

CHAPTER 1 – STARTING A PROPRIETORSHIP

Explain that many of the concepts introduced in this chapter will be used throughout the year and that using the accounting equation is basic to the mastery of accounting. In this chapter, we will be learning about accounting, the accounting equation, how business transactions affect the accounting equation, and how to prepare a balance sheet.

- I. What is accounting?
 - A. **Accounting** – planning, recording, analyzing, and interpreting financial information.
 - B. **Accounting System** – A planned process for providing financial information that will be useful to management.
 - C. **Accounting Records** – Organized summaries of a business’s financial activities.
 - **Ask how many students know someone who works in the accounting field. Ask how many students have a job that provides a paycheck—the companies for which you work must keep accurate records for each employee.**

- II. Accounting is the language of business.
 - A. Individuals who work in the accounting field complete accounting forms and prepare accounting reports. Owners, managers, and accounting personnel use this information. All individuals in an organization can perform their jobs more efficiently if they know the language of business.
 - B. Inaccurate accounting records often contribute to business failure and bankruptcy. Failure to understand accounting information can result in poor business decisions for both businesses and nonprofit organizations. Managers and owners make better business decisions if they understand accounting.
 - C. Nearly everyone in the United States earns money and must submit income tax reports to the government. Everyone must find ways to keep spending within an available income (whether in business or in personal use).
 - **Have students go to <http://accounting.swpco.com>. Choose First-Year Course, choose Activities, and complete the activity for Chapter 1.**

1 - 1 The Accounting Equation

- III. The Accounting Equation
 - A. **Service Business** – a business that performs an activity for a fee.

Have students list service businesses in Fall Creek or Eau Claire.
 - B. **Proprietorship** – a business owned by one person. It may also be called a sole proprietorship.

-- **Ask students why a business might be organized as a proprietorship? Because the owner retains total control of the company.**

C. Business Entity – when a business’s financial information is recorded and reported separately from the owner’s personal financial information (Accounting Concept)

Assets = Liabilities + Owner’s Equity

D. **Accounting equation** – An equation showing the relationship among assets, liabilities, and owner’s equity.

E. **Asset** - Anything of value that is owned

-- **Have students make a list of assets of Fall Creek High School.**

F. **Equities** - Financial rights to the assets of a business

1. A business has two types of equities:

a. Equity of those to whom money is owed. TechKnow Consulting may buy some supplies and agree to pay for the supplies at a later date. The business from whom TechKnow purchases these supplies will have a right to some of TechKnow’s assets until the bill is paid.

Liability – An amount owed by a business.

b. Equity of the owner. Ms. Parks will own TechKnow Consulting and invest in the assets of the business. Therefore, she will have a right to decide how the assets will be used.

Owner’s Equity – the amount remaining after the value of all liabilities is subtracted from the value of all assets.

2. The accounting equation must be in balance to be correct. Thus, the total of the amounts on the left side of the equation must always equal the total of the amounts on the right side.

-- **List individual student assets and liabilities**

This is your own personal financial information. If you own a business, you must keep this separate from the business’s financial information. (Accounting Concept: Business Entity)

-- **Put two lists on the board – personal in one list, assets for a fictional business on the other.**

IV. **Ethics** -- The principles of right and wrong that guide an individual in making decisions.

Business ethics -- The use of personal ethics in making business decisions.

-- **As you analyze the ethics of common business situations throughout this book, use the following three-step checklist as a guide in collecting relevant information regarding an action.**

- A. Is the action illegal? Does the action violate any laws? It's in your best interest as well as the business's best interest not to break any laws.
- B. Does the action violate company or professional standards? Public laws are often only set for minimum standards of behavior. Many businesses and professions set even higher standards of behavior. An action might be legal but still violates the standards of the business or profession. Violating these standards may affect your job security and professional certification.
- C. Who is affected, and how, by the action? If an action is legal and meets business and professional standards, you must rely on your own principles of right and wrong to determine if the action is ethical. Determining how the action affects individuals and groups (business employees and owners, customers, local community, and society) will help you decide if an action is ethical.

1 - 2 How Business Activities Change the Accounting Equation

V. How Business Activities Change the Accounting Equation

A. **Transaction** – A business activity that changes assets, liabilities, or owner's equity.

Example – paying cash for supplies

B. Unit of Measurement – when business transactions are stated in numbers that have common values; using a common unit of measurement (Accounting Concept). In the U.S., it's dollars; in Mexico it's pesos, etc.

Transaction 1: August 1. Received cash from owner as an investment, \$10,000.

C. **Account** – A record summarizing all the information pertaining to a single item in the accounting equation.

D. **Account Title** – The name given to an account.

1. Each part of the accounting equation consists of one or more accounts.
2. Example – Cash is an account title. The Cash account is used to summarize information about the amount of money the business has available.
3. In Transaction 1, Cash is increased by \$10,000, the amount of cash received by the business.

E. **Account Balance** – The amount in an account.

In Transaction 1: Before the owner's investment, the account balance of Cash was zero. After the investment, the account balance of Cash is \$10,000.

F. **Capital** – The account used to summarize the owner's equity in a business.

1. The capital account is an owner's equity account.
2. In Transaction 1, Kim Parks, Capital was zero before the investment. After the investment, the account balance is \$10,000.
3. The accounting equation has changed, but both sides have changed by the same amount. Therefore, the equation is still in balance.

G. Other Transactions

August 3. Paid cash for supplies, \$275.00

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

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

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

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

A. **Revenue Transactions**

Received Cash from Sales – A transaction for the sale of good or services results in an increase in owner's equity

REVENUE – An increase in owner's equity resulting from the operation of a business

When cash is received from a sale, the total amount of both assets and OE is increased

August 12 - Received cash from sales \$295.00

SOLD SERVICES ON ACCOUNT - SALE ON ACCOUNT (charge sale) – a sale for which cash will be received at a later date (Accounts Receivable)

Regardless of when the payment is made, the revenue should be recorded at the time of the sale
(*Accounting concept: Realization of Revenue is applied when revenue is recorded at the time goods or services are sold*)

August 12 - Sold services on account to Oakdale School, \$350.00

B. Expense Transactions

Paid Cash for Rent – A transaction to pay for goods or services needed to operate a business results in a decrease in owner's equity

EXPENSE – A decrease in owner's equity resulting from the operation of a business

August 12 – Paid cash for rent (rent expense) \$300.00

August 12 – Paid cash for telephone bill \$40.00

C. Other Cash Transactions

Received cash on account

August 18 – Received cash on account from Oakdale School \$200.00

Paid Cash to Owner for Personal Use (Drawing Account)

August 18 – Paid cash to owner for personal use \$125.00

WITHDRAWAL (DRAWING) – Assets taken out of a business for the owner's personal use