SOUC 2018

SedonaOffice Users Conference

San Francisco, CA | January 21 – 24, 2018

Accounting 101

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PERENNIAL SOFTWARE

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Generally Accepted Accounting Principles (GAAP)

What is GAAP all about? Very simply stated, it is conceptual framework designed around set practices and processes that should be followed when measuring and reporting information in financials.

They are broad and specific guidelines that should be followed so that reporting is standard across the board. There are thousands of these guidelines and principles so we will not address them all here.

There are, however, basic principles that I would like to talk about. Those principles are Cost, Revenue Recognition, and Matching. These are very important pieces of the Setup of SedonaOffice as well.

Cost speaks to how items are valued. The prices at which they are bought and sold and the fact that although values change due to inflation and recession, they will still be retained at their historical cost.

Revenue Recognition, which says that revenue should be recognized in the period it is earned not necessarily in the period in which cash is received, it is a core tenet of SedonaOffice and in accounting in general.

Matching relates to revenue recognition, in that you want your expenses matching the revenue for the period in which it was earned. True Accrual accounting.

Income Statement - ONLY			
		Cash	Accrual
		Basis	Basis
Revenues		100,000	100,000
Cash Receipts		50,000	
COGS		25,000	25,000
Payroll		45,000	45,000
Rent		10,000	10,000
Utilities		5,000	5,000
		85,000	85,000
Net Income (Loss)		(35,000)	15,000

General Ledger and Subsidiary Ledgers
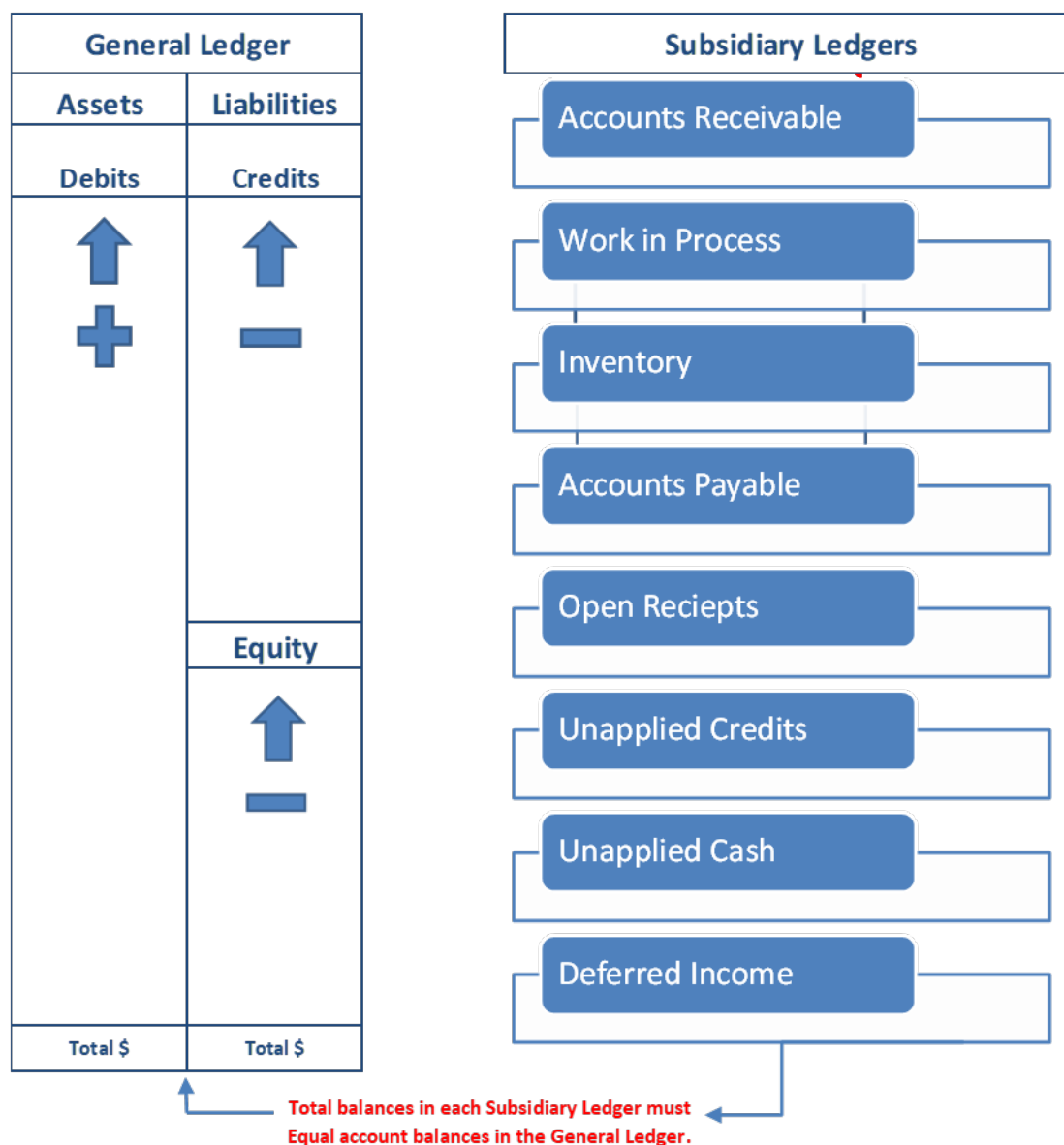
Very Important Point here I would like to reiterate:

Total balances in each Subsidiary Ledger must

Equal account balances in the General Ledger.

The General ledger is a collection of storage areas, called accounts, used to keep track of increases and decreases in both the Balance Sheet and the Income Statement. On the Income Statement, those Debits and Credit will flow, at year end, into Retained Earnings. More on this later.

As shown above, Asset increases are entered on the debit side of accounts and decreases are entered on the credit side. Liabilities and equity account increases are credits and decreases are debits.

Note that in the double entry accounting system, a debit means the left side of an account and credits means the right side of an account.

Balance Sheet

Why do they call it the Balance Sheet? It is because it must balance, meaning total assets must equal total liabilities plus the equity.

Accounts found on the Balance Sheet vary from company to company but do fit into broad groupings.

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Notes




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Balance Sheet Account Type	Descriptions
Assets	Cash, Inventory, Land, Building and equipment owned by the Company and has value
Current Assets	Cash, Account and Notes receivable, inventories and other items that can be converted into cash in less than a year.
Cash	Bank Accounts, Money Market, Savings or Petty cash
Accounts Receivable	Money owed by Customers for Services or Products provided
Inventory	Stock held in house or future sales
Fixed Assets	Assets such as Equipment, Machinery, Furniture generally depreciated over a period of time.
Depreciation	Accounting process used to allocate costs of fixed assets over time.
Liabilities	Amounts the Company owes to others, both short and long term.
Current Liabilities	Amounts that are due within a year.
Short Term Debt	Amount borrowed and due to be paid back with a year.
Accounts Payable	Account used to reflecting amounts due to vendors and suppliers.
Accruals	Where expenses are accrued against current profits but have not yet been paid.
Long Term Debt	Amounts owed to others and due in more than a year.
Equity	Represent the value of the Company, Investments in Company and past Profits and/or losses
Capital Stock	Original investment in the Company. Depends on Entity type.
Retained Earnings	Net Income left in Company at year end. It Accumulates unless distributed.

Notes

General Ledger Accounts with Types

Account Type	Description	Balance Sheet or Income
BANK	Bank	B
AP	Accounts Receivable	B
OCA	Other Current Assets	B
FA	Fixed Asset	B
OA	Other Assets	B
AP	Accounts Payable	B
CC	Credit Cards	B
OCL	Other Current Liabilities	B
LTL	Long Term Liabilities	B
DIST	Distribution Accounts	B
EQ	Equity	B
IN	Income	I
CGS	Cost of Goods Sold	I
EX	Expenses	I
OEX	Other Expense	I
OIN	Other Income	I

It is important to know what type of General Ledger accounts fit into which account types.

Notes

SedonaOffice Required Account

Here are just a few of the General Ledger accounts that are required when using SedonaOffice. There is a list of over 30 accounts SedonaOffice uses to process transactions. The full list of these accounts can be found on our website.

Primary Checking	BANK
Un-deposited funds	OCA
Inventory Receipts	OCL
Sales Tax Payable	OCL
Labor Deferred - Jobs	OCL
Inter-Branch Billing	OCL
Labor Deferred - Service	OCL
Inventory Transfer	OCL
Advanced Deposit	OCL
Unapplied Cash	OCL
Deferred Revenue	OCL
Deferred Revenue Prior to Conversion	OCL
Retained Earnings Prior to Conversion	DIST
Conversion Bal Frwd/AR	EQ
Cost of Goods Sold-Jobs	CGS
Cost of Goods Sold-Service	CGS
Late Fee	OIN

Notes

Control Accounts

As seen on the previous pages, subsidiary ledger accounts, which we identify as General Ledger Control accounts, contain individual details related to a particular accounts and should equal the balances that appears on the General Ledger.

Control Accounts are repositories for transactions that are processed by the system. General Journal entries should not be made into these accounts.

General Journal Entries

General journal entries are made routinely when closing out a given month and addresses accounts such as Prepaid Expense, Depreciation, Accrued Expense, and Payroll.

Notes

Asset = Liabilities + Equity

Here is a Balance Sheet with account types displayed.

Always Safe, Inc.		
Balance Sheet		
Assets		
Current Assets	Current Month	Last Month
Cash on Hand	912,225	909,687
Accounts Receivable	845,084	734,251
Inventory	341,908	359,519
Total Current Assets	2,099,217	2,003,458
Fixed & Other Assets		
Vehicles	487,724	487,724
Furniture & Fixtures	25,114	25,114
Computers & Software	528,280	528,280
Other Equipment	531,515	531,515
Accumulated Depreciation	(1,056,802)	(1,056,048)
Total Fixed Assets	515,831	516,585
Other Assets		
Prepaid - COGS/Insurance	23,531	26,987
Pre-Paid Tax / Expenses	38,670	29,825
Total Other Assets	62,201	56,812
Total Assets	2,677,249	2,576,854
Liabilities & Equity		
Current Liabilities		
Accounts Payable	371,845	308,609
Advance Deposits	122,144	89,135
Unapplied Cash/Credit	14,334	7,665
Deferred Revenues	507,058	518,432
Wages & Salaries - Accrued	58,585	60,210
Sales Tax Payable	5,653	9,137
Current Note Payable	51,842	51,842
Total Current Liabilities	1,131,461	1,045,030
Other Liabilities		
Balance Note Payable	100,974	100,961
Total Other Liabilities	100,974	100,961
Total Liabilities	1,232,434	1,145,991
Equity		
Paid in Capital	9,829	9,829
Retained Earnings - Current	1,019,935	1,019,935
Net Income Current Fiscal Year	415,050	401,099
	1,444,814	1,430,863
Total Liabilities & Equity	2,677,249	2,576,854
Current Ratio	1.86	1.92
Quick Ratio	1.55	1.57
Modified Quick	0.68	0.68

What is the Current Ratio

The Current Ratio is an indicator of company's solvency. Unlike the Quick Ratio, shown below, the Current ratio includes all current assets and liabilities. It speaks to whether or not the company can pay back its liabilities with current assets.

$$= \frac{(\text{Cash} + \text{Account Receivable} + \text{Short Term Investments} + \text{Inventory})}{\text{Current Liabilities}}$$

A ratio that is under 1 indicates that the Company's liabilities are greater than its current assets which could be a problem if future earnings are somewhat stagnant. A high ratio can indicate a state of financial well-being depending on ratios of the assets involved.

What is the Quick Ratio

The Quick Ratio, sometimes called the acid-test ratio is a strong indicator of whether a firm has sufficient short-term assets to cover its immediate liabilities. This metric is more robust than the current ratio. The Quick Ratio is also known as the working capital ratio since it ignores illiquid assets such as inventory.

$$= \frac{(\text{Cash} + \text{Account Receivable} + \text{Short Term Investments})}{\text{Current Liabilities}}$$

Companies with a quick ratio of less than 1 do not have enough liquid assets to pay their current liabilities, which is never a good place to be. If the Quick ratio is much lower than the current ratio, it means that current assets are highly dependent on inventory.

Not everyone calculates these ratios the same as you can see with the Modified Quick ratio below. This ratio removes from Accounts Receivable the Allowance for doubtful accounts, or in this case my customers over 120 days.

$$= \frac{(\text{Cash} - \text{Account Reveivable} - 120 \text{ days Past due})}{\text{Current Liabilities}}$$

Income Statement

The Income Statement, sometimes called the profit and loss statement shows the performance of the business over a period of time.

Income Statement Account Type	Descriptions
Revenue	Dollars earned for Services rendered, Cash and Credit
Costs of Goods Sold	Amounts paid or accured for Materials, Labor, Other Expenes
Gross Profit	Profit before operating expenses and Other Income / Expense
Operating Expenses	Selling and General Administrative expense to operate the business
Operating Income	Amount remaining after subtracting operating expenses from gross profit
Income Before Taxes	Operating Income plus Other Income less Other Expenses
Net Income	This is what the business earned in a designated period of time.

Here is a condensed Income Statement.

Always Safe, Inc.								
COMPARATIVE INCOME STATEMENT								
For the period ended: December 2017								
	October	%	November	%	December	%	YTD	%
Revenues:								
Total Revenue	281,658.41	100.00%	284,272.20	100.00%	285,470.26	100.00%	1,420,097.05	100.00%
Cost of Goods Sold:								
Total cost of Goods Sold	162,860.35	57.82%	164,882.43	58.00%	165,171.75	57.86%	821,141.71	57.82%
Gross Profit	118,798.06	42.18%	119,389.77	42.00%	120,298.51	42.14%	598,955.34	42.18%
Operating Expenses								
Total Operating Expenses	110,128.03	39.10%	109,617.99	38.56%	104,459.74	36.59%	540,480.16	38.06%
Operating Income	8,670.03	3.08%	9,771.78	3.44%	15,838.77	5.55%	58,475.18	4.12%
Other Income / Expense								
Total Other Income	58.86	0.02%	25.00	0.01%	25.00	0.01%	138.86	0.01%
Income Before Taxes	8,728.89	3.10%	9,796.78	3.45%	15,863.77	5.56%	58,614.04	4.13%
Taxes	$ 912.71	0.32%	$ 912.71	0.32%	$ 912.71	0.32%	$ 4,563.55	0.32%
Net Income	$ 7,816.18	2.78%	$ 8,884.07	3.13%	$ 14,951.06	5.24%	$ 54,050.49	3.81%

Notes

Double Entry Accounting

What does SedonaOffice do behind the scenes? Let's go through a few real-life situations.

1. Pay a Subcontractor $ 5,000 for service provided

2. Issue Parts to a Job a total of $ 1,800.

3. Receive inventory into the warehouse. Total cost of $ 850.00

4. Bill for a service Ticket. Time and Material bill for $ 145.

5. Receive money from a customer as a Deposit on Job totaling $10,000

6. Receive $ 150 from a customer who pays a Quarterly RMR invoice.

Subcontractor payment

First, let's record the bill. The bill gets entered into Account Payable. Let's assume it was for a job that is not yet complete.   When the bill is entered the Subcontract vendor payable will increase by $5,000 and Work in Process – Other account will increase by $5,000.

Account	Descrition	Debit	Credit	Branch	Category
14500	Work in process - Other	5,000.00		Michigan	
20000	Account Payable		5,000.00	Michigan	

When the payment is processed through the Pay bills section within SedonaOffice, that process will produce this entry.

Account	Descrition	Debit	Credit	Branch	Category
20000	Account Payable	5,000.00		Michigan	
10000	Cash - Checking		5,000.00	Michigan	

Notes

Parts issued to a job

In this case, the parts will be issued from our Main warehouse and will go into a job that is not yet completed.

Account	Description	Debit	Credit	Branch	Category
14250	Work in process - Parts	1,800.00		Michigan	
13000	Inventory		1,800.00	Michigan	

The parts on this job will be set aside in a job box awaiting pick up by the technician, but is still in fact issued to the job.

Receipt of Inventory

This inventory when received will be added to the Inventory on Hand and will be kept at the Standard cost without Overhead applied. Remember receiving inventory is a two-step process. It should be physically received then electronically received to the warehouse it is placed into.

Account	Description	Debit	Credit	Branch	Category
13000	Inventory	850.00		Michigan	
21000	Open Receipts		850.00	Michigan	

This receipt will sit in this account until the actual invoice is received from the vendor. At which time the open receipt will be added to the vendor payable. Here's what SedonaOffice will do behind the scenes when the bill is actually received.

Account	Description	Debit	Credit	Branch	Category
21000	Open Receipts	850.00		Michigan	
20000	Account Payable		850.00	Michigan	

Notes

Billing for a Service Ticket

When the ticket has been resolved and billed, SedonaOffice will automatically produce this entry:

Account	Descrition	Debit	Credit	Branch	Category
12000	Accounts Receivable	145.00		Michigan	
41000	Service Revenue T&M		145.00	Michigan	Service

You have the option of closing the ticket after billing it or you can leave it open for final review before closing the ticket itself. Processes vary depending on personnel and complexity of the work performed.

Deposit on Account

Here we are assuming the customer submitted a payment along with a signed contract to perform the installation. We will further assume that it is only a partial payment essentially set aside to order the parts required to complete the job. SedonaOffice does this in two parts. First, the payment is processed through Payment Processing and when that is done here's what the entry looks like.

Account	Descrition	Debit	Credit	Branch	Category
11000	Undeposited funds	10,000.00		Michigan	
23000	Advance Deposits		10,000.00	Michigan	

When the Deposit is actually made the funds move from Undeposited to Cash.

Account	Descrition	Debit	Credit	Branch	Category
10000	Cash - Checking	10,000.00		Michigan	
11000	Undeposited funds		10,000.00	Michigan	

Notes

Remember, this amount will sit on the customer ledger reflected as a credit. Once an amount is actually billed, this deposit can be applied directly to that invoice. Here are the entries that will happen behind the scenes to reflect the billing and then subsequent application of the Deposit.

Account	Descrition	Debit	Credit	Branch	Category
12000	Accounts Receivable	15,000.00		Michigan	
40000	Installation - Comm		15,000.00	Michigan	Insatll - Com
23000	Advance Deposits	10,000.00		Michigan	
12000	Accounts Receivable		10,000.00	Michigan	

Receive payment for a previously billed account

Here, the customer is paying for a quarterly recurring billing. This amount will be processed through SedonaOffice payment processing and here is what the entry made behind the scenes will look like.

Account	Descrition	Debit	Credit	Branch	Category
10000	Cash	150.00		Michigan	
12000	Accounts Receivable		150.00	Michigan	

The creation of the bill related to this customer RMR is another story altogether. This is where Deferred Revenue comes into play.

Let's talk about how SedonaOffice handles that transaction. The below journal will take place when cycle billing is performed. Of course, this process is generally run for your entire client base, but the individual entry remains the same.

Account	Descrition	Debit	Credit	Branch	Category
12000	Accounts Receivable	150.00		Michigan	
22000	Deferred Income		150.00	Michigan	

Notes

More than likely you will be billing this customer in advance. Let say this customer was billed in September for the coming quarter. The invoice will cover Oct through Dec. When in October, the revenue recognition will happen through the General Ledger module under Deferred Income. Once recognized for the month here's what that Journal entry will look like.

Account	Descrition	Debit	Credit	Branch	Category
22000	Deferred Income	50.00		Michigan	
44000	Recurring Income		50.00	Michigan	Monitoring

The remainder of the original invoice, or $ 100, will remain in the liability section of your Balance Sheet until those respective months have come to pass.

Notes

Accounting Equation for a Corporation

Remember our equation.

Asset = Liabilities + Equity

Retained Earnings sits in the Equity section of your Balance Sheet. Just as the name would suggest, it is an accumulation of the difference between revenues and expenses. That difference (Revenues and Expenses) runs through Retained Earnings at the beginning of every accounting year automatically in SedonaOffice. So, there is no need to close your revenue and expense accounts into Retained Earnings.

Equity		
Equity		
	310100 - Common Stock	49,954.53
	310200 - Paid in Capital	100,073.33
	320100 - Retained Earnings	34,727,764.78
	Net Income (Loss) Current Fiscal Year	164,498.74
Total Equity		35,042,291.38

The above Balance Sheet, which shows the Equity Section only, reflects Retained Earnings and the current Net income related to a particular period. As stated above, once the new year starts that amount shown as Net Income will roll into Retained Earnings automatically. So, if the above Equity Section of the Balance Sheet was run at 12/31/2017, and the Company was on a Calendar yearend, on day one of the new year Retained Earnings would be the total of Retained Earnings prior of $34 million plus the $164 thousand.

Retained Earnings at the beginning of 2018:

Retained Earnings	12/31/2017	$	34,727,764.78
Net Income	12/31/2017	$	164,498.74
Retained Earnings	1/1/2018	$	34,892,263.52

Notes

Remember, Assets are increased with Debits and reduce with (Credits). Paying down a Payable would reduce Cash and subsequently reduce the payable. Liabilities are reduced with a Debit and increased with a (Credit).

1. Pay a Subcontractor $ 5,000 for service provided

Asset	=	Liabiility	+	Equity
		5,000.00 AP		-
(5,000.00) Cash				

2. Issue Parts to a Job for a total of $ 1,800.

Asset	=	Liabiility	+	Equity
1,800.00 WIP				
(1,800.00) INV				

Here, we are simply moving an Asset from one account to the next. The net effect of this transaction on the Balance Sheet is zero.

3. Receive inventory into the warehouse. Total cost of $ 850.00

Asset	=	Liabiility	+	Equity
850.00 INV				-
		(850.00) OR		

Notes

4. Bill for a service Ticket. Time and Material bill for $ 145.

Asset	=	Liabiility	+	Equity
145.00 AR				
				(145.00) REV

5. Receive money from a customer as a Deposit on Job totaling $10,000

Asset	=	Liabiility	+	Equity
10,000.00 UnDEp				
		(10,000.00) AD		

Asset	=	Liabiility	+	Equity
10,000.00 Cash				
(10,000.00) UnDEp				

Asset	=	Liabiility	+	Equity
15,000.00 AR				
				(15,000.00) REV
		10,000.00 AD		
(10,000.00) AR				

Notes

6. Receive $ 150 from a customer who pays a Quarterly RMR invoice.

Asset	=	Liabiility	+	Equity
150.00 Cash				
(150.00) AR				

Asset	=	Liabiility	+	Equity
150.00 AR				
		(150.00) DEF		

Asset	=	Liabiility	+	Equity
		50.00 DEF		
				(50.00) REV

Account Register

The Account register is found on the Main Application Menu Tree under General Ledger. The Account Register allows you to look into the details that make up General Ledger Balances.
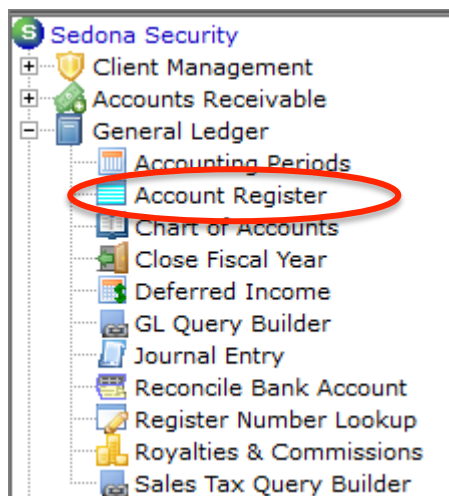
Notes

Account Register Types

Register types found in the Account Register will provide insight as to where the transaction was generated.

Here is a list of all Register types that can be selected in the Account Register and what they mean. These Register Types are in alphabetic order.

AAADJ	Inventory Adjustment
ADVDEP	Customer Payment saved as an Advance Deposit for a Job
BANKFEE	Bank Fees entered and posted Bank Account Reconciliation
BILL	Accounts Payable Bill
BILLPYMT	Payment of an Accounts Payable Bill.
CCARD	Transfer made to a Credit Card type Vendor when an A/P Bill is paid with a Credit Card.
CHK	Accounts Payable Check
CINV	Invoices credited off using Credit Off Invoices function from Accounts Receivable menu.
COGS	Cost transaction recorded typically for Labor and Material Expenses for Jobs, Service Tickets and Over the Counter Part Sales
COMMI	Commissions posted to a Job
CREDIT	Accounts Payable Vendor Credit
CRMEMO	Credit off customer invoice or manual credit memo
DEFINC	Generated by the Deferred Income Posting process; moves amounts from Deferred Income Account to Regular Income Accounts
DEP	Deposit of a Customer payment Batch into a Bank Account
DISCT	Transaction recorded when a discount is taken on an A/P Bill during Bill Payment

Here the rest of the list.

GENJRNL	Manually created Journal Entry
INV	Customer Invoice
JCHANGE	Change made to a manually created Journal Entry
JOBACC	Transaction performed when a job is closed to move invoiced amounts from an accrual account to regular income accounts.
LABOR	Transaction posted when Labor Timesheets are entered for a job
MINC	Customer Payment applied to a Miscellaneous Income account
MWIP	Transaction created when parts are issued to a job which is using work in process accounts
OVRHD	Transaction posted when Labor is applied to a job. Job Setup must have activated posting overhead to the GL.
PPV	Transaction created when there is a variance between the received cost of parts and the cost entered on the A/P Bill.
PYMT	Customer payment
PYROLL	Transaction to post a Payroll Timesheet batch to the G/L
RCPT	Receipt of a Purchase Order
REFUND	Refund of Unapplied cash or credit to a customer
RETURN	Transaction created to credit inventory when inventory parts are returned to a Vendor for credit
ROYALTY	Transaction posted when a cycle batch is posted that contains recurring lines that are setup for Royalties
SALETAX	Sales Tax portion of a Customer Invoice
UNAP	Customer Payment applied to Unapplied Cash during payment processing
VOID	Voiding of an A/P Check
XTFR	Transfer between branches to split a transaction where multiple branches exist.

Notes

Work in Process

Work in Process is just what it sounds like, work that is not yet complete. We will talk more about this in the GL setup track, but understanding why it exists and how it gets relieved is an important accounting process.

If your company has decided to use Work In Process (WIP), all expenses related to Jobs will sit on the Balance Sheet until those jobs are closed. When the job is closed, all expenses related to that job will release to the Income statement.
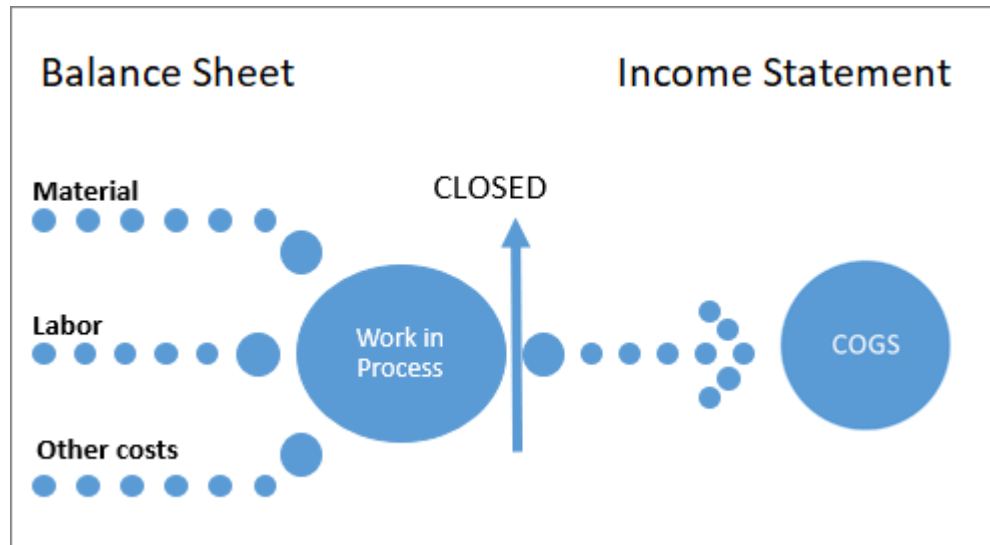
Notes

Work in Process Entries

Transaction Type (GL Register)	G/L Account	Source for GL Account Number	Debit	Credit
Job Invoice				
Job Invoice: Using Work In Process Account for Parts, Labor, Commissions. Install Charges, Recurring Items, Parts.				
INV	Accounts Receivable	Invoice Form (defaulted from G/L Setup Defaults for AR in SedonaSetup)	X	
INV	Income (Install Charges)	Invoice Item Code for Install Charge		X
INV	Deferred Income (Recurring Lines)	Deferred Account setup on the Invoice Item or if none specified, use G/L Setup Defaults for AR in SedonaSetup		X
INV	Income (Parts Invoiced)	Invoice Item Code on the Part setup		X
INV	Sales Tax Liability	Tax Table (associated with Tax Group for site)		X
COG	Materials WIP (Asset)	Material WIP Account for the Job Type		X
COG	COG (Cost of Goods Sold for Parts)	COGS Account for Job Type	X	
COMMI	Commission WIP (Asset)	Job Type setup, if none use Setup Processing for JM		X
COMMI	Commission Expense	Job Type setup, if none use Setup Processing for JM	X	
LABOR	Labor WIP (Asset)	Job Type setup, if none use Install Company, if none use Setup Processing for JM		X
LABOR	Labor Expense	Job Type setup, if none use Install Company, if none use Setup Processing for JM	X	

Journal for Particular items

To get a look at how SedonaOffice records transactions to the GL, where available, select the Icon identified below to get the Journal entry book for the transaction.
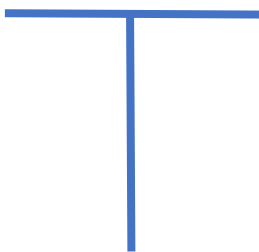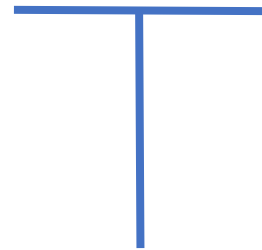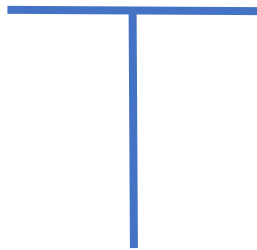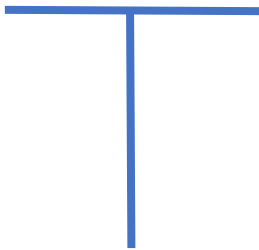

Notes

Extra Credit

Can you create journal entries for these events? T accounts are provided below. In order to receive the credit, you will need to title the T accounts (which are already placed in the proper Account Type group) and book the entries needed to record the transactions. Extra, Extra credit: what is the effect on Total Revenue at the end of December based on these events?

Customer A is billed in September for Oct, Nov, Dec monitoring
Customer A pays $105 in late Oct for billed amount covering Oct, Nov, Dec monitoring.
Customer A cancels on Oct 31, leaving Nov and Dec as 2 months of pre-paid monitoring.
Customer wants refund. Credit is processed for Customer A for $70.00 through Deferred
Refund Customer A $70.00 for the future RMR paid for, but will no longer use.
What happens in the deferred account in November and December?

Assets	Liabilities	Income Statement

Notes