Accounting Foundations: *The Language of Business*

Your Learning Transformation

BEFORE Studying This Chapter...

- You might see business numbers but feel unsure how to perform essential calculations like finding the **profit** from a month's sales or figuring out the correct amount of **tax** to charge a customer.
- Financial terms like **Assets**, **Liabilities**, or **Equity** may sound like abstract jargon with no clear, real-world meaning. You may not understand the fundamental connection between what a company owns and what it owes.
- The process of turning a long list of daily transactions into a useful report like an **Income Statement** might seem like a complete mystery.
- Overall, you might feel that without a proper system, a business is "**flying blind**"—unable to know if it's profitable, track its cash, or make smart decisions.

AFTER Completing This Chapter...

- You will be able to correctly calculate total invoice amounts by adding percentage-based taxes, such as the **12% Value Added Tax (VAT)** in the Philippines.
- You will be able to perform critical business calculations, such as finding a company's profit using the formula **Profit=Revenue−Expenses**.
- You will be able to calculate a company's **profit margin** to understand what percentage of revenue was actual profit.
- You will be able to define the five key building blocks of accounting: **Assets**, **Liabilities**, **Equity**, **Revenue**, and **Expenses**.
- You will be able to apply the "golden rule" of accounting, the **Accounting Equation** (Assets=Liabilities+Equity), which is the foundation for all financial recording.
- You will be able to identify and explain the three core functions of accounting: **Recording**, **Organizing**, and **Reporting**.
- You will be able to understand why accounting is called the "**language of business**" and is essential for making smart decisions and achieving success.

What Is Accounting?

1. Accounting: The Language of Business

Welcome to the world of accounting! If you've ever managed a budget or saved up for something, you've already used some basic accounting principles.

Think of accounting as the **language of business**. Every day, a company engages in financial activities—we call these **transactions**. Examples include selling a product to a customer, paying an employee's salary, or buying new equipment. Accounting is the system we use to record, understand, and communicate the story of these transactions.

This information helps company leaders make smart decisions, allows investors to see if the company is a good investment, and helps the government make sure the right amount of tax is being paid.

Without accounting, a business would be flying blind.

- You wouldn't know if you were making a profit or losing money.
- You couldn't track where your cash was going.
- You wouldn't be able to get a loan from a bank or report to investors.
- Filing accurate tax returns would be impossible, leading to serious penalties.

In short, accounting is essential for survival and success in business.

2. The Core Functions of Accounting

No matter where you are in the world—the U.S., Japan, or the Philippines—the fundamental jobs of accounting are the same. We can break them down into three main functions:

Recording

This is the starting point. We carefully and accurately record every single transaction that happens. This is often called **bookkeeping**.

Example: When a coffee shop sells a latte for $5, a bookkeeper records that $5 of revenue was earned.

Organizing

A long list of transactions isn't very useful. In this step, we classify and summarize the recorded data into categories. This helps us see patterns and understand the bigger picture.

Example: At the end of the month, we can add up all the latte sales to see the total revenue from lattes, and compare it to the total cost of coffee beans and milk.

Reporting

This is the communication step. We take the organized information and create standardized reports called **financial statements**. These statements tell the company's financial story to people both inside and outside the company.

Example: The **Income Statement** is a report that shows if the company was profitable for a specific period.

While these functions are universal, different countries have unique priorities based on their laws and business culture.

United States

The primary focus is on providing clear and transparent information for **investors and shareholders**. Publicly traded companies must follow strict reporting rules set by the Securities and Exchange Commission (SEC).

Japan

There is a strong cultural emphasis on precision and detail. Tax compliance is extremely important, and the rules around consumption tax and social security can be complex.

The Philippines

Businesses face frequent tax reporting requirements, often monthly, to the Bureau of Internal Revenue (BIR). Correctly handling Value Added Tax (VAT) and withholding taxes is a major part of the day-to-day accounting workload.

3. The Five Building Blocks of Accounting

To understand the story that accounting tells, you need to know the main characters. There are five key terms that are the building blocks of all accounting.

Assets

These are the valuable resources the company **owns**. Think of anything that has future economic value.

Examples: Cash in the bank, inventory waiting to be sold, equipment and machinery, buildings.

Liabilities

These are the debts and obligations the company **owes** to others.

Examples: Loans from a bank, money owed to suppliers (called "Accounts Payable"), taxes owed to the government.

Equity

This represents the **owner's stake** in the company. It's what's left over for the owners after you subtract the liabilities from the assets. It's the "net worth" of the business.

Examples: The initial money an owner invests in the business, profits that are reinvested back into the company.

Revenue (or Income)

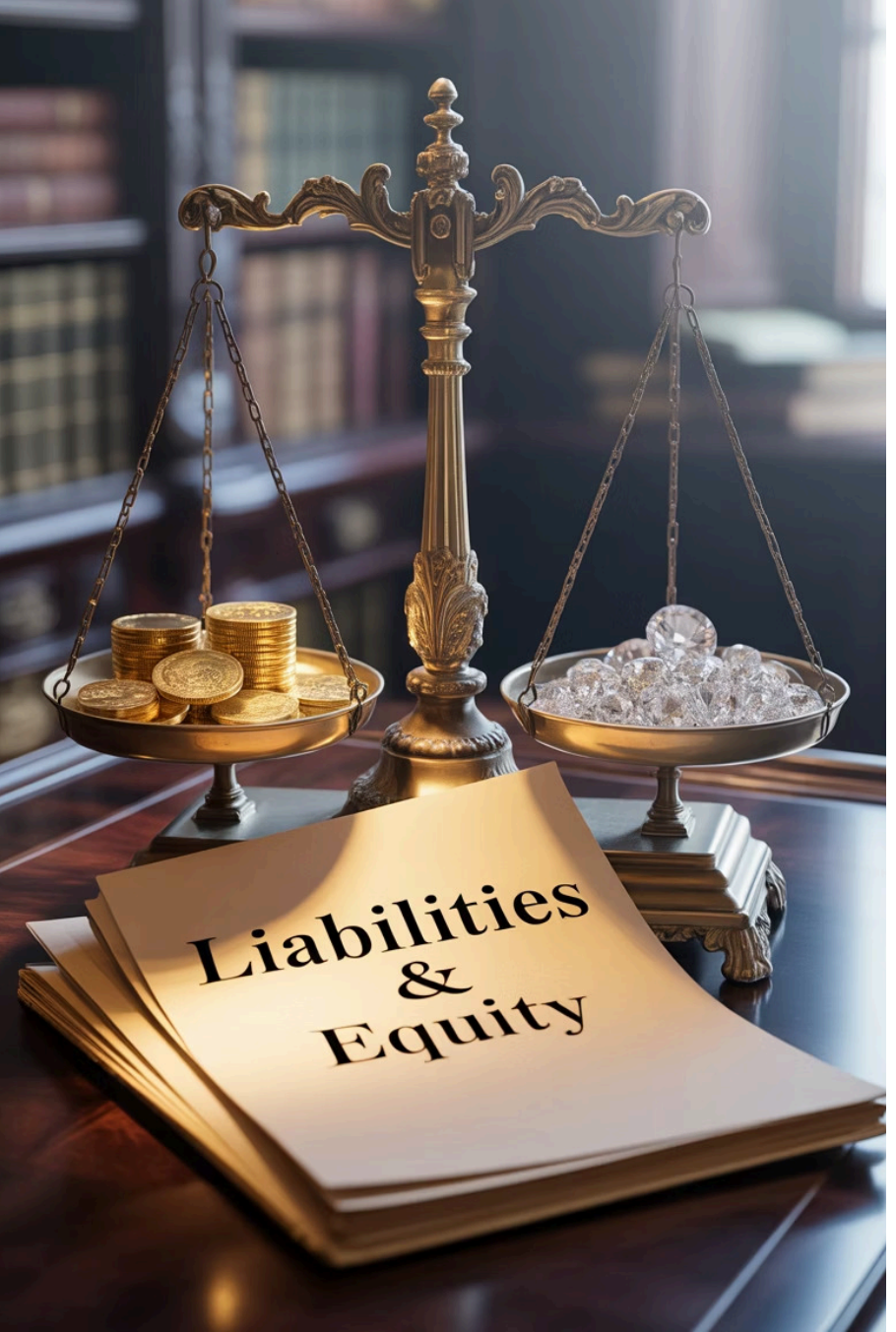
This is the money a company **earns** from its primary business activities, like selling goods or providing services.

Examples: Sales of products, fees for consulting services.

Expenses

These are the **costs** of doing business. It's the money a company spends to generate revenue.

Examples: Employee salaries, rent for the office, electricity bills, advertising costs.



4. The Golden Rule: The Accounting Equation

These five building blocks are all connected by one simple, powerful rule: **The Accounting Equation**. It is the foundation of all accounting.

Assets = Liabilities + Equity

This equation must *always* be in balance. It tells us that everything a company owns (its Assets) must be claimed by someone. It's either claimed by creditors and lenders (Liabilities) or by the owners (Equity).

Let's say you start a small business with $1,000 of your own money. You deposit it into a business bank account.

- The business now has an **Asset** (Cash) of $1,000.
- You, the owner, have a claim to that value, so the **Equity** is $1,000.
- The equation is in balance: **$1,000 (Assets) = $0 (Liabilities) + $1,000 (Equity)**

Now, let's say your business borrows $500 from a bank.

- Your Cash (Asset) increases to $1,500.
- You now have a Liability (Bank Loan) of $500.
- The equation is still in balance: **$1,500 (Assets) = $500 (Liabilities) + $1,000 (Equity)**

Every single transaction can be explained using this equation!

5. You Don't Need to Be a Math Genius!

The math used in accounting is straightforward. If you can do basic arithmetic on a calculator, you can do the math in accounting. The challenge isn't the calculation itself; it's knowing *what* numbers to add, subtract, multiply, or divide.

Addition (+)

Adding up all your sales for the month.

Subtraction (-)

Calculating profit by subtracting expenses from revenue. **Profit = Revenue - Expenses**

Multiplication (×)

Calculating total payroll. **Pay = Hours Worked × Hourly Wage**

Division (÷)

Finding an average cost. Average Cost = Total Cost ÷ Number of Units

The more complex calculations usually involve percentages (%), especially for taxes. Let's look at some real-world examples.

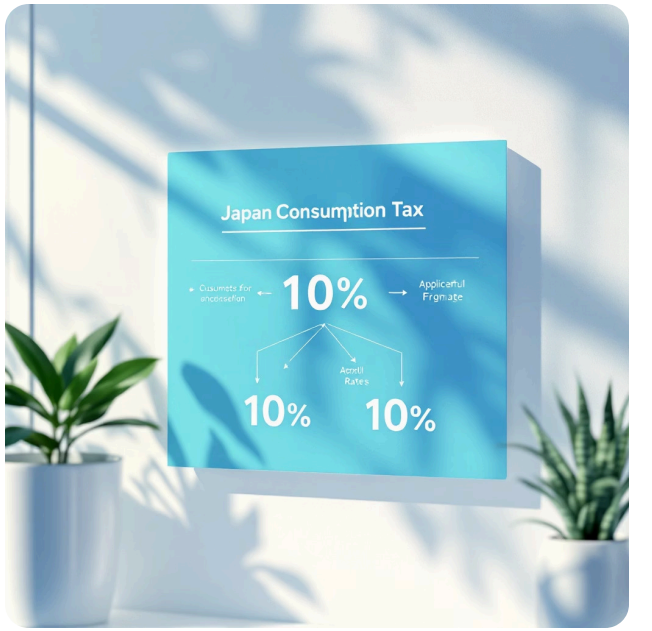
U.S. Sales Tax

States, counties, and cities can charge a sales tax. Let's say the rate in your area is 8%. This means for every dollar of sales, you collect an extra 8 cents for the government.

Philippine VAT

The Value Added Tax is 12%. Businesses add this tax to the price of their goods or services.

Japan Consumption Tax



This is a national tax, currently at 10%.

Understanding these basic calculations is all you need to get started.

6. Practice Problems: Let's Do Some Math!

Don't worry, we'll walk through these step-by-step.

01

Question 1 (U.S.)

You sell a book for $20. The sales tax in California is 7.25%. How much do you charge the customer in total?

02

Question 2 (Philippines)

Your company provides a service for P1,000 (Philippine Pesos). You must add 12% VAT. What is the total invoice amount?

03

Question 3 (Common)

Your business earned $50,000 in revenue last month. Your expenses (salaries, rent, etc.) were $35,000. What was your profit? And what was your profit margin?

04

Question 4 (Accounting Equation)

A company owns a building worth $200,000 (an Asset). It has a bank loan of $120,000 (a Liability). What is the owner's equity in the company?

Answers and Explanations

Answer 1 (U.S. Sales Tax): The total amount is **$21.45**.

01

Calculate the tax amount

A percentage is just a fraction of 100. So, 7.25% is the same as 7.25 ÷ 100, which is 0.0725.

Calculation: $20.00 × 0.0725 = $1.45

02

Add the tax amount to the original price

Calculation: $20.00 + $1.45 = **$21.45**

Shortcut: **You can also multiply the price by 1.0725. The "1" represents the original price, and the ".0725" represents the tax. ($20.00 × 1.0725 = $21.45)**

Answer 2 (Philippines VAT): The total invoice amount is **P1,120**.

01

Calculate the VAT amount

12% is the same as 0.12.

Calculation: P1,000 × 0.12 = P120

02

Add the VAT to the service price

Calculation: P1,000 + P120 = **P1,120**

Shortcut: **P1,000 × 1.12 = P1,120**

Answer 3 (Profit and Profit Margin): The profit is **$15,000** and the profit margin is **30%.**

01

Calculate the Profit

The formula is Revenue - Expenses.

Calculation: $50,000 (Revenue) - $35,000 (Expenses) = **$15,000 (Profit)**

02

Calculate the Profit Margin

This tells you what percentage of your revenue was actual profit. The formula is (Profit ÷ Revenue) × 100.

Calculation: ($15,000 ÷ $50,000) = 0.3

Convert to Percentage: 0.3 × 100 = **30%**

This means that for every dollar of revenue you earned, 30 cents was profit.

Answer 4 (Accounting Equation): The owner's equity is **$80,000**.

01

Start with the Accounting Equation

Formula: Assets = Liabilities + Equity

02

Fill in the numbers you know

Equation: $200,000 = $120,000 + Equity

03

Solve for Equity

To get Equity by itself, you subtract Liabilities from both sides of the equation.

Calculation: $200,000 - $120,000 = $80,000 (Equity)

7. Chapter Summary

- Accounting is the **language of business** that records, organizes, and reports a company's financial story.
- The three core functions are **Recording**, **Organizing**, and **Reporting**.
- The five building blocks are **Assets, Liabilities, Equity, Revenue,** and **Expenses**.
- The golden rule is the **Accounting Equation: Assets = Liabilities + Equity**. This must always be in balance.
- The math in accounting is based on **basic arithmetic and percentages**. The key is to know which numbers to use for the calculation.

Congratulations on completing Chapter 1!

You've just taken your first step into a larger and more exciting world.