

UNIT 1 THE ACCOUNTING EQUATION

I. ASSETS - LIABILITIES = OWNER'S EQUITY

ITEMS OF VALUE - WHAT IS OWED = NET WORTH

II. DEFINITIONS

ACCOUNT - a storage area for financial information.

DEBIT - left side of an account.

T ACCOUNT - a simplified account.

CREDIT - right side of an account.

III. BALANCE SHEET ACCOUNTS

ASSETS are items of value.

CAPITAL is the Owner's Equity account for sole proprietorships and partnerships.

LIABILITIES are amounts owed.

COMMON STOCK is the primary account for tracking the invested equity of a corporation.

OWNER'S EQUITY is the net worth of a business.

RETAINED EARNINGS is the account used to store income earned but not distributed by a corporation.

IV. DEBITS AND CREDITS

Please relate the definitions in Part III to the schematic below. Note the accounting equation has been rewritten to better explain debits and credits.

<u>ASSETS</u>	=	<u>LIABILITIES</u>	+	<u>OWNER'S EQUITY</u>
DR. CR.		DR. CR.		DR. CR.
+ -		- +		- +

The DOUBLE ENTRY system of debits and credits facilitates the increasing and decreasing of the amounts stored in the Balance Sheet Accounts. The above schematic summarizes part of the system. After

rewriting the accounting equation it should be noted that Assets are on the opposite side of the equation from Liabilities and Owner's Equity and are therefore treated in an opposite manner by the system.

NOTE: The following example will show only the current transaction information in each T account.

V. ANALYZING TRANSACTIONS - SAMPLE PROBLEM

Assets = Liabilities + Owner's Equity

- Darin Jones, a sophomore at State University, started the Quick Clean Laundry Service with a \$100 cash investment.

<u>Cash</u>	<u>Capital, Darin Jones</u>
100	100

- On Sept. 1, paid \$50 for 5 months of ads in the school newspaper.

<u>Prepaid Advertising</u>	<u>Cash</u>
50	50

- On Sept. 1, purchased Laundry Supplies for \$25 cash.

<u>Laundry Supplies</u>	<u>Cash</u>
25	25

- On Sept. 1, purchased \$48 of Laundry Equipment paying \$8 down.

<u>Laundry Equipment</u>	<u>Accounts Payable</u>
48	40
<u>Cash</u>	
8	

- Darin made an additional investment of \$50.

<u>Cash</u>	<u>Capital, Darin Jones</u>
50	50

- Paid one-fourth the amount owed on the Laundry Equipment.

<u>Cash</u>	<u>Accounts Payable</u>
10	10

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Free Quick Notes Books has your free copies of accounting, economics, math, and statistics.

VI. TEMPORARY OWNER'S EQUITY STORAGE ACCOUNTS

WITHDRAWALS is a storage account used to record periodic decreases in Owner's Equity by sole proprietors and partners.

EXPENSES represent a decrease in Owner's Equity caused by a decrease in Assets (usually Cash) or an increase in Liabilities (Salaries Payable, Accounts Payable, etc.) resulting from normal business activity. Examples include Salaries, Advertising, and Interest.

REVENUE represents an increase in Owner's Equity caused by an increase in Assets (usually Cash or Accounts Receivable) resulting from normal business activity. Examples include Sales, Interest Income, and Rent Revenue.

VII. DEBITS AND CREDITS

Please relate the definitions in Part VI to the expanded schematic below.

<u>ASSETS</u>	=	<u>LIABILITIES</u>	+	<u>OWNER'S EQUITY</u>
DR. CR.		DR. CR.		DR. CR.
+ -		- +		- +
				<u>WITHDRAWALS</u>
				DR. CR.
				- -
				<u>EXPENSES</u>
				DR. CR.
				+ -
				<u>REVENUE</u>
				DR. CR.
				- +

Free Business Books has useful materials covering many business subjects.

Expense, Revenue, and Withdrawals are temporary storage accounts used to track changes in Owner's Equity and their positive or normal balance is consistent with the eventual change to be made in Owner's Equity. That is, expenses and withdrawals are debits because they will eventually lower Owner's Equity, and

Revenue is a credit because it will eventually increase Owner's Equity. Revenue, Expense, and Withdrawals may also be thought of as changes in Assets and/or Liabilities which cause Owner's Equity to change. The logic of this system will become more apparent as you become more familiar with Part One of **Quick Notes**.

VIII. ANALYZING TRANSACTIONS - SAMPLE PROBLEM

<u>Assets</u>	=	<u>Liabilities</u>	+	<u>Owner's Equity</u>																																								
<p>7. Darin withdrew \$20 for personal use.</p> <table style="width: 100%; border-collapse: collapse;"> <tr> <td style="text-align: center; border-bottom: 1px solid black;">Cash</td> <td style="width: 20px;"></td> <td style="text-align: center; border-bottom: 1px solid black;">Withdrawals, Darin Jones</td> <td style="width: 20px;"></td> <td></td> </tr> <tr> <td style="text-align: center;"> 20</td> <td></td> <td style="text-align: center;"> 20</td> <td></td> <td></td> </tr> </table>	Cash		Withdrawals, Darin Jones			20		20				<p>8. Cash collected for Laundry Services performed during the month amounted to \$140. \$10 was also due for services rendered.</p> <table style="width: 100%; border-collapse: collapse;"> <tr> <td style="text-align: center; border-bottom: 1px solid black;">Cash</td> <td style="width: 20px;"></td> <td style="text-align: center; border-bottom: 1px solid black;">Laundry Revenue</td> <td style="width: 20px;"></td> <td></td> </tr> <tr> <td style="text-align: center;"> 140</td> <td></td> <td style="text-align: center;"> 150</td> <td></td> <td></td> </tr> <tr> <td style="text-align: center; border-bottom: 1px solid black;">Accounts Receivable</td> <td style="width: 20px;"></td> <td></td> <td></td> <td></td> </tr> <tr> <td style="text-align: center;"> 10</td> <td></td> <td></td> <td></td> <td></td> </tr> </table>	Cash		Laundry Revenue			140		150			Accounts Receivable					10						<p>9. Paid \$75 for the use of washers and dryers for September.</p> <table style="width: 100%; border-collapse: collapse;"> <tr> <td style="text-align: center; border-bottom: 1px solid black;">Cash</td> <td style="width: 20px;"></td> <td style="text-align: center; border-bottom: 1px solid black;">Washer/Dryer Expense</td> <td style="width: 20px;"></td> <td></td> </tr> <tr> <td style="text-align: center;"> 75</td> <td></td> <td style="text-align: center;"> 75</td> <td></td> <td></td> </tr> </table>	Cash		Washer/Dryer Expense			75		75		
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<p>10. Received \$5 on account.</p> <table style="width: 100%; border-collapse: collapse;"> <tr> <td style="text-align: center; border-bottom: 1px solid black;">Cash</td> <td style="width: 20px;"></td> <td style="text-align: center; border-bottom: 1px solid black;">Accounts Receivable</td> <td style="width: 20px;"></td> <td></td> </tr> <tr> <td style="text-align: center;"> 5</td> <td></td> <td style="text-align: center;"> 5</td> <td></td> <td></td> </tr> </table>	Cash		Accounts Receivable			5		5																																				
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<p>11. On Sept. 26, two students paid \$10 for next week's Laundry Service.</p> <table style="width: 100%; border-collapse: collapse;"> <tr> <td style="text-align: center; border-bottom: 1px solid black;">Cash</td> <td style="width: 20px;"></td> <td style="text-align: center; border-bottom: 1px solid black;">Unearned Laundry Revenue</td> <td style="width: 20px;"></td> <td></td> </tr> <tr> <td style="text-align: center;"> 20</td> <td></td> <td style="text-align: center;"> 20</td> <td></td> <td></td> </tr> </table>	Cash		Unearned Laundry Revenue			20		20																																				
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<p>12. Paid monthly phone bill of \$10.</p> <table style="width: 100%; border-collapse: collapse;"> <tr> <td style="text-align: center; border-bottom: 1px solid black;">Cash</td> <td style="width: 20px;"></td> <td style="text-align: center; border-bottom: 1px solid black;">Telephone Expense</td> <td style="width: 20px;"></td> <td></td> </tr> <tr> <td style="text-align: center;"> 10</td> <td></td> <td style="text-align: center;"> 10</td> <td></td> <td></td> </tr> </table>	Cash		Telephone Expense			10		10																																				
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