College Accounting
Chapter 2

Analyzing Transactions: The Accounting Equation
Define the accounting elements.
Business Entity

- An individual, association, or organization that engages in economic activities and controls specific economic resources.

- The business entity’s finances are kept separate from the owner’s nonbusiness assets and liabilities (business entity concept).
Assets

Items owned by a business that will provide future benefits.

MUST BE “OWNED” NOT RENTED
Assets

Items owned by a business that will provide future benefits.

*But doesn’t have to be paid off, could still be making payments on it*
Examples:

- Cash
- Merchandise
- Furniture
- Fixtures
- Machinery
- Buildings
- Land
- Accounts Receivable
The amount of money owed to the business by its customers as a result of making sales “on account” or “on credit”

Simply, customers who have promised to pay sometime in the future
Liabilities

A probable future outflow of assets as a result of a past transaction or event.

**IN OTHER WORDS, DEBTS OR OBLIGATIONS OF THE BUSINESS THAT CAN BE PAID WITH CASH, GOODS, OR SERVICES.**
Examples:

- Accounts Payable
- Notes Payable
Accounts Payable

- An unwritten promise to pay a supplier for assets purchased or services rendered
- Referred to as making a purchase “on account” or “on credit”

Be careful!! Don’t confuse accounts receivable and accounts payable. Ask yourself, are we waiting to receive? Or waiting to pay?
Notes Payable

- Formal written promises to pay suppliers or lenders specified sums of money at definite future times
Owner’s Equity

Amount by which the business assets exceed the business liabilities.

Also called:

NET WORTH  OR  CAPITAL
If a business has total assets of $100,000 and total liabilities of $60,000, what is the owner’s equity?

Once the debts are paid, the remaining assets belong to the owner (owner’s equity).
If a business has total assets of $100,000 and total liabilities of $60,000, what is the owner’s equity?

**FORMULA:**

\[
\text{ASSETS} - \text{LIABILITIES} = \text{OWNER’S EQUITY}
\]

\[
$100,000 - $60,000 = $40,000
\]

*Can also be expressed as:*

\[
\text{Assets} = \text{Liabilities} + \text{Owner’s Equity}
\]
The owner of a business may have business assets and liabilities as well as nonbusiness assets and liabilities.

Nonbusiness assets and liabilities are not included in the entity’s accounting records.

If the owner invests money or other assets in the business, the item is now classified as a business asset.
Construct the accounting equation.
The Accounting Equation

Assets = Liabilities + Owner’s Equity

The left side shows the assets.
The Accounting Equation

Assets = Liabilities + Owner’s Equity

The right side shows where the money came from to buy the assets.
Analyze business transactions.
Business Transaction

- An economic event that has a direct impact on the business
- Usually requires an exchange with an outside entity
- We must be able to measure this exchange in dollars
- All business transactions affect the accounting equation through specific accounts
A separate record used to summarize changes in each asset, liability, and owner’s equity of a business.
Analyzing Business Transactions

Three Questions:

- What happened?
- Which accounts are affected?
- How is the accounting equation affected?
Question #1

What happened?

Make certain you understand the event that has taken place.
Which accounts are affected?

- Identify the accounts that are affected.
- Classify these accounts as assets, liabilities, or owner’s equity.
Question #3

How is the accounting equation affected?

• Determine which accounts have increased or decreased.

• Make certain that the accounting equation remains in balance after the transaction has been entered.
Show the effects of business transactions on the accounting equation.
Let’s analyze the effect of transactions on the accounting equation for Jessie Jane’s Campus Delivery.
Investment Example

Jessica Jane, the owner, invested $2,000 in the business.
What happened?

Jessica took $2,000 from her personal bank account and deposited it in a new account in the business’s name.
Identify the accounts that are affected.

CASH

J. J., CAPITAL
Classify these accounts as assets, liabilities, or owner’s equity.

- **CASH**: Asset
- **J. J., CAPITAL**: Owner’s Equity
QUESTION #3A

Determine which accounts have increased or decreased.

CASH: INCREASED

J. J., CAPITAL: INCREASED
Does the accounting equation balance?

\[
\text{ASSETS} = \text{LIABILITIES} + \text{OWNER’S EQUITY}
\]

\[
\text{CASH} = \text{J. J., CAPITAL}
\]

\[
+$2,000 = +$2,000
\]

It balances!

Assets of $2,000 = Liabilities of $0

+ Owner’s equity of $2,000
Purchased delivery equipment for $1,200 cash.
What happened?
Identify the accounts that are affected.
Classify these accounts as assets, liabilities, or owner’s equity.

DELIVERY EQUIPMENT
ASSET

CASH ASSET
Determine which accounts have increased or decreased.

- **Increased**
  - DELIVERY EQUIPMENT
  - ASSET

- **Decreased**
  - CASH
  - ASSET
Let’s look at the accounting equation.

\[
\text{ASSETS} = \text{LIAB.} + \text{O. E.}
\]

\[
\text{CASH} + \text{DEL. EQUIP.} = -$1,200 + +$1,200
\]

The right hand side of the equation is not affected.
Does the accounting equation balance?

Yes!

Total assets stayed the same. One asset increased, the other decreased. No change in liabilities or owner’s equity.
Proving The Accounting Equation Balances

<table>
<thead>
<tr>
<th>ASSETS</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>CASH</td>
<td>$2,000</td>
</tr>
<tr>
<td>DEL. EQUIP.</td>
<td>$1,200</td>
</tr>
<tr>
<td>BAL.</td>
<td>$ 800</td>
</tr>
<tr>
<td></td>
<td>$1,200</td>
</tr>
</tbody>
</table>

LEFT SIDE OF EQUATION:

- CASH: $ 800
- DEL. EQUIP.: 1,200
- TOTAL ASSETS: $2,000
Proving The Accounting Equation Balances

<table>
<thead>
<tr>
<th>LIABILITIES</th>
<th>OWNER’S EQUITY</th>
</tr>
</thead>
<tbody>
<tr>
<td>BAL.  $ 0</td>
<td>$2,000</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>LIABILITIES</th>
<th>OWNER’S EQUITY</th>
</tr>
</thead>
<tbody>
<tr>
<td>BAL.  $ 0</td>
<td>$2,000</td>
</tr>
</tbody>
</table>

RIGHT SIDE OF EQUATION:

<table>
<thead>
<tr>
<th>LIABILITIES</th>
<th>$ 0</th>
</tr>
</thead>
<tbody>
<tr>
<td>OWNER’S EQUITY</td>
<td>2,000</td>
</tr>
<tr>
<td>TOTAL LIAB. &amp; O.E.</td>
<td>$2,000</td>
</tr>
</tbody>
</table>
Purchase On Account Example

Purchased delivery equipment on account for $900.
Questions #1 And #2

What happened?

Identify the accounts that are affected.

Classify these accounts as assets, liabilities, or owner’s equity.

Jessica is buying this delivery equipment “on account.” She will be making payments on it over the next three months. NO CASH WAS EXCHANGED TODAY.
Questions #1 And #2 (continued)

What happened?
Identify the accounts that are affected.
Classify these accounts as assets, liabilities, or owner’s equity.

DEL. EQUIP. ASSET

ACCOUNTS PAYABLE LIABILITY
Determine which accounts have increased or decreased.

- **DEL. EQUIP. ASSET**: Increased
- **ACCOUNTS PAYABLE LIABILITY**: Increased
Let’s look at the accounting equation.

\[
\text{ASSETS} = \text{LIABILITIES} + \text{OWNER’S EQUITY}
\]

\[
\text{DEL.} = \text{ACCOUNTS}
\]

\[
\text{EQUIP.} = \text{PAYABLE}
\]

\[
+$900 = +$900
\]

*This transaction had no effect on owner’s equity.*
QUESTION #3B (continued)

Does the accounting equation balance?

\[
\begin{align*}
\text{ASSETS} &= \text{LIABILITIES} + \text{OWNER'S EQUITY} \\
\text{DL.} &= \text{ACCOUNTS}
\end{align*}
\]

\[
\begin{align*}
\text{EQUIP.} &= \text{PAYABLE} \\
+$900 &= +$900
\end{align*}
\]

It balances!

Assets increased by $900 = Liabilities increased by $900
Proving The Accounting Equation Balances

**ASSETS**

<table>
<thead>
<tr>
<th>CASH</th>
<th>DEL. EQUIP.</th>
</tr>
</thead>
<tbody>
<tr>
<td>$2,000</td>
<td>$1,200</td>
</tr>
<tr>
<td>$2,000</td>
<td>$1,200</td>
</tr>
<tr>
<td>$800</td>
<td>$800</td>
</tr>
<tr>
<td>$800</td>
<td>$2,100</td>
</tr>
</tbody>
</table>

$800 + ($1,200 + $900) = $2,900 TOTAL ASSETS
# Proving The Accounting Equation Balances

<table>
<thead>
<tr>
<th>LIABILITIES</th>
<th>OWNER’S EQUITY</th>
</tr>
</thead>
<tbody>
<tr>
<td>ACCTS. PAY.</td>
<td>J. J., CAPITAL</td>
</tr>
<tr>
<td>BAL.</td>
<td>+$2,000</td>
</tr>
<tr>
<td>$900</td>
<td></td>
</tr>
</tbody>
</table>

\[ \text{BAL.} \quad $900 \quad +$2,000 = \$2,900 \]

**TOTAL LIABILITIES AND OWNER’S EQUITY**
Made $300 payment on equipment loan.
Questions #1 And #2

What happened?
Identify the accounts that are affected.
Classify these accounts as assets, liabilities, or owner’s equity.

CASH
ASSET

ACCOUNTS PAYABLE
LIABILITY
QUESTION #3A

Determine which accounts have increased or decreased.

CASH

ASSET

DECREASED

ACCOUNTS PAYABLE

LIABILITY

DECREASED
Let’s look at the accounting equation.

\[
\begin{align*}
\text{ASSETS} &= \text{LIABILITIES} + \text{OWNER’S EQUITY} \\
\text{CASH} &= \text{ACCOUNTS PAYABLE} \\
-\$300 &= -\$300
\end{align*}
\]

This transaction had no effect on owner’s equity.
QUESTION #3B (continued)

Does the accounting equation balance?

\[
\text{ASSETS} = \text{LIABILITIES} + \text{OWNER’S EQUITY}
\]

\[
\text{CASH} = \text{ACCOUNTS PAYABLE}
\]

\[
-300 = -300
\]

**It balances!**

*Assets decreased by $300 = Liabilities decreased by $300*
## Proving the Accounting Equation Balances

<table>
<thead>
<tr>
<th>ASSETS</th>
<th>DEL. EQUIP.</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>CASH</strong></td>
<td><strong>DEBTS</strong></td>
</tr>
<tr>
<td>$2,000</td>
<td>$1,200</td>
</tr>
<tr>
<td>$800</td>
<td>$1,200</td>
</tr>
<tr>
<td>$500</td>
<td>$2,100</td>
</tr>
</tbody>
</table>

**BAL.:**

- $2,600
### Proving The Accounting Equation Balances

<table>
<thead>
<tr>
<th>LIABILITIES</th>
<th>OWNER’S EQUITY</th>
</tr>
</thead>
<tbody>
<tr>
<td>ACCTS. PAY.</td>
<td>J. J., CAPITAL</td>
</tr>
<tr>
<td>BAL.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>+$900</td>
</tr>
<tr>
<td></td>
<td>$900</td>
</tr>
<tr>
<td></td>
<td>– 300</td>
</tr>
<tr>
<td></td>
<td>$600</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>BAL.</th>
<th>$2,600</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>+$2,000</td>
</tr>
<tr>
<td></td>
<td>$2,000</td>
</tr>
<tr>
<td></td>
<td>$2,000</td>
</tr>
</tbody>
</table>

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**Owner’s Equity Transactions**

<table>
<thead>
<tr>
<th>FOUR TYPES:</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>DECREASE:</strong></td>
<td><strong>INCREASE:</strong></td>
</tr>
<tr>
<td>EXPENSES</td>
<td>REVENUES</td>
</tr>
<tr>
<td>DRAWING</td>
<td>INVESTMENTS</td>
</tr>
</tbody>
</table>
Revenues

- The amount a business charges customers for products sold or services performed
- Recognized when earned (even if cash has not yet been received)
- Increases both assets (cash or accounts receivable) and owner’s equity
Revenues

Examples:

- Delivery Fees
- Consulting Fees
- Rent Revenue (if the business rents space to others)
- Interest Revenue (for interest earned on bank deposits)
- Sales (for sales of merchandise)
Expenses

- Represent the decrease in assets (or increase in liabilities) as a result of efforts made to produce revenues

- Separate accounts are maintained for each type of expense

- Either decrease assets or increase liabilities, but ALWAYS decrease owner’s equity
Expenses

Examples:

- Rent
- Salaries
- Supplies consumed
- Taxes
REVENUE greater than EXPENSES
= NET INCOME

EXAMPLE: Luke Perkins performed $6,000 of tax services (revenue) this year and incurred expenses of $1,500 for rent, $500 for supplies, and $3,000 in salaries.

REVENUE - EXPENSES = NET INCOME

$6,000 - $5,000 = $1,000
EXPENSES greater than REVENUE
= NET LOSS

EXAMPLE: John Atwood performed $8,000 of delivery services (revenue) this year and incurred expenses of $3,500 for rent, $500 for supplies, $3,000 in salaries, and $2,500 for gasoline.

\[
\text{REVENUE} - \text{EXPENSES} = \text{NET LOSS}
\]

\[
\$8,000 \quad - \quad \$9,500 \quad = \quad \$1,500
\]

\[
\$3,500 + \$500 + \$3,000 + \$2,500
\]
Accounting Period Concept

- The concept that income determination can be made on a periodic basis (month, quarter, year, etc.)
- Any accounting period of 12 months is called a fiscal year

Withdrawals

- The owner taking (withdrawing) cash or other assets from the business for personal use
- Reduces owner’s equity and assets
- Also referred to as drawing
Revenue Example

Jessie performed services and received $500 in cash.
What happened?
Identify the accounts that are affected.
Classify these accounts as assets, liabilities, or owner’s equity.

DELIVERY FEES
O.E.
REVENUE

CASH
ASSET
QUESTION #3A

Determine which accounts have increased or decreased.

DELIVERY FEES

CASH

INCREASED

INCREASED
QUESTION #3B

Does the accounting equation balance?

**ASSETS = LIAB. + OWNER’S EQUITY**

**CASH** = **DELIVERY FEES**

+$500 = +$500

It balances!

Assets increased by $500 = Owner’s equity increased by $500
### Proving The Accounting Equation Balances

<table>
<thead>
<tr>
<th>ASSETS</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>CASH</td>
<td>BAL.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>$ 500</td>
<td>$2,100</td>
</tr>
<tr>
<td></td>
<td>$1,000</td>
<td>$2,100</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>DEL. EQUIP.</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>+ 500</td>
<td></td>
</tr>
</tbody>
</table>

**Total assets** = **$3,100**
### Proving The Accounting Equation Balances

<table>
<thead>
<tr>
<th>LIAB.</th>
<th>OWNER’S EQUITY</th>
</tr>
</thead>
<tbody>
<tr>
<td>ACCTS. PAY.</td>
<td>J. J., CAPITAL</td>
</tr>
<tr>
<td>BAL.</td>
<td>BAL.</td>
</tr>
<tr>
<td>$600</td>
<td>$600</td>
</tr>
<tr>
<td>$2,000</td>
<td>$2,000</td>
</tr>
<tr>
<td>$500</td>
<td>$500</td>
</tr>
</tbody>
</table>

$3,100

+$500
Expense Example

Jessie paid $200 for office rent.
Questions #1 And #2

What happened?
Identify the accounts that are affected.
Classify these accounts as assets, liabilities, or owner’s equity.

RENT EXPENSE
O.E. EXPENSE
CASH
ASSET
QUESTION #3A

Determine which accounts have increased or decreased.

INCREASED

RENT EXPENSE

DECREASED

CASH
RENT EXPENSE
CASH

BE CAREFUL! While incurring an expense will increase the expense account, it will cause an overall decrease in owner’s equity.
Does the accounting equation balance?

\[
\text{Assets} = \text{Liabilities} + \text{Owner’s Equity}
\]

- Cash = Rent Expense

\[\text{Assets decreased by } \$200 = \text{Owner’s equity decreased by } \$200\]

It balances!
### Proving The Accounting Equation Balances

<table>
<thead>
<tr>
<th></th>
<th>ASSETS</th>
</tr>
</thead>
<tbody>
<tr>
<td>CASH</td>
<td>BAL. $1,000</td>
</tr>
<tr>
<td>DEL. EQUIP.</td>
<td>BAL. $2,100</td>
</tr>
<tr>
<td></td>
<td>$2,100</td>
</tr>
<tr>
<td>$1,000</td>
<td>− 200</td>
</tr>
<tr>
<td>$800</td>
<td>$2,100</td>
</tr>
</tbody>
</table>

\[ ASSETS = CASH + DEL. EQUIP. \]

\[ $2,900 = $1,000 + $2,100 \]
## Proving The Accounting Equation Balances

<table>
<thead>
<tr>
<th></th>
<th>LIAB.</th>
<th>OWNER’S EQUITY</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>ACCTS. PAY.</td>
<td>BAL.</td>
<td>$600</td>
<td>J. J., Capital</td>
<td>$2,000</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>REVENUES</td>
<td>$500</td>
<td>$500</td>
<td></td>
<td></td>
</tr>
<tr>
<td>EXPENSES</td>
<td>$200</td>
<td>$200</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

$600 + $2,000 + $500 – $200 = $2,900
Expense Example

Jessie paid $50 for telephone expense.
Questions #1 And #2

What happened?

Identify the accounts that are affected.

Classify these accounts as assets, liabilities, or owner’s equity.

- TELE. EXPENSE
- O.E. EXPENSE
- CASH
- ASSET
Determine which accounts have increased or decreased.

**INCREASED**

**TELE. EXPENSE**

**DECREASED**

**CASH**
QUESTION #3B

Does the accounting equation balance?

\[
\text{ASSETS} = \text{LIAB.} + \text{OWNER’S EQUITY}
\]

\[
\begin{align*}
\text{CASH} & = \text{TELE. EXPENSE} \\
-$50 & = -$50
\end{align*}
\]

It balances!

Assets decreased by $50 = Owner’s equity decreased by $50
# Proving The Accounting Equation Balances

<table>
<thead>
<tr>
<th>ASSETS</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>CASH</td>
<td>BAL. $800</td>
</tr>
<tr>
<td>DEL. EQUIP.</td>
<td>$2,100</td>
</tr>
<tr>
<td>BAL.</td>
<td>$750</td>
</tr>
</tbody>
</table>

$800 - 50 = 750

$2,850
### Proving The Accounting Equation Balances

<table>
<thead>
<tr>
<th>LIAB.</th>
<th>OWNER’S EQUITY</th>
</tr>
</thead>
<tbody>
<tr>
<td>ACCTS.</td>
<td>J. J., CAPITAL</td>
</tr>
<tr>
<td>PAY.</td>
<td>BAL. $600</td>
</tr>
<tr>
<td></td>
<td>$600 + $2,000 + $500 - $250 = $2,850</td>
</tr>
</tbody>
</table>
Revenue On Account Example

Jessie performed $600 of services on account.
Questions #1 And #2

What happened?
Identify the accounts that are affected.
Classify these accounts as assets, liabilities, or owner’s equity.

Jessie has performed services for this client. The client will be paying Jessie at a later date.

IT IS REVENUE EVEN THOUGH NO CASH CHANGES HANDS TODAY!
Questions #1 And #2 (continued)

What happened?

Identify the accounts that are affected.

Classify these accounts as assets, liabilities, or owner’s equity.

DELIVERY FEES  O.E.  REVENUE

ACCOUNTS RECEIVABLE  ASSET
QUESTION #3A

Determine which accounts have increased or decreased.

DELIVERY FEES

ACCOUNTS RECEIVABLE

INCREASED

INCREASEDa
Does the accounting equation balance?

\[
\text{ASSETS} = \text{LIAB.} + \text{OWNER'S EQUITY}
\]

\[
\text{ACCTS. RECEIVABLE} = \text{DELIVERY FEES}
\]

\[
+$600 = +$600
\]

It balances!

Assets increased by $600 = Owner’s equity increased by $600
Proving The Accounting Equation Balances

<table>
<thead>
<tr>
<th>ASSETS</th>
<th>CASH</th>
<th>ACCTS. REC.</th>
<th>DEL. EQUIP.</th>
</tr>
</thead>
<tbody>
<tr>
<td>BAL.</td>
<td>$750</td>
<td>$600</td>
<td>$2,100</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>$2,100</td>
</tr>
<tr>
<td></td>
<td>$750</td>
<td>$600</td>
<td>$2,100</td>
</tr>
<tr>
<td></td>
<td>$3,450</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
## Proving The Accounting Equation Balances

<table>
<thead>
<tr>
<th>LIAB.</th>
<th>OWNER'S EQUITY</th>
</tr>
</thead>
<tbody>
<tr>
<td>ACCTS.</td>
<td>J. J., CAPITAL</td>
</tr>
<tr>
<td>PAY.</td>
<td>REVENUES</td>
</tr>
<tr>
<td>BAL.</td>
<td>EXPENSES</td>
</tr>
<tr>
<td>$600</td>
<td>$2,000</td>
</tr>
<tr>
<td>$500</td>
<td>$1,100</td>
</tr>
<tr>
<td>$250</td>
<td>$250</td>
</tr>
</tbody>
</table>

$600 + $2,000 + $1,100 - $250 = $3,450
Purchase Of Supplies Example

Purchased supplies for $80 cash.
Questions #1 And #2

What happened?
Identify the accounts that are affected.
Classify these accounts as assets, liabilities, or owner’s equity.

SUPPLIES
ASSET

CASH
ASSET
Determine which accounts have increased or decreased.

Increased

- Supplies
- Asset

Decreased

- Cash
- Asset
Does the accounting equation balance?

\[
\frac{\text{ASSETS}}{\text{CASH} + \text{SUPPLIES}} = \text{LIAB.} + \text{O. E.}
\]

\[
-80 + 80 = 0
\]

It balances!

Total assets stayed the same. One asset increased, the other decreased. No change in liabilities or owner’s equity.
# Proving The Accounting Equation Balances

## ASSETS

<table>
<thead>
<tr>
<th>BAL.</th>
<th>CASH</th>
<th>ACCTS. REC.</th>
<th>SUPPLIES</th>
<th>DEL. EQUIP.</th>
</tr>
</thead>
<tbody>
<tr>
<td>BAL.</td>
<td>$750</td>
<td>$600</td>
<td>+$80</td>
<td>$2,100</td>
</tr>
<tr>
<td>BAL.</td>
<td>$670</td>
<td>$600</td>
<td>$80</td>
<td>$2,100</td>
</tr>
</tbody>
</table>

Total: $3,450
### Proving The Accounting Equation Balances

<table>
<thead>
<tr>
<th>LIAB.</th>
<th>OWNER’S EQUITY</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>ACCTS. PAY.</td>
</tr>
<tr>
<td>BAL.</td>
<td>$600</td>
</tr>
<tr>
<td>BAL.</td>
<td>$600</td>
</tr>
</tbody>
</table>

$\$600 + $2,000 + $1,100 - $250 = $3,450$
Prepaid insurance with $200 cash.
Questions #1 And #2

What happened?

Identify the accounts that are affected.

Classify these accounts as assets, liabilities, or owner’s equity.

PREPAID INSURANCE

CASH

ASSET

ASSET
QUESTION #3A

Determine which accounts have increased or decreased.

**INCREASED**
- PREPAID INSURANCE
- ASSET

**DECREASED**
- CASH
- ASSET
Does the accounting equation balance?

\[
\text{ASSETS} = \text{LIAB.} + \text{O. E.}
\]

\[
\begin{array}{ccc}
\text{CASH} & + & \text{PREPAID INS.} \\
-200 & + & +200 \\
\end{array}
\]

\[=\]

\text{It balances!}

Total assets stayed the same. One asset increased, the other decreased. No change in liabilities or owner’s equity.
## Proving The Accounting Equation Balances

<table>
<thead>
<tr>
<th></th>
<th>ASSETS</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>CASH</td>
<td>ACCTS. REC.</td>
</tr>
<tr>
<td>BAL.</td>
<td>$670</td>
<td>$600</td>
</tr>
<tr>
<td>– 200</td>
<td></td>
<td></td>
</tr>
<tr>
<td>BAL.</td>
<td>$470</td>
<td>$600</td>
</tr>
</tbody>
</table>

$3,450
## Proving The Accounting Equation Balances

<table>
<thead>
<tr>
<th>LIAB.</th>
<th>OWNER’S EQUITY</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>ACCTS. PAY.</td>
</tr>
<tr>
<td>BAL. $600</td>
<td>$2,000</td>
</tr>
<tr>
<td>BAL. $600</td>
<td>$2,000</td>
</tr>
</tbody>
</table>

$600 + $2,000 + $1,100 - $250 = $3,450
Customer Payment Example

Received $570 in cash for services recognized in an earlier transaction.
What happened?

Identify the accounts that are affected.

Classify these accounts as assets, liabilities, or owner’s equity.

When Jessie provided the delivery services, this client agreed to pay at a later date.

TODAY SHE RECEIVED CASH OF $570 AS A PARTIAL PAYMENT.
What happened?
Identify the accounts that are affected.
Classify these accounts as assets, liabilities, or owner’s equity.
Determine which accounts have increased or decreased.
Does the accounting equation balance?

<table>
<thead>
<tr>
<th>ASSETS</th>
<th>=</th>
<th>LIAB. + O. E.</th>
</tr>
</thead>
<tbody>
<tr>
<td>CASH + $570</td>
<td>+</td>
<td>ACCTS. REC. - $570</td>
</tr>
</tbody>
</table>

It balances!

Total assets stayed the same. One asset increased, the other decreased. No change in liabilities or owner’s equity.
## Proving The Accounting Equation Balances

<table>
<thead>
<tr>
<th>ASSETS</th>
<th>CASH</th>
<th>ACCTS. SUPPLIES</th>
<th>PREPD. INS.</th>
<th>DEL. EQUIP.</th>
</tr>
</thead>
<tbody>
<tr>
<td>BAL.</td>
<td>$470</td>
<td>$600</td>
<td>$80</td>
<td>$200</td>
</tr>
<tr>
<td>$1,040</td>
<td>$30</td>
<td>$80</td>
<td>$200</td>
<td>$2,100</td>
</tr>
</tbody>
</table>

$3,450
### Proving The Accounting Equation Balances

<table>
<thead>
<tr>
<th>LIAB.</th>
<th>OWNER’S EQUITY</th>
</tr>
</thead>
<tbody>
<tr>
<td>ACCTS.</td>
<td>J. J., CAPITAL</td>
</tr>
<tr>
<td>PAY.</td>
<td></td>
</tr>
<tr>
<td>BAL.</td>
<td>$600</td>
</tr>
<tr>
<td>BAL.</td>
<td>$600</td>
</tr>
</tbody>
</table>

\[\text{BAL.}\text{ }$600 + \text{BAL.}\text{ }$2,000 + \text{BAL.}\text{ }$1,100 - \text{BAL.}\text{ }$250 = \text{BAL.}\text{ }$3,450\]
Purchased delivery equipment for $300 cash and $1,200 on account.
What happened?
Identify the accounts that are affected.
Classify these accounts as assets, liabilities, or owner’s equity.

Jessie is buying this delivery equipment by paying some cash now and the rest “on account.” She will be making payments on it over the next four months.
What happened?
Identify the accounts that are affected.
Classify these accounts as assets, liabilities, or owner’s equity.

- CASH ASSET
- DELIVERY EQUIP. ASSET
- ACCOUNTS PAYABLE LIABILITY
QUESTION #3A

Determine which accounts have increased or decreased.

- Decreased
- Increased

Cash Asset
Delivery Equip. Asset
Accounts Payable Liability
Does the accounting equation balance?

\[
\text{ASSETS} = \text{LIABILITIES} + \text{EQUITY}
\]

CASH + DEL. EQUIP. = ACCOUNTS PAYABLE

\[
-\$300 + \$1,500 = +\$1,200
\]

It balances!

Assets increased by $1,200 = Liabilities increased by $1,200
### Proving The Accounting Equation Balances

<table>
<thead>
<tr>
<th>ASSETS</th>
<th>CASH</th>
<th>ACCTS. REC.</th>
<th>SUPPLIES</th>
<th>PREPD. INS.</th>
<th>DEL. EQUIP.</th>
</tr>
</thead>
<tbody>
<tr>
<td>BAL.</td>
<td>$1,040</td>
<td>$30</td>
<td>$80</td>
<td>$200</td>
<td>$2,100</td>
</tr>
<tr>
<td></td>
<td>- 300</td>
<td></td>
<td></td>
<td></td>
<td>+ 1,500</td>
</tr>
<tr>
<td>BAL.</td>
<td>$ 740</td>
<td>$30</td>
<td>$80</td>
<td>$200</td>
<td>$3,600</td>
</tr>
</tbody>
</table>

$4,650
Proving The Accounting Equation Balances

<table>
<thead>
<tr>
<th></th>
<th>LIAB.</th>
<th>OWNER’S EQUITY</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>ACCTS. PAY.</td>
<td>J. J., CAPITAL</td>
</tr>
<tr>
<td>BAL.</td>
<td>$ 600</td>
<td>$2,000</td>
</tr>
<tr>
<td></td>
<td>$1,200</td>
<td>$1,200</td>
</tr>
<tr>
<td>BAL.</td>
<td>$1,800</td>
<td>$2,000</td>
</tr>
</tbody>
</table>

$1,800 + $2,000 + $1,100 – $250 = $4,650
Jessie paid her part-time employees $650 in wages.
Questions #1 And #2

What happened?

Identify the accounts that are affected.

Classify these accounts as assets, liabilities, or owner’s equity.

WAGES
EXPENSE
O.E.
EXPENSE

CASH
ASSET
QUESTION #3A

Determine which accounts have increased or decreased.

**INCREASED**
- WAGES
- EXPENSE

**DECREASED**
- CASH
Does the accounting equation balance?

\[
\text{ASSETS} = \text{LIAB.} + \text{OWNER'S EQUITY}
\]

\[
\text{CASH} = \text{WAGES EXPENSE}
\]

\[-$650 = -$650\]

It balances!

Assets decreased by $650 = Owner’s equity decreased by $650
## Proving The Accounting Equation Balances

### ASSETS

<table>
<thead>
<tr>
<th></th>
<th>CASH</th>
<th>ACCTS. REC.</th>
<th>SUPPLIES</th>
<th>PREPD. INS.</th>
<th>DEL. EQUIP.</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>BAL.</strong></td>
<td>$740</td>
<td>$30</td>
<td>$80</td>
<td>$200</td>
<td>$3,600</td>
</tr>
<tr>
<td>$ – 650</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>BAL.</strong></td>
<td>$ 90</td>
<td>$30</td>
<td>$80</td>
<td>$200</td>
<td>$3,600</td>
</tr>
</tbody>
</table>

$4,000
# Proving The Accounting Equation Balances

<table>
<thead>
<tr>
<th></th>
<th>LIAB.</th>
<th>OWNER'S EQUITY</th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>ACCTS.</td>
<td>J. J.,</td>
<td>REVENUES</td>
<td>EXPENSES</td>
<td></td>
</tr>
<tr>
<td>PAY.</td>
<td></td>
<td>CAPITAL</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>BAL.</td>
<td>$1,800</td>
<td>$2,000</td>
<td>$1,100</td>
<td>$250</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>+ 650</td>
<td></td>
</tr>
<tr>
<td>BAL.</td>
<td>$1,800</td>
<td>$2,000</td>
<td>$1,100</td>
<td>$900</td>
<td></td>
</tr>
</tbody>
</table>

$1,800 + $2,000 + $1,100 - $900 = $4,000
Deliveries Example

Jessie received delivery fees as follows: $430 in cash and $620 on account.
Questions #1 And #2

What happened?

Identify the accounts that are affected.

Classify these accounts as assets, liabilities, or owner’s equity.

CASH
ASSET

DELIVERY EQUIP.
ASSET

DELIVERY FEES
O.E.
REVENUE
Determine which accounts have increased or decreased.

- **INCREASED**
  - CASH
  - DELIVERY EQUIP.
  - DELIVERY FEES

- **ASSET**
  - ASSET
  - O.E. REVENUE
Does the accounting equation balance?

\[
\text{ASSETS} = \text{LIAB.} + \text{OWNER’S EQUITY}
\]

\[
\text{CASH} + \text{ACCTS. REC.} = \text{DELIVERY FEES}
\]

\[
$430 + +$620 = +$1,050
\]

It balances!

Assets increased by $1,050 = Owner’s equity increased by $1,050
# Proving the Accounting Equation Balances

<table>
<thead>
<tr>
<th>ASSETS</th>
<th>CASH</th>
<th>ACCTS. REC.</th>
<th>SUPPLIES</th>
<th>PREPARED INS.</th>
<th>DEL. EQUIP.</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>BAL.</strong></td>
<td>$90</td>
<td>$30</td>
<td>$80</td>
<td>$200</td>
<td>$3,600</td>
</tr>
<tr>
<td><strong>+</strong></td>
<td>430</td>
<td>620</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>BAL.</strong></td>
<td>$520</td>
<td>$650</td>
<td>$80</td>
<td>$200</td>
<td>$3,600</td>
</tr>
</tbody>
</table>

$5,050
# Proving The Accounting Equation Balances

<table>
<thead>
<tr>
<th></th>
<th>LIAB.</th>
<th>OWNER’S EQUITY</th>
<th>EXPENSES</th>
</tr>
</thead>
<tbody>
<tr>
<td>ACCTS.</td>
<td>BAL. $1,800</td>
<td>$1,100</td>
<td>$900</td>
</tr>
<tr>
<td>PAY.</td>
<td>$2,000</td>
<td>+ 1,050</td>
<td></td>
</tr>
<tr>
<td></td>
<td>$1,800 + $2,000</td>
<td>$2,150</td>
<td>$900</td>
</tr>
<tr>
<td></td>
<td>$1,800 + $2,000</td>
<td>$2,150 - $900</td>
<td>$5,050</td>
</tr>
</tbody>
</table>

The accounting equation balances as shown in the table, proving that the total Liabilities (Liabilities, Capital, and Payables) equal the total Owner’s Equity (Revenues - Expenses).
Jessie withdrew $150 for personal expenses.
Jessie is withdrawing some of her equity in the business by taking home an asset (cash). This will reduce the assets and reduce her owner’s equity.

What happened?

Identify the accounts that are affected.

Classify these accounts as assets, liabilities, or owner’s equity.
What happened?

Identify the accounts that are affected.

Classify these accounts as assets, liabilities, or owner’s equity.

J. J., DRAWING

O.E. DRAWING

CASH

ASSET
Determine which accounts have increased or decreased.

**INCREASED**
- J. J., DRAWING

**DECREASED**
- CASH
Determine which accounts have increased or decreased.

**J. J., DRAWING**

**CASH**

*BE CAREFUL! Just like expenses, the drawing account will increase in this situation, but it will cause an overall DECREASE IN OWNER’S EQUITY.*
QUESTION #3B

Does the accounting equation balance?

\[
\text{ASSETS} = \text{LIAB.} + \text{OWNER'S EQUITY}
\]

\[
\text{CASH} = J.J., \text{DRAWING}
\]

\[
-_150 = +150
\]

It balances!

Assets decreased by $150 = Owner’s equity decreased by $150
### Proving The Accounting Equation Balances

<table>
<thead>
<tr>
<th>ASSETS</th>
<th>CASH</th>
<th>ACCTS. SUPPLIES</th>
<th>PREPD. DEL.</th>
</tr>
</thead>
<tbody>
<tr>
<td>BAL.</td>
<td>$520</td>
<td>$650</td>
<td>$80</td>
</tr>
<tr>
<td></td>
<td></td>
<td>$200</td>
<td>$3,600</td>
</tr>
<tr>
<td>– 150</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>BAL.</td>
<td>$370</td>
<td>$650</td>
<td>$80</td>
</tr>
<tr>
<td></td>
<td></td>
<td>$200</td>
<td>$3,600</td>
</tr>
</tbody>
</table>

\[ \text{BAL.} = \text{CASH} + \text{ACCTS. SUPPLIES} + \text{PREPD. DEL.} \]

\[ \text{BAL.} = $4,900 \]
### Proving The Accounting Equation Balances

<table>
<thead>
<tr>
<th></th>
<th>LIAB.</th>
<th>OWNER’S EQUITY</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>ACCTS.</td>
<td>J. J., CAP.</td>
</tr>
<tr>
<td>BAL.</td>
<td>$1,800</td>
<td>$2,000</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>BAL.</td>
<td>$1,800</td>
<td>$2,000</td>
</tr>
</tbody>
</table>

$1,800 + $2,000 - $150 + $2,150 - $900 = $4,900
Prepare and describe the purposes of a simple income statement, statement of owner’s equity, and balance sheet.
Financial Statements

• Three commonly prepared financial statements:
  ▪ Income statement
  ▪ Statement of owner’s equity
  ▪ Balance sheet
Income Statement

- Reports the profitability of business operations for a specific period of time

- Expenses are subtracted from revenues to determine net income/loss

- Also called the profit and loss statement or operating statement
<table>
<thead>
<tr>
<th>Financial statement headings:</th>
</tr>
</thead>
<tbody>
<tr>
<td>1st line: The name of the company</td>
</tr>
<tr>
<td>2nd line: The title of the statement</td>
</tr>
<tr>
<td>3rd line: The time period covered or the date of the statement</td>
</tr>
</tbody>
</table>
Jessie Jane’s Campus Delivery
Income Statement
For Month Ended June 30, 20--

<p>| | | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

This column is used for listing items to be totaled.
<p>| | | | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
</table>

This column is used for Totals.
| Revenues       | Delivery fees | $2,150 |

The first item at the top of a column should include a dollar sign.
# Jessie Jane’s Campus Delivery Income Statement

For Month Ended June 30, 20--

<table>
<thead>
<tr>
<th>Revenues</th>
<th>$2,150</th>
</tr>
</thead>
<tbody>
<tr>
<td>Delivery fees</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Expenses</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Wages expense</td>
<td>$ 650</td>
</tr>
<tr>
<td>Rent expense</td>
<td>200</td>
</tr>
<tr>
<td>Telephone expense</td>
<td>50</td>
</tr>
<tr>
<td><strong>Total expenses</strong></td>
<td><strong>900</strong></td>
</tr>
</tbody>
</table>

Underline before totaling.
# Jessie Jane’s Campus Delivery Income Statement

For Month Ended June 30, 20--

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Revenues</strong></td>
<td></td>
</tr>
<tr>
<td>Delivery fees</td>
<td>$2,150</td>
</tr>
<tr>
<td><strong>Expenses</strong></td>
<td></td>
</tr>
<tr>
<td>Wages expense</td>
<td>$650</td>
</tr>
<tr>
<td>Rent expense</td>
<td>200</td>
</tr>
<tr>
<td>Telephone expense</td>
<td>50</td>
</tr>
<tr>
<td><strong>Total expenses</strong></td>
<td>900</td>
</tr>
<tr>
<td><strong>Net income</strong></td>
<td>$1,250</td>
</tr>
</tbody>
</table>

Revenues are greater than expenses, therefore the total is called Net Income.
<p>| | | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Revenues</strong></td>
<td></td>
<td><strong>$2,150</strong></td>
</tr>
<tr>
<td>Delivery fees</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th><strong>Expenses</strong></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Wages expense</td>
<td><strong>$650</strong></td>
<td></td>
</tr>
<tr>
<td>Rent expense</td>
<td>200</td>
<td></td>
</tr>
<tr>
<td>Telephone expense</td>
<td>50</td>
<td></td>
</tr>
<tr>
<td><strong>Total expenses</strong></td>
<td></td>
<td><strong>$900</strong></td>
</tr>
</tbody>
</table>

| **Net income** | **$1,250** |

*Double underline the net income total.*
The Statement Of Owner’s Equity

- Reports the activities that affected owner’s equity for a specific period of time
- Uses Net Income from the income statement
### Jessie Jane’s Campus Delivery
### Statement of Owner’s Equity
### For Month Ended June 30, 20--

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Jessica Jane, capital, June 1, 20--</td>
<td>$2,000</td>
</tr>
<tr>
<td>Net income for June</td>
<td>$1,250</td>
</tr>
</tbody>
</table>

*Instead of showing revenue increasing and expenses decreasing the owner’s equity, this statement uses the net effect (net income/loss) from the income statement.*
# Jessie Jane’s Campus Delivery
Statement Of Owner’s Equity For Month Ended June 30, 20--

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Jessica Jane, capital, June 1, 20--</td>
<td>$2,000</td>
</tr>
<tr>
<td>Net income for June</td>
<td>$1,250</td>
</tr>
<tr>
<td>Less withdrawal for June</td>
<td>150</td>
</tr>
<tr>
<td></td>
<td><strong>1,100</strong></td>
</tr>
</tbody>
</table>

$1,250 net income – $150 withdrawal = $1,100 increase in capital
<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Jessica Jane, capital, June 1, 20--</td>
<td>$2,000</td>
</tr>
<tr>
<td>Net income for June</td>
<td>$1,250</td>
</tr>
<tr>
<td>Less withdrawal for June</td>
<td>150</td>
</tr>
<tr>
<td>Increase in capital</td>
<td>1,100</td>
</tr>
<tr>
<td>Jessica Jane, capital, June 30, 20--</td>
<td>$3,100</td>
</tr>
</tbody>
</table>

$2,000 beginning O. E. + $1,100 increase = $3,100
The Balance Sheet

- Confirms the accounting equation has remained in balance

- Also referred to as a statement of financial position or statement of financial condition
The balance sheet reports assets, liabilities, and owner’s equity on a SPECIFIC DATE, not a period of time.
## Jessie Jane’s Campus Delivery
### Balance Sheet
#### June 30, 20--

<table>
<thead>
<tr>
<th>Assets</th>
<th>Liabilities</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Cash</strong></td>
<td><strong>Accounts payable</strong></td>
</tr>
<tr>
<td></td>
<td><strong>$1,800</strong></td>
</tr>
<tr>
<td><strong>Accounts receivable</strong></td>
<td>650</td>
</tr>
<tr>
<td><strong>Supplies</strong></td>
<td><strong>Owner’s Equity</strong></td>
</tr>
<tr>
<td></td>
<td><strong>Jessica Jane, capital</strong></td>
</tr>
<tr>
<td><strong>Prepaid insurance</strong></td>
<td></td>
</tr>
<tr>
<td><strong>Delivery equipment</strong></td>
<td><strong>Total liabilities and</strong></td>
</tr>
<tr>
<td></td>
<td><strong>owner’s equity</strong></td>
</tr>
<tr>
<td><strong>Total assets</strong></td>
<td><strong>$4,900</strong></td>
</tr>
<tr>
<td></td>
<td><strong>$4,900</strong></td>
</tr>
</tbody>
</table>

It balances!!!
Define the three basic phases of the accounting process.
Accounting Process

THREE BASIC PHASES:

INPUT

Transactions provide the necessary input
PROCESSING

- Identify accounts
- Classify accounts
- Determine whether increase or decrease?
- Enter transaction and verify balance
### Output

**Income Statement**

\[
\text{REVENUES} - \text{EXPENSES} = \text{NET INCOME}
\]

**Statement of Owner’s Equity**

\[
\text{BEGINNING CAPITAL} + \text{INVESTMENTS} + \text{NET INCOME} - \text{WITHDRAWALS} = \text{ENDING CAPITAL}
\]
OUTPUT

BALANCE SHEET

ASSETS

= 

LIABILITIES

+ 

OWNER’S EQUITY

(Ending Capital)