THE NATURE OF BUSINESS AND ACCOUNTING

- ***Business:*** *an organization which uses (inputs) such as material and labor and transforms them into (outputs) such as goods or services to customers.*
  - ***Objective:*** *Most businesses are created to generate profits. Profit is the excess revenues earned over the expenses it cost to earn them.*

TYPES OF BUSINESS

Service Business	***Merchandising Business***	***Manufacturing Business***
These companies provide a service rather than a product. • Airlines • Accountants	These companies sell products to customers which they purchased. • Wal-Mart • Amazon	They change inputs into products that they can then sell to retailers. • Ford Motor Co. • IBM Co.

Business Entity Concept	***Cost Concept***
This limits the economic data in an accounting system to data related directly to the activities of the business.	*Amounts are initially recorded in the accounting records at their cost or purchase price.*

Debits increase assets, drawing & expenses
Credits increase liabilities, capital & revenues

RULES OF DEBITS AND CREDITS

T-Account *The t-account is a visual representation of the account,*

Account Name	
Debit	Credit
=	=
Left Side	Right Side

Some people believe that debits are good and credits are bad; there is no good or bad, simply the left side of the T-Account or the right side. The effect of a debit or credit on an account depends on the type of account. One way to remember how the accounts work is:

A D E = L C R

Increases by Debit	Increases by Credit
A=Assets	L=Liabilities
D=Drawing	C=Capital
E=Expenses	R=Revenue

THE ACCOUNTING EQUATION

The accounting equation shows the relationships between the Accounts of a company

Assets	***Liabilities***	***Owner's Equity***	***Revenues***	***Expenses***
Debit + / Credit -	Debit - / Credit +	***Capital*** Debit - / Credit + *The owner's INVESTMENT*	Debit - / Credit +	Debit + / Credit -
Assets are what we OWN	*Liabilities are what we OWE*	***Drawing*** Debit - / Credit + *The owners WITHDRAWAL*	Revenues are what we Earn	Expenses are Costs incurred
Cash *Accounts Receivable* *Supplies* *Prepaid Insurance* *Building* *Land*	*Accounts Payable* *Notes Payable* *Mortgage Payable.*		*Fees Earned* *Sales* *Accounting Fees*	Rent exp. Utilities exp. Assets used up Office supplies exp. Insurance exp. Depreciation exp.

<u>Assets = Liabilities + Capital – Drawing + Revenue – Expenses</u>

The equation must balance

ANALYZING TRANSACTIONS

All business transactions can be stated in terms of changes in the elements of the accounting equation.

Clark deposited $25,000 Rip-off bank to start NetSolutions Tutoring Service.

All transaction affect at least 2 accounts; *by analyzing we can see that the company received cash and increased their capital account.*

CASH

debit	credit
$25,000	

CC, CAPITAL

debit	credit
	$25,000

*The debit to **Cash** increased the asset account and the credit to **Capital** increased the equity account*

The accounting equation balances $25,000 = $25,000

After all transactions are completed the accounting equation will look like this

	Assets			= Liabilities +	Owner's Equity							
	Cash	+ Supp.	+ Land	= Accounts Payable	+ Chris Clark, Capital	− Chris Clark, Drawing	+ Fees Earned	− Wages Exp.	− Rent Exp.	− Supplies Exp.	− Utilities Exp.	− Misc. Exp.
a.	+25,000				+25,000							
b.	−20,000		+20,000									
Bal.	5,000		20,000		25,000							
c.		+1,350		+1,350								
Bal.	5,000	+1,350	20,000	+1,350	25,000							
d.	+7,500						+7,500					
Bal.	12,500	1,350	20,000	1,350	25,000		7,500					
e.	−3,650							−2,125	−800		−450	−275
Bal.	8,850	1,350	20,000	1,350	25,000		7,500	−2,125	−800		−450	−275
f.	−950			−950								
Bal.	7,900	1,350	20,000	400	25,000		7,500	−2,125	−800		−450	−275
g.		−800								−800		
Bal.	7,900	550	20,000	400	25,000		7,500	−2,125	−800	−800	−450	−275
h.	−2,000					−2,000						
Bal.	5,900	550	20,000	400	25,000	−2,000	7,500	−2,125	−800	−800	−450	−275

FINANCIAL STATEMENTS

After all transactions are recorded we can use the results to generate the:

Income Statement

Revenues – Expenses = Net Income

NetSolutions, Inc.
Income Statement
For the Year Ending Dec. 31, 2013

Revenues:		
Fees Earned		*7,500*
Operating Exp.		
Wage	*2,125*	
Rent	*800*	
Supplies	*800*	
Utilities	*450*	
Miscellaneous	*275*	
Total Op Expense		*4,450*
Net Income		*3,050*

Statement of Owner's Equity

Beginning Capital + Net Income - Drawing = Ending Capital

NetSolutions, Inc.
Statement of Owner's Equity
For the Year Ending Dec. 31, 2013

CC, Capital Jan 1		*0*
Add: Investment	*25,000*	
Net Income	*3,050*	
Total Additions	*28,050*	
Less: Withdrawals	*(2,000)*	
Increase in Capital		*26,050*
CC, Capital Dec. 31		*26,050*

Balance Sheet

Assets = Liabilities + Owner's Equity

NetSolutions, Inc.
Balance Sheet
Dec. 31, 2013

Assets:		
Cash	*5,900*	
Supplies	*550*	
Land	*20,000*	
Total Assets	*26,450*	
Liabilities:		
Accounts Payable		*400*
Owner's Equity:		
CC, Capital Dec 31		*26,050*
Total Liab + OE		*26,450*

$$\textbf{Ratio of Liabilities to Owner's Equity} = \frac{\text{Total Liabilities}}{\text{Total Owner's Equity}} = \frac{400}{26{,}450} = 0.0015$$