

LESSON

1-1

Accounting in Action



Learning Objectives

- LO1** Describe the different users of accounting information.
- LO2** Prepare a net worth statement and explain its purpose.

The Role of Accounting

LO1

- Data must be recorded and reported in accounting reports.
- Then, the information can be provided to business owners, managers, investors, and others to make business decisions and measure performance.

What Is Accounting?

LO1

- **Accounting** is the process of planning, recording, analyzing, and interpreting financial information.
- An **accounting system** is a planned process designed to compile financial data and summarize the results in accounting records and reports.
- Financial reports that summarize the financial condition and operations of a business are called **financial statements**.

Accounting in Personal Life

LO2

- A **net worth statement** allows the person extending the loan to see the financial position of a borrower on a specific date and make a lending decision.
- Anything of value that is owned is called an **asset**.
- An amount owed is called a **liability**.
- The difference between personal assets and personal liabilities is called **personal net worth**.
 - In business, net worth is also called *equity*.
- **Equity** is the difference between assets and liabilities.

Personal Net Worth Statement

LO2

Saida Khelchy	
Net Worth Statement	
September 27, 20--	
Assets	
Savings Account	2,000.00
Class Ring	250.00
Total Assets	2,250.00
Liabilities	
Owed to Parents	50.00
Ace Electronics	125.00
Total Liabilities	175.00
Net Worth	2,075.00

$$\begin{array}{rcl}
 \text{Total Assets} & - & \text{Total Liabilities} \\
 \text{① (owned)} & & \text{② (owed)} \\
 & = & \text{③ Net Worth} \\
 & & \text{(also known as Equity)}
 \end{array}$$

Ethics in Business

LO2

- The principles of right and wrong that guide an individual in making decisions are called **ethics**.
- The use of ethics in making business decisions is called **business ethics**.

Lesson 1-1 Audit Your Understanding

1. What is accounting?

ANSWER

Accounting is the process of planning, recording, analyzing, and interpreting financial information.

Lesson 1-1 Audit Your Understanding

2. Why is accounting called the language of business?

ANSWER

Accounting provides financial information to everyone who needs it to make good business decisions.

Lesson 1-1 Audit Your Understanding

3. Describe a scenario in which you, as a nonaccountant, might use accounting.

ANSWER

Answers may include creating a personal budget or providing information for a loan or credit card application.

LESSON

1-2

How Business Activities Change the Accounting Equation



Learning Objectives

- LO3** Classify accounts as assets, liabilities, or owner's equity and demonstrate their relationship in the accounting equation.
- LO4** Analyze the effects of transactions on the accounting equation.
- LO5** Distinguish between cash and on account transactions.

The Business—Delgado Web Services

- A business that performs an activity for a fee is called a **service business**.
- A **proprietorship** is a business owned by one person.
 - A proprietorship is sometimes referred to as a *sole proprietorship*.
- A **business plan** is a formal written document that describes the nature of a business and how it will operate.

Accounting Standards and Rules

- The standards and rules that accountants follow while recording and reporting financial activities are commonly referred to as *generally accepted accounting principles* or **GAAP**.

The Accounting Equation

LO3

- Financial rights to the assets of a business are called **equities**.
- The amount remaining after the value of all liabilities is subtracted from the value of all assets is called **owner's equity**.
- The equation showing the relationship among assets, liabilities, and owner's equity is called the **accounting equation**.

The Accounting Equation

LO3

$$\begin{array}{ccc} \text{Assets} & = & \text{Liabilities} + \text{Owner's Equity} \\ \hline \text{Left side amount} & & \text{Right side amounts} \end{array}$$

Receiving Cash

LO4

- Accountants call any business activity that changes assets, liabilities, or owner's equity a **transaction**.
- A record that summarizes all the transactions pertaining to a single item in the accounting equation is called an **account**.
- The name given to an account is called an **account title**.
- The difference between the increases and decreases in an account is called the **account balance**.
- An account used to summarize the owner's equity in a business is called a **capital account**.

Receiving Cash

LO4

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

LO4

Transaction 2

January 2. Paid cash for supplies, \$165.00.

	Assets			=	Liabilities + Owner's Equity	
	Cash	+ Supplies	+ Prepaid Insurance	=		Michael Delgado, Capital
Balances	\$2,000				\$0	\$2,000
Paid cash for supplies	-165	+165				
New Balances	\$1,835	\$165			\$0	\$2,000
Paid cash for insurance	-900		+900			
New Balances	\$935	\$165	\$900		\$0	\$2,000

Transaction 3

January 3. Paid cash for insurance, \$900.00.

Transactions on Account

LO5

- A person or business to whom a liability is owed is called a **creditor**.

Transactions on Account

LO5

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.

Lesson 1-2 Audit Your Understanding

1. Give two examples of service businesses in your area.

ANSWER

Answers should include businesses that perform activities for a fee, such as dry cleaners, car washes, or landscapers.

Lesson 1-2 Audit Your Understanding

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

ANSWER

The right side must also be increased.

Lesson 1-2 Audit Your Understanding

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

ANSWER

If one account is increased, another account on the same side of the equation must be decreased by the same amount.

Lesson 1-2 Audit Your Understanding

4. What does the term *on account* mean?

ANSWER

Purchasing on account means buying items or services and paying for them at a future date.

LESSON

1-3 How Transactions Change Owner's Equity in an Accounting Equation



Learning Objectives

- LO6** Compare and contrast the types of transactions that increase and decrease owner's equity.
- LO7** Explain the difference between expenses and liabilities.

Transactions Affecting Owner's Equity

LO6

- An increase in equity resulting from the sale of goods or services is called **revenue**.
- A sale for which payment will be received at a later date is called a **sale on account**.

Transactions Affecting Owner's Equity

LO6

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

LO6

	Assets				=	Liabilities + Owner's Equity	
	Cash +	Accts. Rec.— Main Street Services	+Supplies	+ 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

LO7

- Unlike a liability, which is an amount that is owed, the cost of goods or services used to operate a business is called an **expense**.

Expense Transactions

LO7

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

LO7

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

- Assets taken from the business for the owner's personal use are called **withdrawals**.

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

Lesson 1-3 Audit Your Understanding

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

ANSWER

Owner's equity is increased.

Lesson 1-3 Audit Your Understanding

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

ANSWER

Owner's equity is increased.

Lesson 1-3 Audit Your Understanding

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

ANSWER

Owner's equity is decreased.