codes by yourself, the accounting has created a Chart of Accounts, a sample follows:

7100	SUPPLIES - SHIPPING	SUPP
7110	SUPPLIES - SHOP	SUPP
7115	SHOP SUPPLIES (W/O)	SUPP
7120	SUPPLIES - FORMS, ENV, PAPER	SUPP

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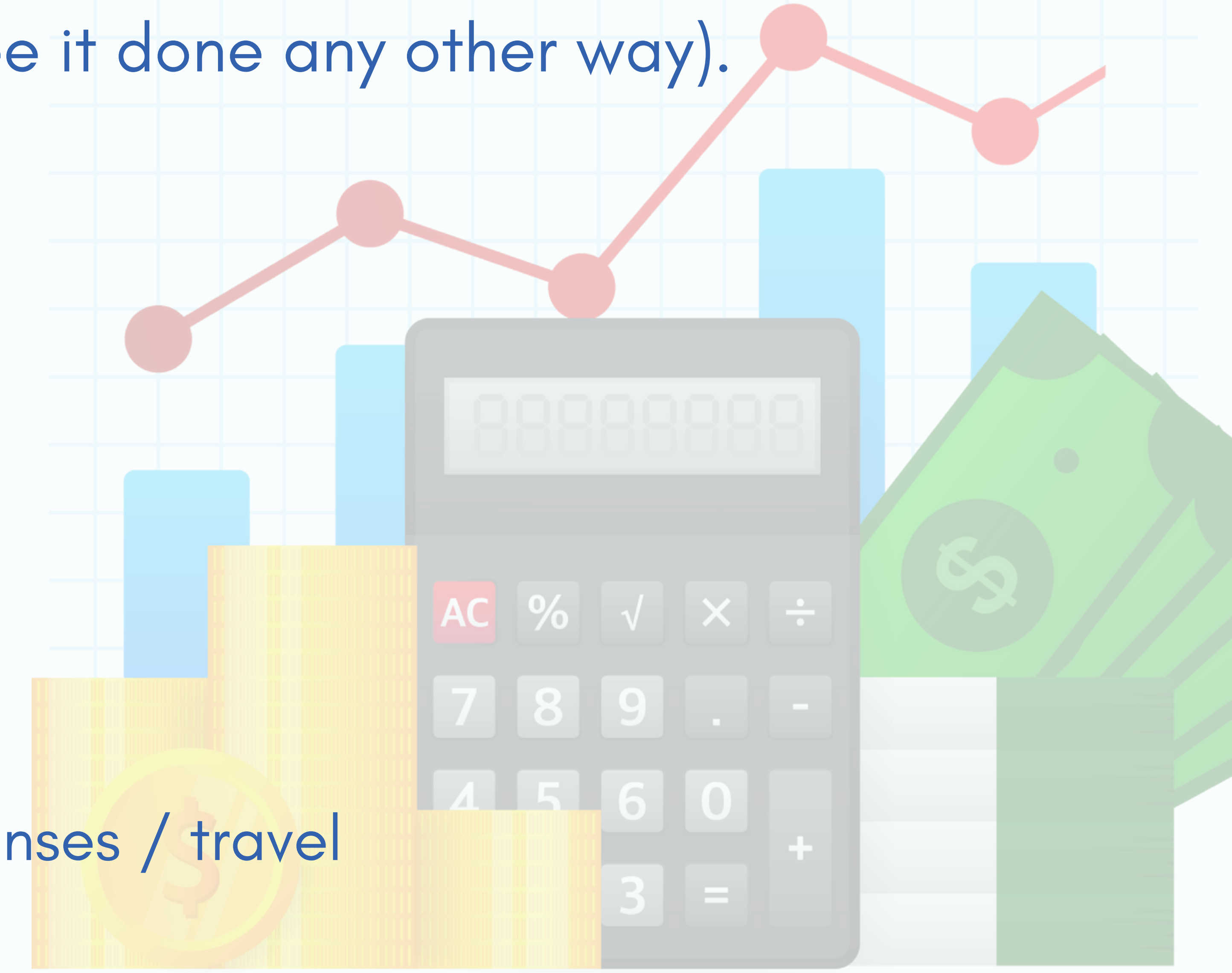
GL Codes continued...

Most companies use a consistent numbering system to categorize different types of purchases and liabilities (this format is so common, it's rare to see it done any other way).

Balance Sheet GL Codes
1000 – Assets
2000 – Liabilities
3000 – Stockholders Equity

P&L GL Codes
4000 – Income
5000 – Cost of Sales
6000 – SG&A Expense – this range normally includes personnel expenses / travel
7000 – SG&A Expense – normally for MRO items, outside services

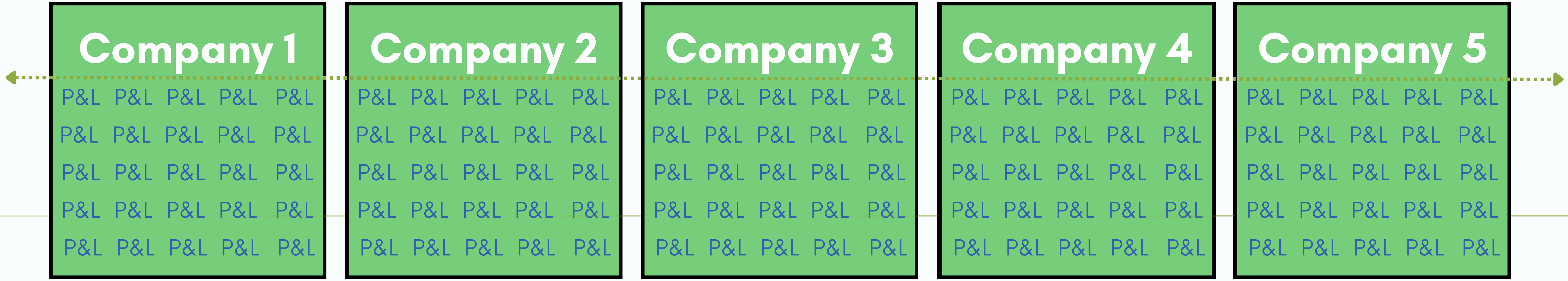


(SG&A stand for Selling, General & Administrative Expenses)

Why do you call the GL codes "blocks" for the financial statements?

- Imagine a holding company with 5 operating companies
- Each company has 25 profit & loss centers
- Every P&L center has employees, recorded under GL code 6100 (employee costs)

➡️ That means GL code 6100 will appear 125 times (5 companies × 25 centers) —each entry representing employee costs in a specific company and P&L center



Tax Considerations

When beginning a business, you must decide what form of business entity to establish. Your form of business determines which income tax return form you must file. Legal and tax considerations enter into selecting a business structure and below are the most common.

- **Sole proprietorships** – Largest form of a business structure
- **Partnerships** – Often seen in real estate
- **Corporations** – Only 5% of US Corporate Tax returns are C-Corps – but 60% of business revenue
- **S corporations** – 77% of companies with less that 500 employees are S Corp
- **Limited liability company (LLC)** – Simpler than an S Corp – still a pass through entity

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Tax Considerations continued...

Book revenue and Tax revenue are normally different – The tax laws drive this, and the “Big Beautiful Bill” made many of the book / tax differences “permanent”. GAAP has nothing to do with the taxation of a business.

I am willing to bet that most of the companies represented here today are S-Corp’s, and the name of the game is to keep tax as low as possible. S-corps’ are “pass through” entities – meaning the corporation does not pay tax – the profit is passed through to the shareholders and the individual shareholders pay tax on the corporations’ profits and their individual 1040’s.

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What did the "Big Beautiful Bill" do for these pass-through corporations?

- Made permanent the 21% C-Corp tax rate
- Made permanent the Individual tax rate which directly affects the pass-through entities shareholders
- Made permanent IRS Section 199A – tax relief for pass through entities shareholders
- Increased IRS Section 179 bonus depreciation from $1,000,000 to $2,500,000 with some added 1st year rules for other properties
- There are other items, but these are the key drivers

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Let's Look at a Balance Sheet

XYZ, Inc.
Balance Sheet
As of December 31, 2018

Assets		
Current Assets		
1000 Cash		
1010 Checking	583,961	
1020 Savings	224,600	
1030 Petty Cash	89,840	
Total Cash		898,402
1100 Accounts Receivable		3,593,607
1200 Work in Process		589,791
1300 Other Current Assets		
1310 Prepaid Rent	164,593	
1320 Prepaid Liability Insurance	109,728	
Total Other Current Assets		274,321
Total Current Assets		**5,356,121**
Non-Current Assets		
1400 Net Computer Equipment		185,167
1500 Net Furniture, Fixtures, & Equipment		178,309
1600 Net Field Equipment		205,741
1700 Net Real Estate		548,642
1800 Net Leasehold Improvements		144,019
1900 Other Assets		240,031
Total Non-Current Assets		**1,501,908**
Total Assets		**6,858,029**

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Let's Look at a P&L Statement

XYZ, Inc.
Profit and Loss Statement
Fiscal Year Ended 12/31/2018

Income		**Jan - Dec '18**
Professional Services Revenues		
4001 Fee Income	4,978,250	
Total Professional Services Revenues		**4,978,250**
Total Income		**4,978,250**
Cost of Sales		
Billable Direct Costs		
5000 Billable Direct Labor		
5010 Billable Direct Employee Salaries	2,535,948	
5020 Billable Direct Officer Salaries	179,613	
Total Billable Labor		2,715,561
5100 Billable Other Direct Expenses		
5110 Billable Materials	50,952	
5120 Billable Sub-Contractors	160,350	
5130 Billable Equipment Rental	11,246	
5140 Billable Other Direct Costs	36,548	
Total Billable Other Direct Expenses		259,096
Total Billable Direct Costs		**2,974,657**
Non-Billable Direct Costs		
5500 Non-Billable Direct Labor		
5510 Non-Billable Direct Officer Salaries	65,943	
5520 Non-Billable Direct Employee Salaries	72,563	
Total Non-Billable Direct Labor		138,506
5600 Non-Billable Other Direct Costs		
5610 Non-Billable Materials	203	
5620 Non-Billable Sub-Contractors	16,500	
5630 Non-Billable Equipment Rental	1,200	
5640 Non-Billable Other Direct Costs	35	
Total Non-Billable Other Direct Expenses		17,938
Total Non-Billable Direct Costs		**156,444**

Let's Look at a Cash Flow Statement

SAMPLE CASHFLOW STATEMENT

Company XYZ Limited

STATEMENT OF CASH FLOWS
For the year ended 31 December 2019

	Current Year	Previous Year	Previous Year
	2019	**2018**	**2017**
Cash flows from operating activities			
Profit for the year	**28,227**	**26,714**	**27,503**
Adjustments for non-cash income and expenses:			
Depreciation & Amortization	16,080	16,544	16,544
(Increase)/Decrease in trade and other receivables	(422)	345	345
(Increase)/Decrease in inventory	(811)	(754)	(754)
Increase/(Decrease) in trade payables	407	(494)	(494)
Net cash from/(used in) operating activities	**43,480**	**42,354**	**43,143**
Cash flows from investing activities			
Investments in Property & Equipment	(15,000)	(15,000)	(15,000)
Net cash from/(used in) investing activities	**(15,000)**	**(15,000)**	**(15,000)**
Cash flows from financing activities			
Issuance/(repayment) of debt	(5000)	-	-
Issuance/(repayment) of equity	-	-	-
Net cash from/(used in) financing activities	**(5000)**	-	-
Net increase/(decrease) in cash and cash equivalents	23,480	27,354	28,143
Cash and cash equivalents at beginning of year	211,069	183,715	171,757
Cash and cash equivalents at end of year	**234,549**	**211,069**	**199,900**

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Key Financial Ratios that these Financial Statements Provide

- **Context is Key:** The most important financial ratios vary based on the specific analysis and its purpose.
- **Comparison is Crucial:** To be most useful, financial ratios should be compared to industry benchmarks, competitors, or a company's historical performance.
  - *We will soon see how the FPDA can give your company this comparison.*
- **Combine Ratios for a Comprehensive View:** Analyzing multiple financial ratios together provides a more complete understanding of a company's financial health.

Important Financial Ratios: Categorized by Primary Purpose

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1. Profitability Ratios:

These ratios measure a company's ability to generate earnings from its sales, assets, and equity. Key profitability ratios include Gross Profit Margin, Operating Profit Margin, Net Profit Margin, Return on Assets (ROA), and Return on Equity (ROE).

We'll see how many of these ratios are shared with FPDA members for benchmarking

2. Liquidity Ratios:

These ratios assess a company's ability to meet its short-term debt obligations. Important liquidity ratios are the Current Ratio, Quick Ratio (Acid-Test Ratio), and Cash Ratio.

Used by banks and others to evaluate the health of a company and is used when assessing how much a bank will loan a company.

3. Solvency Ratios:

These ratios evaluate a company's long-term financial stability and its ability to meet its long-term debt obligations. Solvency ratios include the Debt-to-Equity (D/E) Ratio, Debt-to-Assets Ratio, and Interest Coverage Ratio.

Also used by banks to assess loan levels

4. Efficiency Ratios:

These ratios gauge how efficiently a company uses its assets and liabilities to generate sales and maximize profits. Examples are the Asset Turnover Ratio, Inventory Turnover Ratio, and Receivables Turnover Ratio.

Used internally to assess the processes and efficiency of your company.

5. Valuation Ratios

For Publicly Traded Companies

These ratios help investors assess the attractiveness of a stock. Common valuation ratios include Earnings Per Share (EPS), Price-to-Earnings (P/E) Ratio, Price/Earnings-to-Growth (PEG) Ratio, Price-to-Sales (P/S) Ratio, Price-to-Book (P/B) Ratio, and Dividend Payout Ratio.

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FPDA Connection: Edgewater Research

FPDA is a great source for being able to show each of you how your company compares to other companies within the FPDA Membership.

Edgewater Resource

• Joe Calvello, an analyst with Edgewater, attends the annual FPDA Industry Summit and gives a report on industry trends and his economic outlook.
• Monthly Reporting
• Year End Report comparing your company to all other reporting companies with in the FPDA membership.

FPDA Connection: Cleveland Research

- Owen Flanagan, an analyst with Cleveland Research, also attends the Annual Summit.
- Owen will be presenting to the FPDA on November 20th – I urge you to attend this on-line presentation.
- Cleveland Research does a monthly survey of FPDA members and sends a monthly reporting showing what the industry trends look like.

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Q & A