



ACCOUNTING I

CHAPTER 1

STARTING A PROPRIETORSHIP:

CHANGES THAT AFFECT THE
ACCOUNTING EQUATION



ACCOUNTING IN ACTION

1. Describe different users of accounting information.
2. Prepare a net worth statement and explain its purpose.



THE ROLE OF ACCOUNTING

✗ Accounting Reports

- ✗ daily accounting transactions are recorded and reported.
- ✗ Reports can be provided to business owners, managers, investors, and others to make business decisions and measure performance.



WHAT IS ACCOUNTING?

X Accounting

“language of business”

Inaccurate accounting records = failed business!

○ planned process designed to compile and summarize financial data

X Financial Statements

○ reports that summarize financial condition and operations of a business

■ Used to make sound business decisions



ACCOUNTING IN YOUR LIFE

✗ Net Worth Statement

$$\text{Assets} - \text{Liabilities} = \text{Net Worth}$$

✗ Asset

- anything of value owned.
- Car, house, cash, etc.

✗ Liability

- amount owed
- IOU, car loan, credit card statement

✗ Difference between personal assets & personal liabilities = personal



THE ROLE OF ACCOUNTING

- ✗ Financial Statements
 - ✗ daily accounting transactions are recorded and reported.
- ✗ Statements can be provided to business owners, managers, investors, and others to make business decisions and measure performance.

PERSONAL NET WORTH STATEMENT

Decreasing order

Saida Khelchy
Net Worth Statement

Individual – to check financial strength
Maybe need a car loan or house?

Owed to Parents	50.00
Ace Electronics	125.00
Total Liabilities	175.00
Net Worth	2,075.00

total of a
calculation



$$\begin{array}{ccccc} \text{TOTAL ASSETS} & & \text{TOTAL LIABILITIES} & & \text{NET WORTH} \\ \text{(OWNED)} & - & \text{(OWED)} & = & \text{(ALSO KNOWN AS EQUITY)} \end{array}$$



ETHICS AND BUSINESS

- ✗ Ethics
 - ✗ principles of right and wrong that guide our decisions.
- ✗ Business ethics
 - using ethics to make business decisions
- ✗ Ethics \neq Law
 - Being late for work – illegal? unethical?
- ✗ Accountants – behave ethically?
 - Dealing with a lot of \$\$ – decisions can harm a business



CHECK YOURSELF!

What is accounting?

Planning, recording, analyzing, and interpreting financial information

When would a nonaccountant use accounting?

Buying a house/car, checking if can afford a purchase

Why is accounting called the Language of Business?

Accounting gives financial information to all who need it to make healthy business decisions.

Net Worth Statements

Lesson 1.1

Assets			Liabilities		
Car	5,000	95%	Car Loan	2,700	51%
Savings	250	5%	Student Loan	53,000	1,010%
Total	5,250	100%	Total	55,700	1,061%
			Net Worth	(50,450)	(961%)

What is Tyler's Net Worth?

- Cell Phone - \$200
- Laptop - \$500
- Cash - \$50
- TOTAL ASSETS?
 - 750

- Owe Parents for Phone - \$150
- TOTAL LIABILITIES?
 - 150



This Photo by Unknown Author is licensed under CC BY-NC-ND

- NET WORTH?
 - 600

What is Julie's Net Worth?

- Car - \$8,000
- Computer - \$800
- Cash - \$1,200
- TOTAL ASSETS?
 - 10,000



- Owe Bank for Car - \$7,200
- TOTAL LIABILITIES?
 - 7200

- NET WORTH?
 - 2,800

What is Paul's Net Worth?

- Car - \$12,000
- House - \$200,000
- Motorcycle - \$10,000
- Cash - \$3,000
- TOTAL ASSETS?
 - 225,000

- Owe Bank for House - \$180,000

- Owe Bank for Motorcycle - \$5,000
- TOTAL LIABILITIES?
 - 185,000

- NET WORTH?
 - 40,000



What is Seth's Net Worth?

- Car - \$10,000
- Cash - \$300
- TOTAL ASSETS?
- 10,300



- Owe friend for rent - \$2,000
- Owe Bank for Car - \$9,500
- TOTAL LIABILITIES?
- 11,500
- NET WORTH?
- (1200)

What is Sarah's Net Worth?

- Car - \$10,000
- Loan on car - \$6,700
- Cash - \$1,400
- Cell Phone - \$400
- IOU to Parent for plane ticket - \$600



- TOTAL ASSETS?
 - 11,800

- TOTAL LIABILITIES?
 - 7,300

- NET WORTH?
 - 4,500



HOW BUSINESS ACTIVITIES CHANGE THE ACCOUNTING EQUATION

1. Classify accounts as assets, liabilities, or owner's equity and demonstrate their relationship in the accounting equation.
2. Analyze the effects of transactions on the accounting equation.
3. Distinguish between cash and on account transactions.



THE BUSINESS – DELGADO WEB SERVICES

✗ Business

- ✗ the purchase and sale of products or services to make a profit.

✗ Service business

- performs an activity for a fee.

✗ Proprietorship

- business owned by one person

- Aka – sole proprietorship

- Owner is liable for all outstanding debt (unlimited liability)



ACCOUNTING STANDARDS AND RULES

- ✗ GAAP (Generally Accepted Accounting Principles)
 - ✗ standards and rules that accountants follow to ensure consistent report.
 - ✗ Unit of Measurement – US is Dollars
 - ✗ Business Entity – keep business and personal records separate



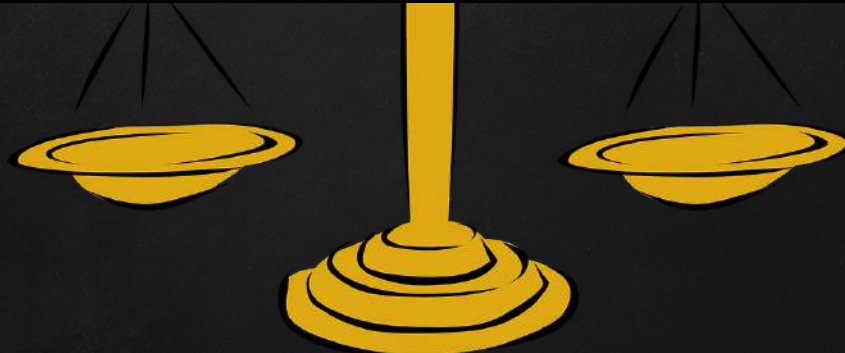
ACCOUNTING EQUATION

- ✕ Equities
 - ✕ financial rights to assets of a business
 - ✕ Equity to whom money is owed (liability)
 - ✕ Equity of owner
 - ✕ OWNED (minus) OWED = NET WORTH
- ✕ Owner's Equity
 - amount remaining after liabilities subtracted from assets.
- ✕ Accounting Equation
 - shows relationship between assets, liabilities, and owner's equity



ACCOUNTING EQUATION

**ACCOUNTING EQUATION MUST
ALWAYS BE IN BALANCE!**





SPEND/RECEIVE MONEY

= ENGAGING IN BUSINESS ACTIVITY

✗ Transaction

- any business activity that changes assets/liab/OE

✗ Account

- record that summarized all transactions pertaining to a single item in the accounting equation.
 - Account title – name given
 - Account balance – difference between increases & decreases



RECEIVING CASH

✗ Capital account

○ account that summarizes the owner's equity in a business.

■ Amount owner has right to after all debts (liabilities) are paid off – aka how much business is truly worth

✗ **Cash** – checking account, cash on hand, savings account.

RECEIVING CASH

Transaction 1

January 2. Received cash from owner as an investment, \$2,000.00.

	Assets	=	Liabilities	+	Owner's Equity
	Cash	=			Michael Delgado, Capital
Beginning Balances	\$0		\$0		\$0
Received cash from owner as an investment	+2,000		0		+2,000
New Balances	\$2,000		\$0		\$2,000

PAYING CASH

**If a transaction only affects
ONE side of accounting
equation, must be a
INCREASE and DECREASE to
keep balance**



TRANSACTIONS ON ACCOUNT

**Buying “on account” is like
charging to the gas station
and paying later**

TRANSACTIONS ON ACCOUNT

Transaction 4

January 5. Bought supplies on account from Canyon Office Supplies, \$220.00

	Assets			=	Liabilities	+	Owner's Equity
	Cash	+ Supplies	+ Prepaid Insurance	=	Accts. Pay.— Canyon Office Supplies	+	Michael Delgado, Capital
Balances	\$935	\$165	\$900		\$0		\$2,000
Bought supplies on account		+220			+220		
New Balances	\$935	\$385	\$900		\$220		\$2,000
Paid cash on account	-100				-100		
New Balances	\$835	\$385	\$900		\$120		\$2,000

Transaction 5

January 9. Paid cash on account to Canyon Office Supplies, \$100.00.



CHECK YOURSELF!

Give two examples of service businesses in your area.

Lawn car, chiropractor, doctor

What must be done if a transaction increases the left side of the equation?

Increase right side (OR decrease left side also)

How can a transaction affect only one side of the equation?

To maintain balance, one account can increase and one decrease on the same side.

What does the term on account mean?

Buying items/services and paying later



HOW TRANSACTIONS CHANGE OWNER'S EQUITY IN AN ACCOUNTING EQUATION

1. Compare the types of transactions that increase/decrease Owner's Equity.
2. Explain the difference between expenses and liabilities.



TRANSACTIONS AFFECTING OWNER'S EQUITY

- ✗ Revenue

- ✗ money earned from sale of goods or services (increases equity)

- ✗ Sale on Account

- ✗ sale that payment will be received for later.

- ✗ Even if no cash is receive, the sale is recorded the day the service is performed or good is purchased.

- ✗ GAAP: Realization of Revenue

TRANSACTIONS AFFECTING OWNER'S EQUITY

Transaction 6

January 10. Received cash from sales, \$1,100.00.

	Assets				=	Liabilities + Owner's Equity	
	Cash +	Accts. Rec.— Main Street Services	+ Supplies	+ Prepaid Insurance	=	Accts. Pay.— Canyon Office Supplies +	Michael Delgado, Capital
Balances	\$835	\$0	\$385	\$900		\$120	\$2,000
Received cash from sales	+1,100						+1,100 (revenue)
New Balances	\$1,935	\$0	\$385	\$900		\$120	\$3,100
Sold services on account		+500					+500 (revenue)
New Balances	\$1,935	\$500	\$385	\$900		\$120	\$3,600

Transaction 7

January 12. Sold services on account to Main Street Services, \$500.00.

TRANSACTIONS AFFECTING OWNER'S EQUITY

	Assets				=	Liabilities + Owner's Equity	
	Cash +	Accts. Rec.— Main Street Services	+ Supplies	+ Prepaid Insurance	=	Accts. Pay.— Canyon Office Supplies	+ Michael Delgado, Capital
Balances	\$835	\$0	\$385	\$900		\$120	\$2,000
Received cash from sales	+1,100						+1,100 (revenue)
New Balances	\$1,935	\$0	\$385	\$900		\$120	\$3,100
Sold services on account		+500					+500 (revenue)
New Balances	\$1,935	\$500	\$385	\$900		\$120	\$3,600

Total of left side:
 $\$1,935 + \$500 + \$385 + \$900 =$
\$3,720

Total of right side:
 $\$120 + \$3,600 =$
\$3,720



EXPENSE TRANSACTIONS

- ✗ Expense
 - ✗ cost used to operate a business
 - ✗ Ex. Utilities expense, miscellaneous expense, fuel expense
 - ✗ **EXPENSE** – cost of doing business
 - ✗ **LIABILITY** – amount owed to someone

EXPENSE TRANSACTIONS

Transaction 8

January 12. Paid cash for communications bill for cell phone and Internet service, \$80.00.

	Assets				=	Liabilities	+	Owner's Equity
	Cash +	Accts. Rec.— Main Street Services	+ Supplies	+ Prepaid Insurance	=	Accts. Pay.— Canyon Office Supplies	+	Michael Delgado, Capital
Balances	\$1,935	\$500	\$385	\$900		\$120		\$3,600
Paid cash for communications bill	-80							-80 (expense)
New Balances	\$1,855	\$500	\$385	\$900		\$120		\$3,520
	Total of left side: \$1,855 + \$500 + \$385 + \$900 = \$3,640					Total of right side: \$120 + \$3,520 = \$3,640		

EXPENSE TRANSACTIONS

Transaction 9

January 13. Paid cash for equipment rental, \$400.00.

	Assets				=	Liabilities	+	Owner's Equity
	Cash +	Accts. Rec.— Main Street Services	+ Supplies	+ Prepaid Insurance	=	Accts. Pay.— Canyon Office Supplies	+	Michael Delgado, Capital
Balances	\$1,935	\$500	\$385	\$900		\$120		\$3,600
Paid cash for communications bill	-80							-80 (expense)
New Balances	\$1,855	\$500	\$385	\$900		\$120		\$3,520
	Total of left side: \$1,855 + \$500 + \$385 + \$900 = \$3,640					Total of right side: \$120 + \$3,520 = \$3,640		
Paid cash for equipment rental	-400							-400 (expense)
New Balances	\$1,455	\$500	\$385	\$900		\$120		\$3,120
	Total of left side: \$1,455 + \$500 + \$385 + \$900 = \$3,240					Total of right side: \$120 + \$3,120 = \$3,240		



OTHER CASH TRANSACTIONS

✗ Withdrawal

- Owner takes money or any asset for PERSONAL use

- NOT an expense as it is not necessary to keep the business running.

OTHER CASH TRANSACTIONS

Transaction 10

January 16. Received cash on account from Main Street Services, \$200.00.

	Assets				=	Liabilities	+	Owner's Equity
	Cash +	Accts. Rec.— Main Street Services	+ Supplies	+ Prepaid Insurance	=	Accts. Pay.— Canyon Office Supplies	+	Michael Delgado, Capital
Balances	\$1,455	\$500	\$385	\$900		\$120		\$3,120
Received cash on account	+200	-200						
New Balances	\$1,655	\$300	\$385	\$900		\$120		\$3,120
Paid cash to owner for personal use	-350							-350 (withdrawal)
New Balances	\$1,305	\$300	\$385	\$900		\$120		\$2,770
	Total of left side: \$1,305 + \$300 + \$385 + \$900 = \$2,890					Total of right side: \$120 + \$2,770 = \$2,890		

Transaction 11

January 16. Michael Delgado withdrew equity in the form of cash, \$350.00.

SUMMARY OF CHANGES IN OWNER'S EQUITY

Transaction Number	Kind of Transaction	Change in Owner's Equity
6	Revenue (cash)	+1,100.00
7	Revenue (on account)	+500.00
8	Expense (communications)	−80.00
9	Expense (equipment rental)	−400.00
11	Withdrawal of equity	−350.00
Net change in owner's equity		+770.00



CHECK YOURSELF!

How is owner's equity affected when cash is received from sales?

Owner's Equity is increased

How is owner's equity affected when services are sold on account?

Owner's Equity is increased

How is owner's equity affected when cash is paid for expenses?

To maintain balance, one account can increase and one decrease on the same side.

What does the term on account mean?

Owner's equity is decreased.