ACCT 100 - INTRODUCTION TO ACCOUNTING
Chapter 2
Analyzing Business Transactions

A business transaction is a financial event that changes the resources of a firm. Examples of common business transactions include such things as purchases, sales, payments, and receipts of cash among other things.

There are five basic types of accounts. They are summarized in this chapter. We will be using this information to form the foundation for everything else we will be doing over the course of the semester.

<u>Assets</u>

- Properties or things of value owned by a business
- Examples include cash, equipment, patents, land, supplies, etc.

<u>Liabilities</u>

- Debts or obligations
- Money that is owed to others
- Claims of creditors (i.e. someone who you owe money to) against the assets of a business

<u>Equity</u>

- The owner�s rights or claims to the assets of a business (after the creditors)
- Synonymous with the terms "capital" and "net worth."
- The owner's investment (adjusted for other things you will learn about)

<u>Revenues</u>

- Amounts earned by a business
- Can be in the form of cash, credit card receipts, or credit sales to charge customers (who will pay for goods/services at a later time)
- GAAP says revenues should be recorded when earned, not necessarily when paid
- When businesses generate revenues, the owner's equity increases

<u>Expenses</u>

- Costs of the business that relate to the earning of revenues

- Can be in the form of cash, or on account (that will be paid later)
- GAAP says expenses should be recorded when incurred, not necessarily when paid
- When businesses incur expenses, the owner's equity decreases

Fundamental Accounting Equation

- Must always be in balance: The left side must always equal the right side
  - We will deal with the equation throughout the semester
  - Equation can be restated in a number of different ways
  - If you know two of the three items, you can always get the third unknown

Assets = Liabilities + Equity

Expanded Equation shows the effect of Revenues and Expenses

Assets = Liabilities + Equity

Capital + Revenue - Expenses

Recording Transactions using fundamental accounting equation: How?

Go through the Mental Mechanics:

1) Determine what accounts are involved. (Minimum of two accounts.)
2) Determine proper classification of accounts.
3) Determine whether account is being increased or decreased.
4) Record transaction.
5) Insure that equation is in balance: The left equals the right.

We will practice how to record transactions a lot during class.

The Financial Statements

Financial Statements

The result of the "summarizing" process of accounting.
All financial statements are inter-connected; therefore, the order of preparation is

important.

Headings are important:

Each financial statement has a three-part heading

Name of the Company
Name of the Statement
Time period covered - or date

Dollar signs, total lines, and double-ruled lines are important.
These go out to external users. The appearance is important.

Three financial statements that we will learn and expand upon during the semester:

Income Statement
Statement of Owner's Equity
Balance Sheet

Income Statement

- Always prepared first.
  Shows the results of operations.
- Shows Total Revenues, Total Expenses, and the resulting Net Income or Net Loss.
- Sometimes referred to as the "P and L" which is slang for profit and loss statement.
- Individual amounts go in first column; totals go in second column.
- Dollar signs on the first revenue listed, the first expense listed, and net income or loss.
- Double underlines after net income or loss.
- Format
- Revenues

	XXX	
	XXX	
	XXX	
Total Revenues		XXX
Expenses		
	XXX	
	XXX	
	XXX	
Total Expenses		XXX

Net Income	XXX

Statement of Owner's Equity

- This statement connects the income statement to the balance sheet. (Sometimes referred to as the "bridge.")
- Net Income or loss is needed to prepare the statement; therefore, this statement is always prepared second.
- Shows the total change to the capital account over a specific time period.
- Covers the same period of time as the income statement.

Basic Format:

Capital, Beginning Balance		XXX
Add: Net Income	XXX	
Less: Withdrawal	(XXX)	
Net Increase (decrease) to capital		XXX
Capital, Ending Balance		XXX

Balance Sheet

- A snapshot of a business at any point in time : the third line of the heading is just the date - it does not specify a time period like the other two statements.
- Sometimes called a Statement of Financial Position.
- Summarizes the assets, liabilities, and equity accounts of a business.
- The ending capital balance, which appears in the equity section of the balance sheet, comes from the Statement of Owner's Equity.
- The Balance Sheet proves the equality of the accounting equation.
  A "report form" of a balance sheet has the data presented in a vertical fashion.
- The "account form" shows assets on the left and liabilities and equity on the right.
- In a two-column balance sheet, detail amounts are placed in the left column. Totals are placed in the right-hand column.
- Dollar signs on the first account under each classification.
- Double underlines under each grand total (Total Assets and Total Liabilities and Equity.)

There is a very good overview of the financial statements on page 39 of your text. I suggest you copy this page and attach it to your notes for future reference. We will be preparing financial statements A LOT over the course of the semester.

READ THIS CHAPTER and understand all the transactions in it. This is a building block chapter and contains basic transactions common to all businesses. If you do not understand how the accounting equation works, go back and study and do more exercises until you do.