

College Accounting



Chapter 1: Starting a Proprietorship – Changes that Affect the Accounting Equation

Goals of Chapter 1:

- Describe how a proprietorship is started and the types of transactions that occur when a business is organized
 - Define accounting terms related to starting a sole proprietorship and changes that affect the accounting equation
 - Classify accounts as assets, liabilities & owner's equity in the accounting equation
 - Use the accounting equation to analyze transactions
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1-1: Getting Started as a Business

■ **Accounting:**

- Planning, Recording, Analyzing and Interpreting of financial information

■ **Accounting System:**

- Planned process to provide financial information useful to management

■ **Accounting is the Language of Business**

- Essential to all parties

■ **Accounting Records:**

- Organized summaries of a business's financial activities

■ **Financial Statements:**

- Financial reports that summarize the financial condition and operations of a business
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1-1: Getting Started as a Business

- **Service Business:**

- A business that performs an activity for a fee

- **Proprietorship:**

- a business owned by one person

Accounting Concept: 

- **Business Entity:**

- Keeping business records separate from personal ones
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1-1: THE ACCOUNTING EQUATION

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- **Assets**: anything of value that is owned by a business
- **Equities**: financial rights to the assets of business - 2 types
 1. **Liabilities**: An amounts owed by a business to creditors
 2. **Owner's Equity**: the amount remaining in a business after the value of all liabilities are subtracted from the value of all assets

Accounting Equation: shows relationship between assets, liabilities and owner's equity

Assets	=	Liabilities + Owner's Equity	
Left side amount		Right side amounts	
\$0	=	\$0	+ \$0

1-2: How Business Activities Change the Accounting Equation

- **Transaction**: a business activity that changes the value of assets, liabilities or owner's equity

Accounting Concept : 



- **Unit of Measurement**: business transactions are stated in numbers that have common values so that financial reports and records can be clearly stated, understood and compared (i.e. dollars)

1-2: How Business Activities Change the Accounting Equation

- **Account**: a record summarizing all the information about a single item in the accounting equation
 - **Account Title**: the name given to an account (business decides the names they will call their accounts)
 - **Account Balance**: the actual value of the Account
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1-2: RECEIVING CASH

Transaction 1 August 1. Received cash from owner as an investment, \$5,000.00.

	Assets	=	Liabilities	+	Owner's Equity
	Cash	=			Kim Park, Capital
Beginning Balances	\$0		\$0		\$0
Received cash from owner as an investment	+5,000				+5,000
New Balances	\$5,000		\$0		\$5,000

Capital Account: the amount used to summarize the owner's investment in the business

1-2: PAYING CASH

Transaction 2 August 3. Paid cash for supplies, \$275.00.



	Assets			=	Liabilities + Owner's Equity	
	Cash	+ Supplies	+ Prepaid Insurance	=		Kim Park, Capital
Balances	\$5,000	\$0	\$0		\$0	\$5,000
➤ Paid cash for supplies	-275	+275				
Balances	\$4,725	\$275	\$0		\$0	\$5,000
➤ Paid cash for insurance	-1,200		+1,200			
New Balances	\$3,525	\$275	\$1,200		\$0	\$5,000

Transaction 3 August 4. Paid cash for insurance, \$1,200.00.

1-2: TRANSACTIONS ON ACCOUNT

Transaction 4 August 7. Bought supplies on account from Supply Depot, \$500.00.

Buying on Account: buying on credit results in or increases a liability – Accounts Payable.

	Assets			=	Liabilities + Owner's Equity	
	Cash	+ Supplies	+ Prepaid Insurance	=	Accts. Pay.— Supply Depot	+ Kim Park, Capital
Balances	\$3,525	\$275	\$1,200	=	\$0	\$5,000
 Bought supplies on account		+500			+500	
New Balances	\$3,525	\$775	\$1,200	=	\$500	\$5,000
 Paid cash on account	-300				-300	
New Balances	\$3,225	\$775	\$1,200	=	\$200	\$5,000

Transaction 5 August 11. Paid cash on account to Supply Depot, \$300.00.

Paying on Account: decreases the liability Accounts Payable.

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

1. Revenues
 2. Expenses
 3. Withdrawals
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- Profit or Loss

1. Revenues: an increase in owner's equity resulting from the operation of a business.

- Types of Sales/Revenues transactions:
 - a) Received Cash from Sales
 - b) Sold Services on Account – sales that are charged to client account – cash will be received at a later date

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

Accounting Concept: 

Realization of Revenue:

- ❑ Revenue is always “recognized” and recorded at the time the sale is made.
 - ❑ It doesn't matter if the cash is received at the time of the sale or at a later date.
 - ❑ Revenue results in an increase in owner's equity and an increase in an asset.
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1-3: REVENUE TRANSACTIONS

Transaction 6 August 12. Received cash from sales, \$295.00.

	Assets				=	Liabilities + Owner's Equity	
	Cash +	Accts. Rec.— Oakdale School	+ Supplies	+ Prepaid Insurance	=	Accts. Pay.— Supply Depot	+ Kim Park, Capital
Balances	\$3,225	—0—	\$775	\$1,200		\$200	\$5,000
➔ Received cash from sales	+295						+295 (revenue)
New Balances	\$3,520	—0—	\$775	\$1,200		\$200	\$5,295
➔ Sold services on account		+350					+350 (revenue)
New Balances	\$3,520	\$350	\$775	\$1,200		\$200	\$5,645
	Total of left side: \$3,520 + \$350 + \$775 + \$1,200 = \$5,845					Total of right side: \$200 + \$5,645 = \$5,845	

Transaction 7 August 12. Sold services on account to Oakdale School, \$350.00.

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

2. **Expenses**: a decrease in owner's equity resulting from the operation of a business.

(Examples: Telephone bills, utilities, advertising, payroll, taxes, maintenance etc.)

- Owner's Equity Decreases and Assets Decrease
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1-3: EXPENSE TRANSACTIONS

Transaction 8 August 12. Paid cash for rent, \$300.00.

	Assets				=	Liabilities + Owner's Equity	
	Cash +	Accts. Rec.— Oakdale School	+ Supplies	+ Prepaid Insurance	=	Accts. Pay.— Supply Depot	+ Kim Park, Capital
Balances	\$3,520	\$350	\$775	\$1,200		\$200	\$5,645
➤ Paid cash for rent	-300						-300 (expense)
New Balances	\$3,220	\$350	\$775	\$1,200		\$200	\$5,345
➤ Paid cash for telephone bill	-40						-40 (expense)
New Balances	\$3,180	\$350	\$775	\$1,200		\$200	\$5,305
	Total of left side:					Total of right side:	
	\$3,180 + \$350 + \$775 + \$1,200 = \$5,505					\$200 + \$5,305 = \$5,505	

Transaction 9 August 12. Paid cash for telephone bill, \$40.00.

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

3. **Withdrawals**: assets (cash or other assets) taken out of a business for the owner's personal use.
- Owner's Equity Decreases and Assets Decrease
 - **NOT** a normal operation of the business – therefore, **not** considered an expense – must be recorded separately.

Other Cash Transactions:

- **Received Cash on Account**: a business collects the cash from a sale previously made on "Account"
 - Does **NOT** affect Owner's Equity
 - **Not** a Revenue transaction
 - Increase Cash and decreases Accounts Receivable



1-3: OTHER CASH TRANSACTIONS

Transaction 10 August 18. Received cash on account from Oakdale School, \$200.00.

	Assets				=	Liabilities + Owner's Equity	
	Cash +	Accts. Rec.— Oakdale School	+ Supplies	+ Prepaid Insurance	=	Accts. Pay.— Supply Depot	+ Kim Park, Capital
Balances	\$3,180	\$350	\$775	\$1,200		\$200	\$5,305
Received cash on account	+200	-200					
New Balances	\$3,380	\$150	\$775	\$1,200		\$200	\$5,305
Paid cash to owner for personal use							-125 (withdrawal)
New Balances	\$3,255	\$150	\$775	\$1,200		\$200	\$5,180
	Total of left side: \$3,255 + \$150 + \$775 + \$1,200 = \$5,380					Total of right side: \$200 + \$5,180 = \$5,380	

Transaction 11 August 18. Paid cash to owner for personal use, \$125.00.



TERMS REVIEW

- account
- account title
- account balance
- accounting
- accounting equation
- accounting system
- accounting records
- Asset
- business ethics
- ethics
- capital
- equities
- expense
- financial statements
- liability
- owner's equity
- proprietorship
- revenue
- sale on account
- service business
- transaction
- withdrawals