Chapter 2

Analyzing Transactions: The Accounting Equation
Define the accounting elements.
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*
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*
Assets (cont.)

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
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.
Assets and the Cost of Products We Buy

Next time you buy something, think of all the assets a company needs to produce that product. If the product comes from a capital-intensive industry, one that requires heavy investments in assets, the company must price the product high enough to cover the cost of using the assets and replacing them when they wear out. For example, AT&T recently reported that the cost of property, plant, and equipment used for operating purposes came to over $244 billion.
Construct the accounting equation.
The Accounting Equation

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

*The left side shows the assets.*
The Accounting Equation (cont.)

Assets = Liabilities + Owner’s Equity

The right side shows where the money came from to buy the assets.
Example

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?

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

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

*Can also be expressed as:*

\[
\text{Assets} = \text{Liabilities} + \text{Owner’s Equity}
\]
Learning Objective 3

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
Account

- A separate record used to summarize changes in each asset, liability, and owner’s equity of a business.
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.
Question #2

- 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.
Chapter 4

Show the effects of business transactions on the accounting equation.
Let’s analyze the effect of transactions on the accounting equation
Damon Williams, the owner, invested $2,000 in the business.
What happened?

Damon took $2,000 from his personal bank account and deposited it in a new account in the business’s name.
QUESTION #2A

Identify the accounts that are affected.

CASH

D.W., CAPITAL
QUESTION #2B

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

- CASH: Asset
- D.W., CAPITAL: Owner’s Equity
QUESTION #3A

Determine which accounts have increased or decreased.

- INCREASED
  - CASH
  - D.W., CAPITAL
Does the accounting equation balance?

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

\[ \text{CASH} = +\$2,000 = \text{D.W., CAPITAL} + +\$2,000 \]

It balances!

Assets of $2,000 = Liabilities of $0 + Owner’s equity of $2,000
Cash Purchase Example

- 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.

Questions #1 And #2

DELIVERY EQUIPMENT CASH

ASSET ASSET
Determine which accounts have increased or decreased.

**INCREASED**
- DELIVERY EQUIPMENT
- ASSET

**DECREASED**
- CASH
- ASSET
QUESTION #3B

Let’s look at the accounting equation.

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

CASH + DEL. EQUIP. =

\(-$1,200 + +$1,200 =

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

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

\[
\begin{align*}
\text{CASH} & + \\
-1,200 & +
\end{align*}
\]

\[
\begin{align*}
\text{DEL. EQUIP.} & + \\
+1,200 & +
\end{align*}
\]

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

LEFT SIDE OF EQUATION:

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

### 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.

Damon is buying this delivery equipment “on account.” He will be making payments on it over the next three months. NO CASH WAS EXCHANGED TODAY.
What happened?

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

DEL. EQUIP.  ACCOUNTS PAYABLE

ASSET  LIABILITY
Determine which accounts have increased or decreased.

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

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

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

\[
+$900 = +$900
\]

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

Does the accounting equation balance?

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

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

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

\[
+\$900 = +\$900
\]

\[\text{It balances!} \]

\[\text{Assets increased by } \$900 = \text{Liabilities increased by } \$900\]
### Proving The Accounting Equation Balances

<table>
<thead>
<tr>
<th>ASSETS</th>
<th>CASH</th>
<th>DEL. EQUIP.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$2,000</td>
<td>$1,200</td>
</tr>
<tr>
<td></td>
<td>$800 - 1,200</td>
<td></td>
</tr>
<tr>
<td>BAL.</td>
<td>$800</td>
<td>$1,200 + 900</td>
</tr>
<tr>
<td></td>
<td></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>D.W., CAPITAL</td>
</tr>
<tr>
<td></td>
<td>+$2,000</td>
</tr>
<tr>
<td>BAL.</td>
<td>$900</td>
</tr>
<tr>
<td>+$900</td>
<td></td>
</tr>
<tr>
<td>BAL.</td>
<td>$900</td>
</tr>
</tbody>
</table>

\[
$900 + $2,000 = $2,900
\]

**TOTAL LIABILITIES AND OWNER’S EQUITY**
Made $300 payment on equipment loan.
What happened?
- Identify the accounts that are affected.
- Classify these accounts as assets, liabilities, or owner’s equity.

Questions #1 And #2

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.

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

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

\[
-\$300 = -\$300
\]

This transaction had no effect on owner’s equity.
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>CASH</th>
<th>DEL. EQUIP.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$2,000</td>
<td>$1,200</td>
</tr>
<tr>
<td></td>
<td>– 1,200</td>
<td></td>
</tr>
<tr>
<td>BAL.</td>
<td>$ 800</td>
<td>$1,200</td>
</tr>
<tr>
<td></td>
<td>+ 900</td>
<td></td>
</tr>
<tr>
<td></td>
<td>$ 800</td>
<td>$2,100</td>
</tr>
<tr>
<td></td>
<td>– 300</td>
<td></td>
</tr>
<tr>
<td>BAL.</td>
<td>$ 500</td>
<td>$2,100</td>
</tr>
</tbody>
</table>

$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>D.W., CAPITAL</td>
</tr>
<tr>
<td></td>
<td>+$2,000</td>
</tr>
<tr>
<td>BAL.</td>
<td>$2,000</td>
</tr>
<tr>
<td></td>
<td>+$900</td>
</tr>
<tr>
<td>BAL.</td>
<td>$900</td>
</tr>
<tr>
<td></td>
<td>$2,000</td>
</tr>
<tr>
<td></td>
<td>– 300</td>
</tr>
<tr>
<td>BAL.</td>
<td>$600</td>
</tr>
<tr>
<td></td>
<td>$2,000</td>
</tr>
</tbody>
</table>

**Total:** $2,600
# Owner’s Equity Transactions

## Four Types:

<table>
<thead>
<tr>
<th>Decrease</th>
<th>Increase</th>
</tr>
</thead>
<tbody>
<tr>
<td>Expenses</td>
<td>Revenues</td>
</tr>
<tr>
<td>Drawing</td>
<td>Investments</td>
</tr>
</tbody>
</table>

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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
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.
Examples:

- Rent
- Salaries
- Supplies consumed
- Taxes
Net Income

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.

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

\[
\$6,000 - \$5,000 = \$1,000
\]

\[
\$1,500 + \$500 + \$3,000
\]
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.

REVENUE – EXPENSES = NET LOSS

$8,000 – $9,500 = ($1,500)

$3,500 + $500 + $3,000 + $2,500
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
Damon performed services and received $500 in cash.
Questions #1 And #2

- 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

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QUESTION #3A

Determine which accounts have increased or decreased.

- DELIVERY FEES: INCREASED
- CASH: INCREASED
Does the accounting equation balance?

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

\[ \text{CASH} = \text{DELIVERY FEES} \]

\[ +$500 = +$500 \]

\text{It balances!}

\text{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>$500</td>
<td></td>
</tr>
<tr>
<td>DEL. EQUIP.</td>
<td>$2,100</td>
<td></td>
</tr>
</tbody>
</table>

BAL. $1,000 $2,100

$3,100
Proving The Accounting Equation

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

$3,100
Expense Example

- Damon 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
Determine which accounts have increased or decreased.

Increased

Rent Expense

Decreased

Cash
QUESTION #3A (continued)

- Determine which accounts have increased or decreased.

**RENT EXPENSE**

**CASH**

**BE CAREFUL! While incurring an expense will increase the expense account, it will cause an overall **DECREASE IN OWNER’S EQUITY**.**
QUESTION #3B

Does the accounting equation balance?

**ASSETS** = **LIAB. + OWNER’S EQUITY**

CASH = RENT EXPENSE

$-200 = -200$

It balances!

Assets decreased by $200 = Owner’s equity decreased by $200
Proving The Accounting Equation

Balances

ASSETS

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

\[ \text{BAL. } CASH + \text{BAL. } \text{DEL. EQUIP.} = \text{Total Assets (BAL. }$2,900) \]
Proving The Accounting Equation

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

$600 + $2,000 + $500 - $200 = $2,900
Damon 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**

**DECREASED**

**TELE. EXPENSE**

**CASH**
Does the accounting equation balance?

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

Cash: \(-\$50\) = Tele. Expense: \(-\$50\)

It balances!

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

<table>
<thead>
<tr>
<th>ASSETS</th>
<th>CASH</th>
<th>DEL. EQUIP.</th>
</tr>
</thead>
<tbody>
<tr>
<td>BAL.</td>
<td>$800</td>
<td>$2,100</td>
</tr>
<tr>
<td>– 50</td>
<td></td>
<td></td>
</tr>
<tr>
<td>BAL.</td>
<td>$750</td>
<td>$2,100</td>
</tr>
</tbody>
</table>

$2,850
## 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>D.W., CAPITAL</td>
</tr>
<tr>
<td>BAL.</td>
<td>BAL.</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
</tbody>
</table>

\[ \text{BAL.} = \text{BAL.} + \text{REVENUES} - \text{EXPENSES} \]

\[ \text{BAL.} = $600 + $2,000 + $500 - $250 = $2,850 \]
Damon 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.

Damon has performed services for this client. The client will be paying Damon 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
Determine which accounts have increased or decreased.

- DELIVERY FEES
  - INCREASED

- ACCOUNTS RECEIVABLE
  - INCREASED
Does the accounting equation balance?

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

\[
\text{ACCTS. RECEIVABLE} + \$600 = \text{DELIVERY FEES} + \$600
\]

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><strong>BAL.</strong></td>
<td>$750</td>
<td>+$600</td>
<td>$2,100</td>
</tr>
<tr>
<td></td>
<td>$750</td>
<td>$600</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. PAY.</td>
<td>D.W., CAPITAL</td>
</tr>
<tr>
<td>BAL.</td>
<td>REVENUES</td>
</tr>
<tr>
<td>$600</td>
<td>$500</td>
</tr>
<tr>
<td>$2,000</td>
<td>+ 600</td>
</tr>
<tr>
<td>$600</td>
<td>$1,100</td>
</tr>
</tbody>
</table>

$600 + $2,000 + $1,100 - $250 = $3,450
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
QUESTION #3B

Does the accounting equation balance?

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

\[
\begin{align*}
\text{CASH} & \quad + \quad \text{SUPPLIES} \\
-80 & \quad + \quad +80
\end{align*}
\]

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

CASH: $3,450
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>D.W., CAPITAL</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
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: ASSET
CASH: ASSET
Determine which accounts have increased or decreased.

- **Prepaid Insurance**: Increased
- **Cash**: Decreased

**Asset**
Does the accounting equation balance?

\[
\begin{align*}
\text{ASSETS} & = \text{LIAB.} + \text{O. E.} \\
\text{CASH} + & \text{PREPAID INS.} = \\
-200 + & +200 =
\end{align*}
\]

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. REC.</th>
<th>SUPPLIES</th>
<th>PREPD. INS.</th>
<th>DEL. EQUIP.</th>
</tr>
</thead>
<tbody>
<tr>
<td>BAL.</td>
<td>$670</td>
<td>$600</td>
<td>$80</td>
<td>+$200</td>
<td>$2,100</td>
</tr>
<tr>
<td>– 200</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>BAL.</td>
<td>$470</td>
<td>$600</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. PAY.</td>
<td>D.W., CAPITAL</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
Customer Payment Example

- Received $570 in cash for services recognized in an earlier transaction.
Questions #1 And #2

What happened?

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

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

**TODAY HE 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.

CASH

ASSET

ACCOUNTS RECEIVABLE

ASSET
QUESTION #3A

Determine which accounts have increased or decreased.

- CASH
  - INCREASED

- ACCOUNTS RECEIVABLE
  - DECREASED
Does the accounting equation balance?

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

\begin{align*}
\text{CASH} + \text{ACCTS. REC.} &= \text{LIAB.} + \text{O. E.} \\
+\$570 + \text{\(\color{red} -$570\)}} &= \text{LIAB.} + \text{O. E.}
\end{align*}

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>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>$ 470</td>
<td>$600</td>
<td>$80</td>
<td>$200</td>
<td>$2,100</td>
</tr>
<tr>
<td>+</td>
<td>570</td>
<td>– 570</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>BAL.</td>
<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. PAY.</td>
<td>D.W., CAPITAL</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
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.

Damon is buying this delivery equipment by paying some cash now and the rest “on account.” He 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.
Determine which accounts have increased or decreased.

- Decreased
- Increased
- Increased

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

\[
\begin{align*}
\text{ASSETS} & = \text{LIABILITIES} + \text{EQUITY} \\
\text{CASH} + \text{DEL. EQUIP.} & = \text{ACCOUNTS PAYABLE} \\
-300 + 1500 &= +1200
\end{align*}
\]

It balances!

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

<table>
<thead>
<tr>
<th></th>
<th>CASH</th>
<th>ACCTS.</th>
<th>SUPPLIES</th>
<th>PREPD.</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>LIAB.</th>
<th>OWNER’S EQUITY</th>
</tr>
</thead>
<tbody>
<tr>
<td>ACCTS.</td>
<td>D. W., CAPITAL</td>
</tr>
<tr>
<td>BAL.</td>
<td>BAL.</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td>$ 600</td>
<td>$2,000</td>
</tr>
<tr>
<td>+ 1,200</td>
<td></td>
</tr>
<tr>
<td>$1,800</td>
<td>$2,000</td>
</tr>
</tbody>
</table>

$1,800 + $2,000 + $1,100 - $250 = $4,650
Damon paid his 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**
- **DECREASED**

- WAGES
- EXPENSE
- 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

<table>
<thead>
<tr>
<th>ASSETS</th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>CASH</td>
<td>ACCTS. SUPPLIES</td>
<td>PREPD. INS.</td>
<td>DEL. EQUIP.</td>
<td></td>
</tr>
<tr>
<td>BAL.</td>
<td>$740</td>
<td>$30</td>
<td>$80</td>
<td>$200</td>
<td>$3,600</td>
</tr>
<tr>
<td></td>
<td>− 650</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>BAL.</td>
<td>$ 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>LIAB.</th>
<th>OWNER’S EQUITY</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td>ACCTS. PAY.</td>
<td>D. W., CAPITAL</td>
</tr>
<tr>
<td>$1,800</td>
<td>$2,000</td>
</tr>
<tr>
<td>$1,100</td>
<td>$250 + 650</td>
</tr>
</tbody>
</table>

$1,800 + $2,000 + $1,100 - $900 = $4,000
Damon 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.

<table>
<thead>
<tr>
<th>CASH</th>
<th>ASSET</th>
</tr>
</thead>
<tbody>
<tr>
<td>DELIVERY EQUIP.</td>
<td>ASSET</td>
</tr>
<tr>
<td>DELIVERY FEES</td>
<td>O.E.</td>
</tr>
</tbody>
</table>
Determine which accounts have increased or decreased.

- Cash Asset: Increased
- Delivery Equipment Asset: Increased
- Delivery Fees O.E. Revenue: Increased
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>PREPD. INS.</th>
<th>DEL. EQUIP.</th>
</tr>
</thead>
<tbody>
<tr>
<td>BAL.</td>
<td>$90</td>
<td>$30</td>
<td>$80</td>
<td>$200</td>
<td>$3,600</td>
</tr>
<tr>
<td>+ 430</td>
<td></td>
<td>+ 620</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>BAL.</td>
<td>$520</td>
<td>$650</td>
<td>$80</td>
<td>$200</td>
<td>$3,600</td>
</tr>
</tbody>
</table>

Total Assets: $5,050
Proving The Accounting Equation Balances

<table>
<thead>
<tr>
<th></th>
<th>LIAB.</th>
<th>OWNERS’ EQUITY</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>ACCTS. PAY.</td>
<td>D. W., CAPITAL</td>
</tr>
<tr>
<td>BAL.</td>
<td>$1,800</td>
<td>$2,000</td>
</tr>
<tr>
<td></td>
<td>$1,800 + $2,000</td>
<td>$1,100</td>
</tr>
<tr>
<td></td>
<td>$1,800 + $2,000</td>
<td>$2,150 + $1,050</td>
</tr>
<tr>
<td></td>
<td>$1,800</td>
<td>$2,000</td>
</tr>
<tr>
<td></td>
<td>$1,800 + $2,000</td>
<td>$2,150</td>
</tr>
<tr>
<td></td>
<td>$1,800 + $2,000</td>
<td>$2,150 - $900</td>
</tr>
<tr>
<td></td>
<td>$1,800</td>
<td>$2,000</td>
</tr>
<tr>
<td></td>
<td>$1,800 + $2,000</td>
<td>$2,150</td>
</tr>
<tr>
<td></td>
<td></td>
<td>$900</td>
</tr>
<tr>
<td></td>
<td>$1,800</td>
<td>$2,000</td>
</tr>
<tr>
<td></td>
<td>$1,800 + $2,000</td>
<td>$2,150 + $900</td>
</tr>
</tbody>
</table>

$1,800 + $2,000 + $2,150 - $900 = $5,050
Damon withdrew $150 for personal expenses.
Questions #1 And #2

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

Damon is withdrawing some of his equity in the business by taking home an asset (cash). This will reduce the assets and reduce his owner’s equity.
What happened?

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

D.W., DRAWING

O.E., DRAWING

CASH

ASSET
QUESTION #3A

Determine which accounts have increased or decreased.

**INCREASED**
- D.W., DRAWING

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

**D.W., 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.**
 Does the accounting equation balance?

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

\[
\text{CASH} = \text{D.W., DRAWING}
\]

\[
-150 = +150
\]

**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. REC.</th>
<th>SUPPLIES</th>
<th>PREPD. INS.</th>
<th>DEL. EQUIP.</th>
</tr>
</thead>
<tbody>
<tr>
<td>BAL.</td>
<td>$520</td>
<td>$650</td>
<td>$80</td>
<td>$200</td>
<td>$3,600</td>
</tr>
<tr>
<td></td>
<td>$370</td>
<td>$650</td>
<td>$80</td>
<td>$200</td>
<td>$3,600</td>
</tr>
<tr>
<td></td>
<td>$4,900</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
# 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>D.W., CAP.</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.
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.
Damon’s Campus Delivery
Income Statement
For Month Ended June 30, 20--

Financial statement headings:
1st line: The name of the company
2nd line: The title of the statement
3rd line: The time period covered or the date of the statement
This column is used for listing items to be totaled.
Damon’s Campus Delivery
Income Statement
For Month Ended June 30, 20--

This column is used for Totals.
Damon’s Campus Delivery
Income Statement
For Month Ended June 30, 20--

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

The first item at the top of a column should include a dollar sign.
# Damon’s Campus Delivery
## Income Statement
For Month Ended June 30, 20--

<table>
<thead>
<tr>
<th>Revenues</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Delivery fees</td>
<td>$2,150</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.*
# Damon’s Campus Delivery

## Income Statement

For Month Ended June 30, 20__

<table>
<thead>
<tr>
<th>Category</th>
<th>Amount</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.*
## Damon’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>$2,150</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>

<table>
<thead>
<tr>
<th>Net income</th>
<th>$1,250</th>
</tr>
</thead>
</table>

*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
**Damon’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>Damon, 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.*
Damon’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>Damon, 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>1,100</td>
</tr>
</tbody>
</table>

$1,250 net income – $150 withdrawal = $1,100 increase in capital
Damon’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>Damon, 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>Damon, 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.
Damon’s Campus Delivery  
Balance Sheet
For Month Ended June 30, 20--

<table>
<thead>
<tr>
<th>Assets</th>
<th>Liabilities</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>Accounts payable</td>
</tr>
<tr>
<td>$ 370</td>
<td>$1,800</td>
</tr>
<tr>
<td>Accounts receivable</td>
<td></td>
</tr>
<tr>
<td>650</td>
<td></td>
</tr>
<tr>
<td>Supplies</td>
<td>Owner’s Equity</td>
</tr>
<tr>
<td>80</td>
<td>Damon, capital</td>
</tr>
<tr>
<td>Prepaid insurance</td>
<td>3,100</td>
</tr>
<tr>
<td>200</td>
<td></td>
</tr>
<tr>
<td>Delivery equipment</td>
<td>Total liabilities and owner’s</td>
</tr>
<tr>
<td>3,600</td>
<td>equity</td>
</tr>
<tr>
<td>Total assets</td>
<td>Total liabilities and owner’s</td>
</tr>
<tr>
<td>$4,900</td>
<td>equity</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
INCOME STATEMENT

REVENUES - EXPENSES = NET INCOME

STATEMENT OF OWNER’S EQUITY

BEGINNING CAPITAL + INVESTMENTS + NET INCOME - WITHDRAWALS = ENDING CAPITAL
BALANCE SHEET

ASSETS

= LIABILITIES

+ 

OWNER’S EQUITY

(Ending Capital)