The 5 Buckets of Accounting.

The 5 Buckets of accounting is a very basic overview designed to show the simplicity of accounting.

The first thing you want to remember is that there are only five buckets in accounting. Okay? Now what I mean by that is that there is only five categories and they are assets, liabilities, equity, revenue, and expenses. All of your transactions have to fit into one of those five. Well actually, two of the five because it's double entry accounting, so for every transaction, you have two sides. But, there are only five buckets to choose from. So everything has to fit in these five. And it's not any more complicated than that. So once you understand these five and how they relate, you could be a CPA. I mean seriously, it is this easy. Accounting is the most misunderstood, easiest thing in the world. It's the greatest scam accountants have portrayed on people because it’s very difficult to learn and understand because it is taught wrong, but it is really this simple once you understand and do it. So it's one of those things that's hard to learn, but super easy to do.

We have all heard of these accounts:

Assets. Okay, again there are only five buckets. The first one is assets. We all know what these are, but here's the problem: I am going to read you this definition that I've found online, "Things that are resources owned by a company and which have a future economic value that can be measured and can't be expressed in dollars." This is why no one gets accounting. Come on! assets are simple; it's cash, investments, accounts receivables, money people owe you, inventory, pre-paid supplies, land, buildings, equipment and vehicles. Anything that has value is an asset. So we all really understand assets, but we don't get the legalized definitions. But it's really this simple, it's cash, it's your accounts receivable, inventory, pre-paid assets, and supplies, land, buildings, computers, microphones, mostly all hard stuff. Stuff that you have to go out and buy, touch, and that last many years when you use it. So again, assets are really this simple.

Liabilities. Little more complicated, because when you process these transactions, there's usually two things buried in there. One would be interest expense, and one would be principle. But beyond that, we all understand what a liability is. We owe money to somebody, right? And this definition is really not that bad, "A liability is a legally binding obligation, payable to another entity," or person, or something like that. So liabilities are loans and payables. It could be the payable tax deposits due on 15th, it could be the car loan you have, it could be the fact that you owe your vendors for the supplies and/or equipment you purchased, a bank loan. Again, we all pretty much understand what a liability is. It's when you owe money to somebody.

Equity. This one is probably the most confusing. I'll give you the definition I found online, "Owner’s equity represents the owner’s investment in the business, minus the owner's draws or withdrawals plus business net-income". Alright, so mathematically, equity is assets minus the amount of liabilities. The definition is not that bad. But is real terms equity works like this, it's basically your initial investment, any additional investment, plus any profits that the company earned, less anything you pulled out to pay yourself with. That is basically equity works. So it is the most confusing because it's basically more of an equation than a simple thing like a liability or an asset. But again, it's really as simple as your investment, plus all of your profits minus any withdrawals. You don't really need to use it a lot, you just need to understand it. The trickiest part is when you take money from your company that is not payroll. You will not reduce profit but you reduce your cash. That's the hardest part of equity, in understanding equity.

Revenue. We all understand sales and income. Here is the definition, "Fees earned from providing services and/or merchandise you've sold". One of the mistakes we see in recording revenue is your accountant would go and make your bank deposits as revenue. And if you deposit money from a bank, your savings, or credit card advance is put to revenue and not to a loan. This is caught by you reviewing your general ledger report. Again a common error is when you receive a loan, sometimes it gets classified as revenue. That's one thing you got to be careful about, but otherwise the definition itself, we all get that, that's probably the easiest one.

Expenses. The definition of an expense, "An expense in accounting, is money spent or cost incurred in an entity's efforts to generate revenue." We all understand expenses. It's utility bill, it's your rent payment, it's your phone bill, it is your office supplies. The cost you incur in order to do business and provide services or the goods that you are going to sell. It could be the shipping products or mailing a bill. Expenses do get a little tricky and it is easy to make mistakes when recording expenses. For example, it is a common error to record the purchase of an asset as an expense. For example, if you go out and purchase a car for the business and put $5,000 down on a car. That 5,000 is not an expense, it's an asset. Sometimes, when you go out and you buy a whole bunch of inventory, that's an asset, not an expense, it later becomes an expense, when you ship merchandise. But expenses, for the most part, are pretty simple, it's basically the cost incurred in business, rent, utility bills, phone bill, supplies, and cost of goods sold.

So, again, I'm not trying to oversimplify this, because it is this simple. There are only five categories that all of your transactions are going to fit into. That is really it. So, get to know these things. Get a feel for them. Go online and google them, get some examples. But for the most part, again, accounting is really this simple. Accounting transactions have to fit into five categories. Accounting is probably one of the most misunderstood, easiest things in the world. Once you kind of get the big picture of this, it’s pretty basic and pretty simple. So hang in there.

Here is a chart on how the debit or credit impact a bucket.This shows if a bucket is increased or decrease when recorded as a debit or credit. This is probably the most difficult thing in accounting.

Bucket	Debit	Credit
Assets	Increase	Decrease
Liabilities	Decrease	Increase
Equity	Decrease	Increase

Revenue	Decrease	Increase
Expenses	Increase	Decrease