

FOUNDATIONS SERIES

# Baratelli Foundations: Accounting Reference

Five essential references for reading, recording, and reviewing your books.

This collection brings together five essential accounting references in one place. Whether you're a small business owner trying to understand your financials, or a student building a solid foundation, these guides are designed to be clear, practical, and immediately useful. Each guide stands on its own — read them in order or jump to the one you need.

*For: small business owners · bookkeepers · students · early-career finance professionals.*

	Guide Title	What You'll Learn
Guide 1	The Chart of Accounts Explained	Account types, numbering, and sample accounts
Guide 2	How to Read Financial Statements	Income statement, balance sheet, cash flow
Guide 3	The Accounting Cycle Step by Step	All 8 steps from transaction to closing
Guide 4	Common Bookkeeping Mistakes & Fixes	Top 15 errors and how to correct them
Guide 5	Debits & Credits Cheat Sheet	Quick-reference for every account type

Pair this reference with *Baratelli Foundations: Journal Entries Reference* for the 46 worked examples behind every concept in this collection.

## The Chart of Accounts Explained

*Account types, numbering conventions, and real-world examples*

The Chart of Accounts (COA) is the master list of every account your business uses to record financial transactions. Think of it as the filing system for your entire business — every journal entry, every invoice, every paycheck gets sorted into one of these buckets. A well-organized COA makes your financial statements accurate and your tax prep much easier.

### The Five Account Types

Account Type	Normal Balance	What It Tracks	Examples
<b>Assets</b>	Debit	Things the business OWNS or is OWED	Cash, Accounts Receivable, Inventory, Equipment, Buildings
<b>Liabilities</b>	Credit	Things the business OWES to others	Accounts Payable, Loans Payable, Sales Tax Payable, Unearned Revenue
<b>Equity</b>	Credit	The owner's stake in the business	Owner's Capital, Retained Earnings, Common Stock, Treasury Stock
<b>Revenue</b>	Credit	Money EARNED from business operations	Sales Revenue, Service Revenue, Interest Income, Rental Income
<b>Expenses</b>	Debit	Costs incurred to run the business	Wages Expense, Rent Expense, COGS, Depreciation, Utilities

### Standard Numbering Convention

Most businesses assign account numbers so that reports sort automatically and new accounts can be inserted without renumbering everything. The most common system uses 4-digit numbers by category:

Number Range	Account Type	Example Accounts
1000 – 1999	Assets	1000 Cash, 1100 Accounts Receivable, 1500 Equipment
2000 – 2999	Liabilities	2000 Accounts Payable, 2100 Notes Payable, 2200 Sales Tax Payable
3000 – 3999	Equity	3000 Owner's Capital, 3100 Retained Earnings, 3900 Owner's Drawing
4000 – 4999	Revenue	4000 Sales Revenue, 4100 Service Revenue, 4500 Interest Income

5000 – 5999	Cost of Goods Sold	5000 Cost of Goods Sold, 5100 Freight-In
6000 – 6999	Operating Expenses	6000 Wages Expense, 6100 Rent, 6200 Utilities, 6300 Insurance
7000 – 7999	Other Income/Expense	7000 Gain on Sale of Asset, 7100 Interest Expense

**Tip:** Leave gaps between account numbers (e.g., 1000, 1100, 1200) so you can add new accounts later without disrupting the sequence.

### Sample Chart of Accounts — Small Service Business

Acct #	Account Name	Type	Normal Balance
1000	Checking Account	Asset	Debit
1010	Savings Account	Asset	Debit
1100	Accounts Receivable	Asset	Debit
1200	Prepaid Insurance	Asset	Debit
1500	Equipment	Asset	Debit
1510	Accumulated Depreciation — Equipment	Contra Asset	Credit
2000	Accounts Payable	Liability	Credit
2100	Credit Card Payable	Liability	Credit
2200	Sales Tax Payable	Liability	Credit
2300	Payroll Tax Payable	Liability	Credit
2500	Notes Payable	Liability	Credit
3000	Owner's Capital	Equity	Credit
3900	Owner's Drawing	Equity (Contra)	Debit
4000	Service Revenue	Revenue	Credit
4100	Other Income	Revenue	Credit
6000	Salaries & Wages Expense	Expense	Debit
6100	Rent Expense	Expense	Debit
6200	Utilities Expense	Expense	Debit
6300	Insurance Expense	Expense	Debit
6400	Depreciation Expense	Expense	Debit

<b>6500</b>	<b>Office Supplies Expense</b>	Expense	Debit
<b>6600</b>	<b>Professional Fees</b>	Expense	Debit
<b>7100</b>	<b>Interest Expense</b>	Other Expense	Debit

**Tip:** Your chart of accounts should match how you think about your business. A restaurant owner needs 'Food & Beverage Cost'; a consultant needs 'Professional Development.' Customize it to tell YOUR story.

# How to Read Financial Statements

*Understand your Income Statement, Balance Sheet, and Cash Flow Statement*

Your accountant or bookkeeper produces three core financial statements. Most business owners glance at them, feel confused, and set them aside. This guide walks you through each one — what it tells you, what to look for, and what the numbers actually mean for your business.

## Statement 1: The Income Statement (Profit & Loss)

The Income Statement shows what your business **earned and spent over a period of time** (a month, quarter, or year). It answers the question: *Did we make money?*

Line Item	What It Means	Watch For
Sales Revenue	Total income earned from selling goods or services	Is it growing month over month?
Cost of Goods Sold (COGS)	Direct costs to produce what you sold (materials, labor)	Should move proportionally with revenue
Gross Profit	Revenue minus COGS — what's left to cover overhead	Gross margin % = $\text{Gross Profit} \div \text{Revenue}$
Operating Expenses	Overhead costs: rent, wages, marketing, insurance, etc.	Are any categories growing unexpectedly?
Operating Income (EBIT)	Gross Profit minus Operating Expenses	Your core business profitability
Interest Expense	Cost of borrowing money (loans, lines of credit)	High interest can erode a healthy operation
Net Income (Net Loss)	The bottom line — profit after all expenses	This flows into equity on the balance sheet

**Tip:**  $\text{Gross Margin \%} = \text{Gross Profit} \div \text{Revenue}$ . Most healthy service businesses run 50–70%+. Product businesses vary widely by industry. Track this number every month.

## Statement 2: The Balance Sheet

The Balance Sheet shows what your business **owns, owes, and is worth at a single point in time**. It always balances: **Assets = Liabilities + Equity**. Think of it as a financial snapshot.

Section	What It Includes	Key Question to Ask
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Current Assets	Cash, accounts receivable, inventory, prepaids — items convertible to cash within 12 months	Do we have enough cash to pay bills?
Non-Current Assets	Equipment, buildings, vehicles, intangibles — long-term resources	Are assets depreciating faster than we're reinvesting?
Current Liabilities	Accounts payable, short-term loans, accrued expenses — due within 12 months	Can we cover these with current assets?
Long-Term Liabilities	Mortgages, long-term notes payable — due beyond 12 months	Is our debt load manageable?
Owner's Equity / Retained Earnings	What's left after liabilities — the owner's residual claim	Is equity growing over time?

**Tip:**  $Current\ Ratio = Current\ Assets \div Current\ Liabilities$ . A ratio above 1.0 means you can cover short-term obligations. Below 1.0 is a warning sign.

### Statement 3: The Cash Flow Statement

The Cash Flow Statement shows **where cash came from and where it went** during the period. A business can show a profit on the income statement and still run out of cash — this statement is where you catch that disconnect.

Section	What It Shows	Healthy Sign
Operating Activities	Cash generated (or used) by normal business operations — collecting from customers, paying suppliers and employees	Positive and growing — this funds everything else
Investing Activities	Cash spent on or received from long-term assets — buying equipment, selling property	Negative is often OK — it means you're investing in growth
Financing Activities	Cash from borrowing or equity, and repayments — loan proceeds, owner contributions, debt repayment	Manageable — watch that borrowing isn't masking poor operations
Net Change in Cash	The sum of all three sections — did cash go up or down?	Ending cash balance should be sufficient for upcoming obligations

**Tip:** Profitable but cash-poor? Check Accounts Receivable on the balance sheet — you may be earning revenue that customers haven't paid yet. Collections are often the real issue.

**Going deeper** — For ratio analysis, valuation methods, and the formulas that turn these three statements into decisions, see **Baratelli Foundations: Corporate Finance Reference** (Sections 3, 6, and 7).

# The Accounting Cycle Step by Step

*From source document to closed books — every step explained*

The accounting cycle is the complete process of recording and reporting a business's financial activity for a given period. It repeats every month, quarter, or year. Understanding this cycle helps you know where your bookkeeper is in the process at any given time — and what needs to happen before your financial statements are ready.

## Identify & Analyze Transactions

### Step 1

Every financial event — a sale, a bill received, a payroll run — starts with a source document: a receipt, invoice, bank statement, or contract. You must determine which accounts are affected and by how much.

*Tip: Not every business event is a financial transaction. Signing a contract, for example, is not recorded until money or obligation changes hands.*

## Record in the Journal (Journal Entry)

### Step 2

The transaction is recorded in the general journal as a journal entry — debits on the left, credits on the right, always equal. This is the official first entry into the accounting system. (See the Baratelli Foundations: Journal Entries Reference for detailed examples.)

*Tip: Every journal entry needs a date, account names, amounts, and a brief description (memo). This is your audit trail.*

## Post to the General Ledger

### Step 3

Each journal entry is posted (transferred) to the individual account it affects in the General Ledger. The ledger keeps a running balance for each account — think of each account as its own mini bank statement.

*Tip: In modern accounting software (QuickBooks, Xero), posting happens automatically when you save a transaction.*

## Prepare the Unadjusted Trial Balance

### Step 4

At period end, all ledger balances are listed in a trial balance to verify that total debits equal total credits. If they don't balance, there's an error somewhere that must be found before moving forward.

*Tip: A balanced trial balance does NOT mean the accounts are correct — only that debits equal credits. Errors can still exist in the wrong accounts.*

**Record Adjusting Entries****Step 5**

Adjusting entries update account balances to reflect economic reality at period end. Common adjustments include: recognizing prepaid expenses used up, accruing wages earned but unpaid, recording depreciation, and recognizing earned portions of unearned revenue.

*Tip: Adjusting entries are required under the accrual basis of accounting. Cash-basis businesses make very few adjustments.*

**Prepare the Adjusted Trial Balance****Step 6**

After adjusting entries are posted, a new trial balance is prepared to confirm everything still balances. This adjusted trial balance is the foundation for preparing the financial statements.

*Tip: This is the most important trial balance — it's the data that goes directly into your financial reports.*

**Prepare Financial Statements****Step 7**

The three core financial statements are prepared from the adjusted trial balance: (1) Income Statement — revenues and expenses for the period; (2) Balance Sheet — assets, liabilities, and equity at period end; (3) Cash Flow Statement — sources and uses of cash.

*Tip: The income statement is always prepared first because net income flows into the balance sheet's equity section.*

**Record Closing Entries & Start Again****Step 8**

Revenue, expense, and drawing accounts (called temporary accounts) are zeroed out by closing entries so they start fresh in the new period. Their balances are transferred to Retained Earnings (or Owner's Capital). A post-closing trial balance confirms only permanent accounts remain open.

*Tip: Closing entries are usually done once a year (at fiscal year end), not monthly. Balance sheet accounts (permanent) are never closed.*

**Tip:** The cycle repeats every accounting period. Monthly closings give you 12 opportunities a year to catch errors, spot trends, and make informed decisions — don't skip them.

# Common Bookkeeping Mistakes & How to Fix Them

*The top 15 errors small businesses make — and what to do instead*

Most bookkeeping problems aren't caused by complex accounting rules — they come from a handful of common habits and misunderstandings. Here are the 15 mistakes that accountants see most often, and exactly how to fix (or avoid) each one.

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|-----|---|
| #01 | <p><b>Mixing Personal and Business Finances</b></p> <p><b>The Mistake:</b> Using a personal bank account or credit card for business expenses — or paying personal bills from the business account.</p> <p><b>The Fix:</b> Open a dedicated business checking account and credit card from day one. Every transaction should be clearly business or personal. Commingling funds is one of the top red flags in an IRS audit.</p>                      |
| #02 | <p><b>Not Reconciling the Bank Account Monthly</b></p> <p><b>The Mistake:</b> Assuming the bank balance in your accounting software matches your actual bank statement without verifying.</p> <p><b>The Fix:</b> Reconcile every bank and credit card account every single month. Unreconciled accounts hide errors, duplicate entries, and even fraud.</p>   |
| #03 | <p><b>Recording Expenses in the Wrong Account</b></p> <p><b>The Mistake:</b> Posting office supplies to 'Equipment,' or lumping all expenses into 'Miscellaneous' because you're unsure where they go.</p> <p><b>The Fix:</b> Invest 30 minutes setting up a proper chart of accounts (see Guide 1). When in doubt, ask your accountant — a misclassified expense can overstate assets or understate deductions.</p>                                  |
| #04 | <p><b>Forgetting to Record Owner Contributions and Withdrawals</b></p> <p><b>The Mistake:</b> The owner deposits personal money into the business (or takes money out) without recording it — leading to unexplained balance differences.</p> <p><b>The Fix:</b> Every owner contribution should debit Cash and credit Owner's Capital. Every withdrawal should debit Owner's Drawing and credit Cash. These are NOT business income or expenses.</p> |
| #05 | <p><b>Using Cash Basis When Accrual Is Required</b></p> <p><b>The Mistake:</b> Recording income only when cash is received and expenses only when paid, even when the business has significant receivables or payables.</p> <p><b>The Fix:</b> Most businesses with inventory or revenues above ~\$25M are required to use accrual accounting. Even smaller businesses benefit from accrual — it gives a truer picture of profitability.</p>          |

#06	<p><b>Not Tracking Accounts Receivable Properly</b></p> <p><b>The Mistake:</b> Recording a sale but not following up on payment — or not recording the sale until cash is received.</p> <p><b>The Fix:</b> Invoice immediately when the sale is made. Run an Accounts Receivable aging report weekly. Anything over 60 days needs active follow-up. Uncollected receivables destroy cash flow.</p>
#07	<p><b>Duplicating Transactions</b></p> <p><b>The Mistake:</b> Entering a bill manually AND importing it from a bank feed — resulting in double expenses that understate profits.</p> <p><b>The Fix:</b> Establish a clear workflow: either import from the bank and match, OR enter manually — not both. Review your bank reconciliation; duplicate entries show up as reconciling items.</p>
#08	<p><b>Mishandling Sales Tax</b></p> <p><b>The Mistake:</b> Treating collected sales tax as revenue, or forgetting to remit it on time.</p> <p><b>The Fix:</b> Sales tax you collect belongs to the government — it's a liability, not income. Set up a dedicated Sales Tax Payable account and pay on time. Late remittance triggers penalties and interest.</p>
#09	<p><b>Failing to Record Depreciation</b></p> <p><b>The Mistake:</b> Expensing an asset purchase entirely in the year of purchase (when it should be capitalized), or never recording depreciation on long-term assets.</p> <p><b>The Fix:</b> Assets over your capitalization threshold (usually \$2,500+) should be capitalized and depreciated over their useful life. Missing depreciation overstates income and understates asset values.</p>
#10	<p><b>Ignoring Petty Cash</b></p> <p><b>The Mistake:</b> Spending from petty cash with no receipts and no replenishment entries — leaving an unexplained hole in cash.</p> <p><b>The Fix:</b> Keep all petty cash receipts. When the fund is low, replenish it with a check equal to the total receipts. Record each expense category at that time. The petty cash account balance should always equal physical cash + receipts.</p>
#11	<p><b>Not Backing Up Accounting Data</b></p> <p><b>The Mistake:</b> Keeping financial records only on a local computer or a single device with no backup.</p> <p><b>The Fix:</b> Use cloud-based accounting software (QuickBooks Online, Xero) or set up automatic off-site backups daily. A crashed hard drive with no backup has cost business owners years of records.</p>

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- #12** **Waiting Until Tax Time to Update the Books**
- The Mistake:** Letting transactions pile up for months and then doing a massive catch-up in December or January.
- The Fix:** Update your books weekly, or at minimum monthly. Waiting creates errors, missed deductions, and enormous stress. Monthly financials also help you catch problems before they become crises.
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- #13** **Paying Contractors Without Collecting a W-9**
- The Mistake:** Paying a freelancer or vendor over \$600 in a year without having a W-9 on file, making it impossible to file a 1099.
- The Fix:** Collect a W-9 from every independent contractor before making the first payment — not after. 1099-NEC forms are due by January 31 each year. Penalties apply per missing form.
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- #14** **Misclassifying Employees as Independent Contractors**
- The Mistake:** Treating a worker as a contractor to avoid payroll taxes, when the IRS would classify them as an employee based on the level of control you exercise.
- The Fix:** The IRS uses a multi-factor test. If you control how, when, and where someone works, they are likely an employee. Misclassification can result in back payroll taxes, penalties, and interest.
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- #15** **No Separation of Duties**
- The Mistake:** One person handles all of the bookkeeping, bill payment, bank reconciliation, and check signing — leaving no internal check on errors or fraud.
- The Fix:** In small businesses this is difficult, but try to separate who approves expenses from who records them and who signs checks. Have someone other than the bookkeeper review the bank reconciliation each month.
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# Debits & Credits Cheat Sheet

*The quick-reference guide every accountant tapes to their monitor*

Debits and credits are the language of accounting. Every transaction is recorded using at least one debit and one credit, and they must always be equal. The trick is remembering which direction each account type moves. Use this cheat sheet until it becomes second nature.

## The Golden Rules of Debits & Credits

**DEBIT (Dr)** — Left side of every journal entry

Increases: Assets, Expenses, Dividends/Drawings

Decreases: Liabilities, Equity, Revenue

**CREDIT (Cr)** — Right side of every journal entry

Increases: Liabilities, Equity, Revenue

Decreases: Assets, Expenses, Dividends/Drawings

*Memory trick: **DEA-D** = Debit increases Expenses, Assets, Drawings. **CLER** = Credit increases Liabilities, Equity, Revenue.*

## Complete Account Reference — Normal Balances & Effects

Account Type	Account Name Examples	Normal Balance	Debit Effect	Credit Effect
<b>Asset</b>	Cash	Debit	Increase ↑	Decrease ↓
<b>Asset</b>	Accounts Receivable	Debit	Increase ↑	Decrease ↓
<b>Asset</b>	Inventory	Debit	Increase ↑	Decrease ↓
<b>Asset</b>	Prepaid Expenses	Debit	Increase ↑	Decrease ↓
<b>Asset</b>	Equipment / Vehicles	Debit	Increase ↑	Decrease ↓
<b>Asset</b>	Buildings / Land	Debit	Increase ↑	Decrease ↓
<b>Asset</b>	Intangible Assets	Debit	Increase ↑	Decrease ↓
<b>Contra Asset</b>	Accumulated Depreciation	Credit	Decrease ↓	Increase ↑
<b>Contra Asset</b>	Allowance for Doubtful Accounts	Credit	Decrease ↓	Increase ↑
<b>Liability</b>	Accounts Payable	Credit	Decrease ↓	Increase ↑
<b>Liability</b>	Notes Payable / Loans Payable	Credit	Decrease ↓	Increase ↑

<b>Liability</b>	Sales Tax Payable	Credit	Decrease ↓	Increase ↑
<b>Liability</b>	Payroll Tax Payable	Credit	Decrease ↓	Increase ↑
<b>Liability</b>	Unearned Revenue	Credit	Decrease ↓	Increase ↑
<b>Liability</b>	Accrued Expenses Payable	Credit	Decrease ↓	Increase ↑
<b>Liability</b>	Finance / Operating Lease Liability	Credit	Decrease ↓	Increase ↑
<b>Equity</b>	Owner's Capital / Common Stock	Credit	Decrease ↓	Increase ↑
<b>Equity</b>	Retained Earnings	Credit	Decrease ↓	Increase ↑
<b>Equity</b>	Additional Paid-In Capital (APIC)	Credit	Decrease ↓	Increase ↑
<b>Contra Equity</b>	Owner's Drawing / Dividends	Debit	Increase ↑	Decrease ↓
<b>Contra Equity</b>	Treasury Stock	Debit	Increase ↑	Decrease ↓
<b>Revenue</b>	Sales Revenue	Credit	Decrease ↓	Increase ↑
<b>Revenue</b>	Service Revenue	Credit	Decrease ↓	Increase ↑
<b>Revenue</b>	Interest Income	Credit	Decrease ↓	Increase ↑
<b>Revenue</b>	Gain on Sale of Asset	Credit	Decrease ↓	Increase ↑
<b>Contra Revenue</b>	Sales Returns & Allowances	Debit	Increase ↑	Decrease ↓
<b>Contra Revenue</b>	Sales Discounts	Debit	Increase ↑	Decrease ↓
<b>Expense</b>	Cost of Goods Sold	Debit	Increase ↑	Decrease ↓
<b>Expense</b>	Wages & Salaries Expense	Debit	Increase ↑	Decrease ↓
<b>Expense</b>	Rent Expense	Debit	Increase ↑	Decrease ↓
<b>Expense</b>	Utilities Expense	Debit	Increase ↑	Decrease ↓
<b>Expense</b>	Depreciation Expense	Debit	Increase ↑	Decrease ↓
<b>Expense</b>	Insurance Expense	Debit	Increase ↑	Decrease ↓
<b>Expense</b>	Interest Expense	Debit	Increase ↑	Decrease ↓
<b>Expense</b>	Bad Debt Expense	Debit	Increase ↑	Decrease ↓
<b>Expense</b>	Payroll Tax Expense	Debit	Increase ↑	Decrease ↓
<b>Expense</b>	Amortization Expense	Debit	Increase ↑	Decrease ↓
<b>Expense</b>	Loss on Disposal of Asset	Debit	Increase ↑	Decrease ↓

**Color Key:**

<b>Asset</b>	<b>Contra Asset</b>	<b>Liability</b>	<b>Equity</b>
<b>Contra Equity</b>	<b>Revenue</b>	<b>Contra Revenue</b>	<b>Expense</b>

**Tip:** When you're unsure which way an entry goes, ask: 'What happened to the business?' If an asset went up — debit it. If a bill arrived — credit a liability. If you earned money — credit revenue. Start there and the other side follows automatically.

**Companion reference** — The cheat sheet on this page is the grammar. The 46 worked applications live in **Baratelli Foundations: Journal Entries Reference** — each entry shows exactly which accounts move and why.

**NEXT STEP — Going Deeper**

If these five references answered your questions, the **CFO & Controller's Guide** is the full controller seat — the close cadence, statement preparation, controls, and audit readiness behind everything in this Foundations reference.

**CFO & Controller's Guide — 489pp paid flagship**

- Full month-end close cadence and workpaper standards
- Financial statement preparation in production detail
- Internal controls aligned to SOX 404 expectations
- Audit readiness, sampling, and reviewer commentary
- The full controller seat — not just the references

Read at: [baratelliinstitute.com/cfo-controllers-guide](http://baratelliinstitute.com/cfo-controllers-guide)

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