Excerpt of Chapter 4, and Table of Contents from the book:

Radical Accounting

A Way Out of the Dark and into the Profit

With a few QuickBooks™ Accounting Software Tips & Tricks

By Madeline Bailey

www.radicalaccounting.com

"Devoured your eBook over several sittings yesterday, finished up this morning. I was actually voluntarily sitting at my desk at 6:45 a.m. on a Sunday morning, reading about BOOKKEEPING, of all things!! Am taking a break from setting up my first Chart of Accounts to send you this email. A quick read of your eBook ***has tremendously raised my comfort level*** *with managing our family and small business bookkeeping tasks, and I wanted to share my appreciation."* Stephanie Roberts, Lotus Pond Press, www.FastFengShui.com	*"I am so excited about Madeline's book, Radical Accounting. I've read it cover to cover twice, marking it up with stickies and margin notes, and had it open on my lap when I sat down in front of a brand new QB account to create my Chart of Accounts from scratch. The day it all clicked - when I finally got it -* ***when the P&L became clear and it all made sense*** *- I was jumping up and down. I've been self employed for 8 years and until I read her book I thought my Chart of Accounts was just something I kept for my tax preparer so she'd know how much to deduct from my Schedule C. I wanted to understand more about how the finances affect my businesses, but I didn't know where to go to learn. Now I recommend it to everyone who runs his or her own business. It's concise, to the point, and puts all the pieces together. THANK YOU for such an awesome resource and for explaining it so clearly."* Lara Eve Feltin, Partner, Biznik, www.biznik.com

"Of all the accounting textbooks. or educational literature I've read, or been subject to, this one may be the easiest to understand and apply in the real world. I think ***this book should be required reading for all entrepreneurs*** *thinking of starting their own business, or those who continuously have trouble communicating effectively with that highly paid accountant they use."*

Scott D. Hayes, Controller, Oregon Dept. of Fish & Wildlife. Previously: Business Manager, OR State Data Center, Internal Auditor, OR Dept. of Transportation, Controller, Oregon Dept. of Commerce

4: Accounting Basics Made Fun (Of)

> *"Money frees you from doing things you dislike. Since I dislike doing nearly everything, money is handy."*
>
> *Groucho Marx, Comedian*[1]

There is only one business bookkeeping system—the double-entry system. Luca Pacioli published the first textbook of double-entry bookkeeping in 1494. Believe it or not, there has been virtually no change since then. His system of debits and credits is so confusing that no one can figure it out, let alone improve upon it, so it remains intact. (Just kidding, Pacioli.) The real reason that we're still using double-entry bookkeeping is because it works, produces balanced books, and has become an ingrained standard.

Double-entry bookkeeping is what they teach in accounting school. Fledgling accountants learn to enter a bookkeeping transaction using a journal entry. A ***journal entry*** *has two or more line items (entries) that balance debits and credits*.

- One entry is considered ***primary***; the other ***offsetting***.
- One entry will be a ***debit***; the other a ***credit.***
- One entry shows what account the money is *going to*; the other what account the money is *coming from*.

Luckily for you, popular accounting software insulates you from having to learn the rules of double-entry bookkeeping. However, you might not want to use your software as directed. If you get stuck or want to do something tricky, a journal entry is the way to go. You can do anything, change anything, or manipulate anything with a journal entry.

One trick to making a journal entry is learning *when* to use a debit and *when* to use a credit. Here's a **Journal Entry Debit / Credit Chart** to help. Post this "cheat sheet" near your computer, so that it'll always be handy.

Journal Entry Debit / Credit Chart		
Account Type	**Debits**	**Credits**
Income	Decrease	Increase
Expense	Increase	Decrease
Equity	Decrease	Increase
Asset	Increase	Decrease
Liability	Decrease	Increase

With time, you'll memorize some basics…like your bank account is an asset account so when you want to increase it, you debit it. Here's a journal entry for a bank deposit from the sale of a product:

Account Name	Account Type	Debit	Credit
Bank Account	Asset	$99.95	
Product Sales	Income		$99.95

See how the credits and debits balance? See how you're becoming empowered? Don't see it yet? Just for fun, let's say you remember that when your bank account is increased, it's debited. The first time you hear about a "debit card" your empowered mind will go "red flag—possible money trick." You *know* that using your debit card decreases your bank account. So why is it called a debit card? (The answer comes later in the book.)

Not certain of debits and credits? There's always the trial-and-error method: try it one way, check your financial report to see if you're correct, and if not, change it to the opposite way. If you make a mistake, relax. Depending on your software, you can either correct your mistake by reversing the entry or make an adjusting entry. Trust me, your accounting software package offers you a way to fix mistakes. Accounting really *is* one part doing the work and one part auditing it.

Which Accounting Software?

Business accounting software, such as QuickBooks® and Peachtree®, are designed as double-entry systems. Underneath the seemingly innocent check is a journal entry. Personal accounting software, such as Quicken® and Money®, are called single-entry systems. Underneath the check is a checkbook entry.

Calendar or Fiscal Year?

The tax period for most small businesses is the ***calendar year***. You close out your books on December 31st and open them for the new tax year on January 1st.

On one hand, does it really make sense to do your biggest bookkeeping chore of the year when you're high on sugar cookies and hung over from eggnog? The U.S. government doesn't think so, so their fiscal year starts Oct 1st. The State of California doesn't think so either, so their fiscal year starts on July 1st. *A **fiscal year** is any 12-month accounting period.*

On the other hand, payroll requires the calendar year. So unless you have a good reason to buck the herd, keep it simple and use the calendar year, eggnog or not.

On yet a third hand, you might consider switching to another fiscal year if you have a seasonal business. No matter how many hands you have, don't stack up your paperwork for the slow season. By then you'll have a real mess on your collective hands. Do the bookkeeping as you go along and cycle other tasks for the slow season.

Cash or Accrual Basis?

Despite opinions to the contrary the "cash vs. accrual" basis does not refer to something that happens after dark in the privacy of your own home. Sure, cash vs. accrual is for adults only but it's not as confusing as it may seem at first.

For ***cash accounting*** *your income consists of what you actually received during the tax period, and your expenses consist of what you actually paid out.*

If you use the ***accrual basis*** *your income is made up of all the invoices your business issued during the year, even if you have not received payment. You also deduct your bills even if you have not paid them yet*. So if bills exceed invoices, or if you have an agreement with your vendors whereby they're financing you with trade credit, consider using the accrual basis. If your business stocks inventory then the IRS requires the accrual basis. Corporations tend to use the accrual basis; private business owners tend to use the cash basis.

To decide whether cash or accrual would be best for your business, ask you tax advisor. You can also run your P&L Report, first using the cash basis and then the accrual basis, to see which is to your advantage tax-wise. Whatever decision you make…you won't be groping in the dark.

What are Account Types?

Accounting is structured around ***account types.*** You're already familiar with account types but you probably don't use that terminology and may not be familiar with their nuances of use. “Bank Account” is one account type you’re familiar with; “Credit Card” is another. While all account types are found in the chart of accounts, some end up on the P&L Report and some end up on the Balance Sheet.

Account types maintain standards in accounting. Financial reports are universally formatted with a standard “look and feel” that doesn’t deviate from software to software, or business to business. Once you understand how to read your own financial reports, it’ll be that much easier to read financial reports from another business. Each account type has a specific location on the financial report. The locations are set in stone! Check out the tablets:

Profit and Loss Report Format

The Profit and Loss Report is a report of money coming in, money going out, and how much your business made (profit) or lost, for any given time period.

  Income
- Cost of Goods
= Gross Profit
- Expenses
= Net Profit   (*also called Income for Operations*)
+ Other Income
- Other Expense
= Profit

Profit and Loss Report Account Types Chart	
Account Type	**Functionality**
Income	Money received from primary business activities.
Cost of Goods Sold	Money spent to purchase goods or services that will be directly resold to customers.
Expense	Money spent for primary business activities.
Other Income	Money received from secondary income.
Other Expense	Money spent for secondary expenses.

Balance Sheet Statement Format

The Balance Sheet is a report of how much your business owns, owes, and how much it's worth, as of a specific date.

Assets
+ Bank Account
+ Accounts Receivable
+ Inventory
+ Fixed Assets
+ Other Assets
= Total Assets

Liabilities & Equities
  Accounts Payable
+ Credit Card
+ Other Current Liabilities
+ Long Term Liabilities
= Total Liabilities
+ Equity
+ Retained Earnings
= Total Liabilities & Equity

The formula is: **Assets = Liabilities + Equities.**
The two sides of the equation balance. Get it? It's a Balance Sheet.

Balance Sheet Statement Account Types Chart	
Account Type	**Functionality**
Bank Account	Checking, money market, petty cash, etc. Also called a Current Asset account type.
Accounts Receivable	Invoices, or other money owed by customers. A/R for short. Also called an Other Current Asset.
Inventory	Raw materials, work in progress, and stock of goods on hand.[2] Also called an Other Current Asset.
Fixed Asset	Property used in the production of goods and services, such as machines and oil wells.
Other Asset	Something of value that could be sold for cash, like a stock portfolio or gold.
Accounts Payable	Bills or other money owed to vendors. Abbreviated as A/P. Also called a Current Liability.
Credit Card	Plastic card with a credit limit. Also called a Current Liability.
Other Current Liability	A loan you'll pay back in one year or less, like a loan from a friend.
Long Term Liability	A loan you'll pay back over a long period of time, like a loan from a parent, or bank.
Equity	Owners, partners, and investors money.

Setup Account Names By Account Types

You'll design your chart of accounts by choosing account names that are meaningful to you, account type by account type. Before you get started choosing account names, let's look at the guiding principal behind designing your chart of accounts—your business model!

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[1] Groucho Marx, www.quotations-page.com
[2] Inventory, *Barron's Dictionary of Business Terms*