A business can appear busy, collect payments every day, and still be quietly dying. Another company can report a profit while struggling to pay tomorrow's payroll. A third may have plenty of cash only because it borrowed heavily, not because its services are successful. Accounting exists to separate these situations. It is a system for identifying what happened, deciding when it happened economically, placing it into the correct category, preserving evidence, and explaining the result. The numbers are not the business itself; they are a model of the business. When the model is accurate, an owner can see problems that ordinary bank activity hides.

The business must first be treated as an entity separate from its owner. Imagine the company as a person standing on one side of a table and the owner standing on the other. When the owner deposits $10,000, the company receives cash, but it has not earned revenue from a customer. The deposit is an owner contribution that increases equity, meaning the owner's claim against the business. If the owner later removes $1,000 for personal use, that withdrawal is not automatically a business expense. The company did not consume the money while serving a customer; value simply moved back to the owner. Mixing personal groceries, household bills, business chemicals, customer deposits, and payroll inside one account destroys this separation and makes every report less trustworthy.

An account is best understood as a labeled container. The cash container holds money available in bank accounts and approved cash funds. Accounts receivable holds amounts customers owe for completed work. Equipment contains the recorded cost of long-lasting tools, machines, and vehicles. Accounts payable contains unpaid vendor obligations. Revenue collects value earned through business activity, while expenses collect resources consumed in earning that revenue. These containers are not physical locations where money is stored. They are organized records that allow thousands of events to be summarized without losing their meaning.

All the containers fit into the accounting equation, Assets = Liabilities + Equity. Assets are useful resources controlled by the business. Liabilities are claims belonging to lenders, vendors, employees, governments, and other outsiders. Equity is the residual claim belonging to the owner after liabilities are deducted. A company with $100,000 in assets and $70,000 in liabilities has $30,000 in equity. That does not mean the owner has $30,000 available to spend because the value may be locked inside equipment or unpaid invoices. The equation describes ownership of value, while the cash account describes only one form that value can take.

Suppose a cleaning company begins the month with $12,000 in cash and no debt. It earns $20,000 from completed jobs, but customers pay only $14,000 before month-end. The remaining $6,000 becomes accounts receivable because the work is finished and the company has a right to collect. During the month, it incurs $8,000 of employee wages, uses $2,000 of chemicals and job supplies, and incurs $3,000 of overhead such as insurance, software, advertising, and office costs. The company therefore produces

$7,000 of accounting profit because 20,000 - 8,000 - 2,000 - 3,000 = 7,000. Yet cash did not rise by the full $7,000 because $6,000 of the sales remains uncollected. Profit measures economic performance, while cash measures immediate payment ability.

The distinction becomes even clearer when equipment enters the picture. Suppose the company pays $9,000 cash for a commercial machine expected to be used for several years. Cash falls immediately, but recording a $9,000 expense in the purchase month would make that month look far worse than the later months that also benefit from the machine. Accounting generally records the equipment as an asset and gradually recognizes depreciation expense over its useful life. Depreciation is the allocation of recorded cost across periods of use; it is not a prediction of the exact selling price and does not create a replacement fund. The company can report profit while its bank balance drops because purchasing a long-term asset consumes cash without becoming an immediate full expense. A sensible owner therefore studies both earnings and cash movement.

Time is one of accounting's central problems. Under cash accounting, income is generally recognized when money is received, while expenses are generally recorded when payment is made. Under accrual accounting, revenue is recognized when earned and expenses when incurred, even if payment occurs later. If work is completed on June 28 and the customer pays July 15, cash accounting normally places the income in July, while accrual reporting places it in June. Neither method is simply "honest" while the other is dishonest; they answer timing questions under different rules. The business must use a consistent method and understand the legal requirements governing its situation. The IRS explains that the cash and accrual methods determine when income and expenses enter a tax year, although financial reporting and tax reporting can still produce different amounts.

Accrual accounting prevents payment timing from rewriting economic history. Suppose an electric bill covers power used in December but is not paid until January. December received the benefit, so accrual reporting recognizes December's expense and records an unpaid liability. Paying the bill in January reduces cash and removes the obligation, but it does not create January expense again. The same reasoning applies to wages employees have earned but have not yet received. A company that delays vendor payments cannot use that delay to pretend its costs disappeared. Accrual accounting attempts to place revenue and related costs into the period where the activity occurred.

Receiving money early presents the opposite problem. If a customer prepays $12,000 for twelve months of service, the bank account increases immediately, but the company has not earned the entire amount. It now owes future work, so the unperformed portion is recorded as unearned revenue, which is a liability. After one month of service, $1,000 becomes earned revenue and the liability falls by the same amount. If the company spends all $12,000 immediately, it may later lack the resources needed to fulfill the remaining agreement. Accounting exposes that danger by distinguishing cash held from revenue earned. A deposit can increase financial responsibility before it increases profit.

The income statement measures performance across a span of time. It begins with revenue, subtracts costs, and ends with profit or loss. Gross profit usually represents revenue minus costs directly connected with delivering the service or product, though service businesses must define those direct costs consistently. Operating profit subtracts overhead required to run the company. Net income includes the broader collection of recognized revenues, expenses, gains, losses, interest, and other applicable items. Revenue tells us how much business activity occurred, while profit reveals what remained after recognized costs. A company celebrating sales growth without measuring the cost of producing those sales may be celebrating larger losses.

The balance sheet answers a different question because it describes financial position on one date. It reports assets such as cash, receivables, equipment, and prepaid costs; liabilities such as unpaid bills, loans, card balances, and taxes payable; and the resulting equity. Current assets are expected to be converted into cash, sold, or consumed relatively soon, while current liabilities are obligations due in the near term. If current liabilities greatly exceed useful current assets, the company may have difficulty meeting immediate commitments. A large receivable balance may look impressive, but its quality depends on whether customers will actually pay. The balance sheet therefore invites questions that the totals cannot answer by themselves.

The statement of cash flows explains why the bank balance changed. Operating cash flow concerns ordinary business activity, including customer collections, vendor payments, and wages. Investing activity commonly includes purchasing or selling long-term assets. Financing activity includes borrowing, repaying loan principal, receiving owner capital, or distributing money to owners. A company might report $40,000 of profit but experience a $10,000 decrease in cash because customers have not paid and equipment was purchased. Another could experience a $50,000 cash increase while reporting a loss because a loan supplied the money. The SEC's explanation of financial statements emphasizes that the balance sheet, income statement, cash-flow statement, and equity statement answer different questions and must be read together.

The statement of equity completes the connection. Beginning equity increases when owners contribute capital and when the company produces profit. It decreases through losses and owner distributions or withdrawals. Suppose beginning equity is $30,000, the owner contributes another $5,000, the business earns $12,000, and the owner withdraws $7,000. Ending equity becomes $40,000 because 30,000 + 5,000 + 12,000 - 7,000 = 40,000. The $7,000 withdrawal did not reduce business profit because it happened after profit was produced. It reduced the amount of value left inside the company.

The reports are connected rather than independently invented. Net income from the income statement increases equity. Ending equity appears on the balance sheet. Ending cash from the cash-flow statement must agree with the cash reported on that same balance sheet. Accounts receivable on the balance sheet helps explain why reported revenue exceeds customer collections. Accounts payable helps explain why recognized expenses may exceed vendor payments. Depreciation reduces income without creating a current cash payment, so it helps explain why cash flow and profit differ. A set of statements that does not connect properly contains an error, an omitted adjustment, or an unresolved classification problem.

Pricing becomes more intelligent when accounting separates job costs from overhead. Direct costs can be reasonably traced to a particular job, such as field labor, chemicals, fuel for the trip, subcontractors, or rented equipment. Overhead supports the business as a whole, including general insurance, office administration, advertising, accounting software, storage, licenses, and management time. If a $150 service requires $60 of direct cost, the remaining $90 is not automatically final profit. That amount must first help pay overhead, taxes, equipment needs, and the owner's desired return. An owner who counts chemicals but treats personal labor as free will underprice the work. Time has economic value even when the owner does not issue a paycheck to themselves.

Markup and margin must also be separated. If a job costs $100 and the business adds a 40 percent markup, the selling price becomes $140. The resulting gross profit is $40, but the margin is only about 28.6 percent because $40 \div 140 \approx 28.6\%$. To earn a 40 percent margin on a $100 cost, the required price is approximately $166.67. Markup compares profit with cost, while margin compares profit with revenue. Confusing the two can quietly erase the profit expected from a price. Discounts become especially dangerous when the original margin is already thin.

Break-even analysis tells the company how much contribution is needed to cover fixed expenses. Suppose a service sells for $250 and carries $100 of variable cost, leaving a $150 contribution margin. Variable costs rise as more jobs are performed, while fixed costs such as rent, core software, and basic insurance remain relatively stable within a reasonable operating range. If fixed monthly costs total $6,000, the business needs 40 jobs because 6000 ÷ 150 = 40. The forty-first job begins contributing toward operating profit, assuming prices and costs behave as expected. Reducing the price without reducing cost raises the number of jobs required. More sales are helpful only when each sale contributes enough to support the company.

Working capital explains why growth can create financial stress. It is commonly measured as current assets minus current liabilities. A company may win a large commercial contract requiring immediate payroll and supply purchases while the customer pays sixty days later. The job may ultimately be profitable, but the business must finance the gap between performing the work and receiving payment. Rapid growth can therefore consume cash before it produces cash. Accounts-receivable aging reports show how long customer invoices have remained unpaid, while accounts-payable reports show when vendor obligations are due. These schedules reveal whether the business is financing customers with money it needs for its own operations.

Taxes create several accounting traps. Sales tax collected from customers, where required, generally belongs to the government rather than the company, making it a liability instead of revenue. Amounts withheld from employee paychecks must be remitted and should not be treated as available operating money. Employer payroll taxes are business expenses, while employee withholdings are amounts temporarily held for payment to the authorities. Loan proceeds are not taxable sales revenue simply because cash entered the account, and repayment of loan principal is not an ordinary expense simply because money left. The legal form of a business affects reporting obligations, but forming an LLC does not by itself determine one universal tax treatment. Entity elections, ownership, activities, and applicable federal, state, and local rules must be evaluated correctly.

The general ledger is the complete organized collection of the company's accounts. Transactions first enter through journals or accounting software and are then posted into the appropriate ledger categories. A trial balance lists account balances and verifies that total debits equal total credits. Equal totals do not guarantee perfection because an amount could be entered in the wrong account on both sides. Adjusting entries recognize matters not yet captured through ordinary cash activity, including depreciation, used supplies, unpaid wages, accrued interest, expired insurance, and revenue earned from customer advances. Closing entries reset temporary revenue and expense accounts after a period ends, while permanent asset, liability, and equity balances continue. This monthly cycle turns scattered activity into completed financial information.

Bank reconciliation compares the accounting cash record with the bank's record. Differences may come from outstanding checks, deposits still processing, card fees, returned customer payments, automatic withdrawals, interest, duplicated entries, or unauthorized transactions. The goal is not to alter one balance until the numbers agree without explanation. Every difference should be identified and supported. Reconciliation often uncovers mistakes while they are still small enough to correct. Credit cards, payment processors, loans, and payroll clearing accounts may also need separate reconciliations. A business that waits until year-end may spend days untangling problems that could have been corrected in minutes during the proper month.

Internal control protects both assets and information. Whenever possible, the person receiving money should not be the only person recording deposits and reconciling the account. Purchases should require authorization at appropriate dollar levels, while receipts and invoices should accompany transactions. Software access should match each person's responsibilities rather than giving everyone administrator privileges. Payroll lists should be reviewed for nonexistent workers, unauthorized rate changes, and unapproved hours. Small companies with few employees can use bank alerts, owner review, outside reconciliation, numbered invoices, locked payment cards, and periodic vendor checks. Trust and control are not enemies because a sound system protects honest people from suspicion while making concealed wrongdoing harder.

Documentation turns an entry into defensible information. A $500 software category in the books does not prove what was purchased, why it served the business, or who approved it. Receipts, invoices, contracts, customer records, canceled checks, deposit information, mileage support, and payroll documents establish the surrounding facts. The IRS states that business books should summarize transactions and retain supporting records for income, purchases, expenses, payroll, and other activity. Digital storage is useful only when documents remain readable, organized, secure, and backed up. Photographing receipts without a naming or attachment system can merely create a different kind of disorder. Reliable records should allow another knowledgeable person to trace a financial statement amount back to the transactions that created it.

Accounting standards provide consistency when outside users need comparable statements. In the United States, GAAP means generally accepted accounting principles. The Financial Accounting Standards Board maintains the authoritative source of nongovernmental U.S. GAAP. A small private company may instead produce tax-basis, cash-basis, or another special-purpose set of reports when appropriate, but the basis should be clear. Management accounting can organize information differently for internal decisions, such as profitability by crew, customer, division, route, or service. Tax accounting follows legal rules for determining taxable income. One set of numbers should not be used blindly for every purpose because each framework answers a different question.

A dependable monthly routine keeps accounting useful. Bank and card activity should be reconciled, customer receivables reviewed, unpaid vendor bills examined, payroll liabilities verified, loans matched to statements, and unusual transactions investigated. Supplies and equipment records should be updated, necessary accruals and depreciation posted, and financial statements compared with prior months and the budget. The owner should ask why revenue changed, which services produced margin, whether customers are paying more slowly, where cash went, and which obligations are approaching. Reports should lead to action, such as correcting prices, collecting invoices, reducing waste, building reserves, or delaying expansion. Accounting loses much of its value when it becomes a historical filing exercise performed only for taxes.

The central discipline is refusing to let money disguise itself. A deposit must reveal whether it came from a customer, lender, owner, refund, or transfer. A payment must show whether it purchased an expense, asset, loan reduction, owner withdrawal, or government obligation. Profit must be separated from cash, growth from health, sales from collections, and ownership value from spendable funds. Numbers become meaningful only after transactions are classified according to their actual substance. Accounting gives a business memory, but its greater gift is judgment. It allows the owner to stop guessing what the company is becoming and begin seeing it.