

Financial Accounting

(Cheat Sheet)



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Financial Accounting

Financial accounting is a type or branch of accounting that begins with the recording, sorting and storing of a business's transactions in accounts contained in its general ledger. After reviewing and adjusting the amounts to comply with generally accepted accounting principles, the amounts are summarized and presented in the form of financial statements. When the financial statements of a U.S. corporation are distributed to someone outside of the corporation, the financial statements should include the following:

- Income statement
- Statement of comprehensive income
- Balance sheet
- Cash flow statement
- Statement of stockholders' equity
- Notes to the financial statements

Double-Entry; Debit and Credit

It is the norm for a corporation to use the *double-entry accounting system*. Double-entry accounting means that every transaction will affect two or more accounts. It also uses the terms *debit* and *credit*, which had their origin five centuries ago. Today, you should associate *debit* with *left side* of an account, and associate the term *credit* with the *right side* of an account. As a result, every business transaction will have an amount recorded (as a debit) on the left side of an account and will have an amount recorded (as a credit) on the right side of an account.

Example 1. If a corporation borrows \$10,000 from its bank, the corporation will *debit* the account Cash and will *credit* the account Loans Payable.

Example 2. When a corporation pays its June rent on June 1, the corporation will *debit* Rent Expense and will *credit* Cash.

Today's accounting software will assure that the double-entry system is adhered to.

Generally Accepted Accounting Principles (GAAP)

When a U.S. corporation's financial statements are distributed to someone outside of the corporation, they must comply with generally accepted accounting principles (GAAP or US GAAP). GAAP includes underlying concepts such as the historical cost principle, matching principle, revenue recognition, full disclosure principle, plus many detailed rules or standards that are required by the *Financial Accounting Standards Board (FASB)*. Some of the rules or standards include the accounting for hedging transactions, pensions, leases, foreign currency translation, and many more.

Accrual Method of Accounting

US GAAP usually requires that a corporation's financial statements be prepared using the accrual method (or basis) of accounting. (Individuals on the other hand are likely to use the cash method of accounting.) Under the accrual method, revenues are reported on the income statement and the related receivable will be reported on the balance sheet when the amount is *earned* (as opposed to when the cash is received). Similarly, expenses and losses are reported on the income statement and the related liability is reported on the balance sheet when they occur (as opposed to waiting until the amount is paid).

Other Types or Branches of Accounting

As noted earlier financial accounting is just one type or branch of accounting. The others include cost accounting, management accounting, not-for-profit accounting, governmental accounting, income tax accounting, auditing, forensic accounting, accounting systems, auditing, and more.