



Introduction to Accounting

B. Carter/R. Gallant

Semester 1



Introduction to Accounting 120 is a course intended to provide essential understandings, economic framework, consumer skills and attitudes to successfully participate in a society influenced by financial and business decisions. Students will better manage personal finances, understand obligations of business owners and make informed decisions concerning life careers and choices. The intention of this course is to encourage students to further their education in post-secondary business studies.

Materials Needed:

Textbook & Workbook - Accounting: A Systems Approach

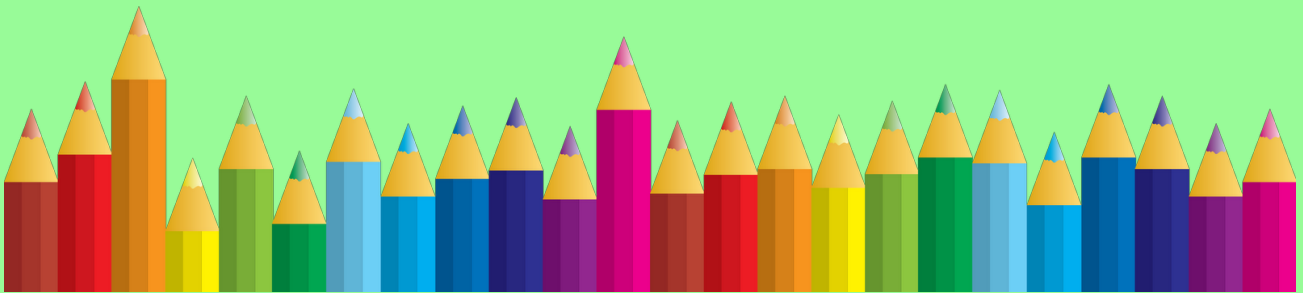
Binder

Calculator

Curriculum Outcomes:

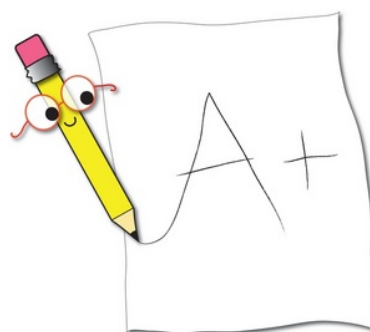
By the end of this course, students will be able to demonstrate an understanding of:

- The Necessity and Basic Activities of Accounting in Various Forms of Businesses
- Financial Position and the Preparation of a Simple Balance Sheet
- Changes in Financial Position and Their Effect on the Balance Sheet
- Debit and Credit Theory and Journalizing
- Owner's Equity, Income Statements & Report Form Balance Sheets
- Source Documents and Accounting for Sales Taxes
- Posting to the General Ledger
- Six-column Worksheet, the Preparation of a Classified Balance Sheet and Income Statement and how Financial Decisions are Based on These Documents
- Adjusting Entries, Closing Entries, Depreciation, the Extended Worksheet and the Preparation of a Post-closing Trial Balance



Evaluation:

Assignments	15%
Quizzes	15%
Tests	40%
Exam	30%



Why do we need accounting?

Unit 1 (first 2 outcomes):

- The Necessity and Basic Activities of Accounting in Various Forms of Businesses
- Financial Position and the Preparation of a Simple Balance Sheet

FIVE main activities involved in Accounting:

- gathering financial information
- preparing and collecting permanent records
- re-arranging, summarizing and classifying financial information
- preparing information reports & summaries
- establishing controls to promote accuracy and honesty among employees

Four Types of Businesses

Service

- LAWN CARE
- HAIR DRESSER
- DENTIST

Manufacturing

- PRODUCTION OF GOODS
- AUTO MAKERS

Merchandising

- SALE OF GOODS
- "THE WAL-MART"
- DENIM WEARHOUSE

Non-Profit

- WRED
- BIG BROS/ BIG SIS
- SPCA

THREE forms of business ownership:

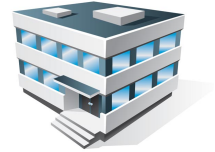
<p>Sole Proprietorship ONE OWNER</p>	<p><i>• vacation</i></p> <p><u>Pro</u></p> <ul style="list-style-type: none"> • scheduling • decision control • profits 	<p><u>Con</u></p> <ul style="list-style-type: none"> • Risky • Responsibilities
<p><u>Pro</u></p> <ul style="list-style-type: none"> • shared risk • shared responsibility 	<p><u>Con</u></p> <ul style="list-style-type: none"> • shared profits • conflict • less control 	<p>Partnership MORE THAN ONE OWNER</p>
<p>Corporation MORE THAN ONE OWNER <i>(Board of Directors)</i></p> <p>• GOVT CHARTERED</p>	<p><u>Pro</u></p> <ul style="list-style-type: none"> • Board for decision • Large profits 	<p><u>Con</u></p> <ul style="list-style-type: none"> • Little say in decisions • job security

What does a person need to start a business?

- money
- an idea
- plan
- investors
- location
- building
- employees
- merchandise / stock



RESOURCES



To start any type of pro-fit making business, a person needs resources such as land, building, goods for sale, equipment, etc.

Since these resources are scarce in the sense that they exist in limited amounts, all require effort to produce and for which a price must be paid, these resources are called **economic resources**.



HUMAN RESOURCES (OR LABOUR)

People are required to begin any business, but from an accounting standpoint, people are considered a human **resource** or **labour**.



You will learn that a business accounts for this resource with a payroll system. For this reason, human resources are excluded from the list of economic resources to begin a business.

How would a business acquire the economic resources to begin a business?

- Borrow (Bank loan)
- Invest (Personal Savings)

When the owner of a business obtains a loan from a chartered bank, the money is used to purchase economic resources such as equipment, furniture or delivery trucks.

In borrowing from the bank, the business has acquired a **debt** and is a **debtor**.

The bank becomes a **creditor** because it has granted **credit** - a time period in which to pay back the money borrowed - to the business.

Debtor → a person/business who owes money

Creditor → a person/business whom money or goods are owed to.

Until a debt that is owed to a business is paid off, a creditor has a **claim** against the economic resources of the business.

For example, when money is borrowed from the bank, the bank has a legal claim against the economic resources of the borrower until the debt has been paid.

In Canada, the legal system allows creditors to sue debtors for small overdue amounts; a banker who lent \$500 to a business may place a claim before the **small claims court**.

We can show these ideas in two equations:

ECONOMIC RESOURCES	=	CLAIMS AGAINST ECONOMIC RESOURCES
\$100 000	=	\$100 000

Notice that the economic resources are placed on the left side of the equation and the claims against the resources are on the right.

Assets = Liabilities + Owner's Equity

ECONOMIC RESOURCES	=	CLAIMS OF CREDITORS	+	CLAIM OF OWNER
\$100 000		\$30 000 <i>(borrowed)</i>		\$70 000 <i>(personal investment)</i>

This equation is very similar to the first except it breaks up the claims into two groups. The claims of creditors represents borrowed resources and claim of owner represents the amount invested by the owner(s). The equations must always be balanced.

OE = A - L

In the language of accounting:

Economic resources are known as **assets**

Liabilities replace the claims of creditors

The claim of the owner is called **Owner's Equity**

ECONOMIC RESOURCES	=	CLAIMS OF CREDITORS	+	CLAIM OF OWNER
\$100 000		\$30 000		\$70 000

$Assets = Liabilities + Owners Equity$
--

THE ACCOUNTING EQUATION

A	=	L	+	OE
ASSETS	=	LIABILITIES	+	OWNER'S EQUITY
\$100 000		\$30 000		\$70 000

- Assets are the economic resources required to establish any business.
- Liabilities represent the debts of the business (claims of the creditors)
- Owner's equity is the claim of the owner against the assets
- Liabilities always come before Owner's equity on the right side of the equation; in Canadian courts the claims of creditors are considered before those of the owner(s)
- If you know the value of two elements of the equation you can figure out the value of the third:

SOME TERMS TO KNOW

(relating to the Accounting Equation)

Cash: currency, cheques, money orders, and bank deposits **Asset**

Bank Loan Payable: the claim of a bank against the assets of a borrowing business **Liability**

Accounts Payable: amounts owing to creditors (other than banks) for the purchase of goods or services **Liability**
purchased on account / credit

Mortgage Payable: a long-term debt wherein the collateral consist of the property bought **Liability**

APPLYING THE ACCOUNTING EQUATION

Example:

J. Emery Real Estate is a small business that has been established as a sole proprietorship and is owned by Jane Emery. The business consists of buying and selling homes, office buildings, and other types of real estate. What kind of business is this? *SERVICE*

J. Emery Real Estate began with the following assets and liabilities: Cash, \$60 000; Automobile, \$15 000; Furniture, \$8000; Office Equipment, \$7000; Bank Loan Payable, \$20 000; Accounts Payable, \$10 000.

	A	=	L	+	OE
	ASSETS	=	LIABILITIES	+	OWNER'S EQUITY
Cash	60 000		<i>Claims of Creditors</i>		<i>personal invest</i>
Auto	15 000		Bank Loan		60 000
Furniture	8 000		A/P		
Equip	7 000		10 000		
	\$ 90 000	=	\$ 30 000	+	\$ 60 000

$$OE = A - L$$

$$OE = 90000 - 30000$$

$$OE = 60000$$

1. Solve for the unknown in each of the following equations:

	ASSETS	=	LIABILITIES	+	OWNER'S EQUITY
a)	\$500	=	\$100	+	<u>400</u>
b)	\$4000	=	<u>1500</u>	+	\$2500
c)	\$740	=	\$300	+	<u>440</u>
d)	<u>1800</u>	=	\$800	+	\$1000
e)	\$9000	=	<u>2800</u>	+	\$6200
f)	\$4800	=	\$2100	+	<u>2700</u>
g)	<u>11400</u>	=	\$4500	+	\$6900

2. On March 10 of this year, Jeanne Fung opened an accounting office. The following is a list of her business's assets and liabilities on that date: Accounts Payable, \$300; Office Equipment, \$4000; Cash, \$700; Bank Loan Payable, \$3300; Office Furniture, \$1900. Determine the owner's equity while writing an accounting equation that itemizes the three elements of the equation.

ASSETS	=	LIABILITIES	+	OWNER'S EQUITY
\$ <u>4000</u> \$ <u>700</u> \$ <u>1900</u>	=	\$ <u>300</u> \$ <u>3300</u>	+	\$ <u>3000</u>
\$ <u>6600</u>	=	\$ <u>3600</u>	+	\$ <u>3000</u>

$$\begin{aligned}
 OE &= A - L \\
 &= 6600 - 3600 \\
 &= 3000
 \end{aligned}$$

3. Norman Liebensson, owner of the Saskatchewan Garden Maintenance Company, started his business with the following economic resources and debts: Cash, \$1000; Land, \$52 000; Building, \$124 000; Bank Loan Payable, \$8500; Mortgage Payable, \$130 000; Maintenance Equipment, \$9500; Accounts Payable, \$3000, Truck, \$8000; and Office Equipment, \$900.

a) List assets and liabilities; then calculate owner's equity.

ASSETS		LIABILITIES	
<u>Cash</u>	\$ <u>1000</u>	<u>Bank Loan</u>	\$ <u>8500</u>
<u>Land</u>	<u>52000</u>	<u>Mortgage</u>	<u>130000</u>
<u>Building</u>	<u>124000</u>	<u>A/P</u>	<u>3000</u>
<u>M. Equip</u>	<u>9500</u>		
<u>Truck</u>	<u>8000</u>		
<u>O. Equip.</u>	<u>900</u>		
Total Assets.....	\$ <u>195400</u>	Total Liabilities.....	\$ <u>141500</u>
Assets \$ <u>195400</u> = Liabilities \$ <u>141500</u> + Owner's Equity \$ <u>53900</u>			

3. Norman Liebenson, owner of the Saskatchewan Garden Maintenance Company, started his business with the following economic resources and debts: Cash, \$1000; Land, \$52 000; Building, \$124 000; Bank Loan Payable, \$8500; Mortgage Payable, \$130 000; Maintenance Equipment, \$9500; Accounts Payable, \$3000, Truck, \$8000; and Office Equipment, \$900.

Assume accounts payable are: Guthrie Home Hardware Ltd., \$1000; and P&P Equipment Supplies, Inc., \$2000.

a) List assets and liabilities; then calculate owner's equity.

ASSETS		LIABILITIES	
Cash	\$ 1000	Bank Loan	\$ 8500
Land	52000	Mortgage	130000
Building	124000	A/P:	
M. Equip	9500	Guthrie Home..	1000
Truck	8000	P&P Equipment..	2000
O. Equip.	900		
Total Assets.....		Total Liabilities.....	
	<u>\$ 195400</u>		<u>\$ 141500</u>
		OE	\$ 53900

b) Write the accounting equation for the Saskatchewan Garden Maintenance Company, itemizing the three elements.

ASSETS

_____ + _____ + _____ + _____ + _____ + _____
 \$ _____ + \$ _____ + \$ _____ + \$ _____ + \$ _____ + \$ _____

= \$ _____

LIABILITIES

+

OWNER'S EQUITY

_____ + _____ + _____ + _____
 \$ _____ + \$ _____ + \$ _____ + \$ _____

= \$ _____

Andrea Cooper owns and operates Andrea's Delivery Service. She gave you the following information about her assets & liabilities for her beginning business: Cash, \$2 000; Bank Loan, \$12 000; bought supplies on account from Beta Company, \$600, Supplies on hand, \$500; Land, \$25 000; purchased supplies on credit from Delta Company; Building, \$75 000; Truck, \$20 000; Equipment, \$10 000; bought supplies on account from Zebra Company, \$200; and Mortgage Payable \$80 000.

(Check: Assets total \$132 500)

$\$800$

a) List assets and liabilities; then calculate owner's equity.

ASSETS		LIABILITIES	
Cash	\$ 2 000	Bank Loan	\$ 12 000
Supplies	\$ 500	Accounts Payable:	\$
Land	\$ 25 000	Beta Co.	\$ 600
Building	\$ 75 000	Delta Co.	\$ 800
Truck	\$ 20 000	Zebra Co.	\$ 200
Equipment	\$ 10 000	Mortgage	\$ 80 000
Total Assets.....	\$ <u>132 500</u>	Total Liabilities.....	\$ <u>93 600</u>

Assets \$ 132 500 = Liabilities \$ 93 600 + Owner's Equity \$ 38 900

Alice Tang has just begun a clothing alteration and repair called Needles and Pins. She borrowed \$15 000 from the bank and opened a bank account in the name of the business, bought a piece of land and small house which will be her store location for \$135 000; took out a mortgage on the land and building, \$100 000; bought a used sewing machine on the account from Al's Sewing Machines Ltd., \$450; bought sewing supplies on credit from Fabrics Unlimited, \$250; and bought \$700 of other equipment with cash from her personal bank account. Note: Divide the cost of purchased property between land (\$35 000) and the building (\$100 000).

- a) Identify each of the items that are involved with Alice's business by using the language of accounting, for example, Cash is an economic resource.

↓

$$15\,000 - 700 = 14\,300$$

- b) Identify each of the people or businesses listed above as a creditor or a debtor.

- c) Prepare an itemized accounting equation for Needles and Pins.

Debtor → Needles + Pins ASSETS	=	Creditors LIABILITIES	+ OWNER'S EQUITY
Cash \$ 14 300		Bank Loan \$ 15 000	_____
Land 35 000		Mortgage 100 000	_____
Building 100 000		A/P: 0	_____
Sew machine 450		Al's Sewing 450	_____
Supplies 250		Fabrics Unltd. 250	_____
Equipment 700		_____	_____
_____		_____	_____
_____		_____	_____
Total Assets... \$ <u>150 700</u>		Total Liabilities... \$ <u>115 700</u>	\$ <u>35 000</u>

$$\begin{aligned}
 OE &= A - L \\
 &= 150\,700 - 115\,700 \\
 &= 35\,000
 \end{aligned}$$

Preparing the Balance Sheet

Heading - Line 1: Who
Line 2: What
Line 3: When

*Full Company Name
Balance Sheet
as at September 18 2017*

Asset Section

On the first line, center the title ASSETS
Look carefully at the order of assets - the order is how quickly each asset can be converted into cash - this is called Liquidity Order.

ASSETS

Cash.....	\$60 000.00
Automobile.....	15 000.00
Furniture.....	8 000.00
Office Equipment.....	<u>7 000.00</u>

Liability Section

On the first line, center the title LIABILITIES
Order of Liabilities - the order of retiring debts: based on due dates - debts that need to be paid off first, come first in the order.

LIABILITIES

Bank Loan Payable.....	\$20 000.00
Accounts Payable:	
Bell Furniture Co.	\$3 000.00
Ryan Equipment Co.	2 000.00
Westtown Motors Ltd.	<u>5 000.00</u> <u>10 000.00</u>
Total Liabilities.....	\$30 000.00

*Bank Loans come first because they are usually considered a 'demand' loan - meaning that a bank has the right to ask for payment on demand.
*Rule for Accounts Payable: Creditors usually give the business a period of time to repay the loan - 30, 60 or 90 days.

Owner's Equity Section

On the first line, center the title OWNER'S EQUITY
The word 'capital' is always present in the stating of the owner's equity. "Capital" means investment.

Sole Proprietorship
OWNER'S EQUITY

J. Emery, Capital.....	\$60 000
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Partnership
PARTNER'S EQUITY

D. Stockli, Capital.....	\$35 000
R. Patrick, Capital.....	\$35 000

Corporation
SHAREHOLDERS' EQUITY

Share Capital.....	<u>\$125 000</u>
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Totals & Use of Rules (Under lines)

After the Assets, Liabilities and Equity are entered, both sides of the sheet must be totaled (assets should equal the total Liabilities & Equity). A dollar sign appears with each total.
A **double rule (line)** is drawn across each money column to indicate that they are complete.

Total Assets..... \$90 000.00

Total Liabilities & Owner's Equity..... \$90 000.00

THE BALANCE SHEET

a financial statement reporting assets, liabilities and owner's equity as at a certain date.

Using the example from J. Emery Real Estate, we will complete a balance sheet for the business as of September 30th, 2015.

First, we will put the businesses Assets & Liabilities into the accounting equation:

ASSETS				=	LIABILITIES		+	OWNER'S EQUITY
<u>Cash</u>	<u>Automobile</u>	<u>Furniture</u>	<u>Office Equipment</u>	=	<u>Bank Loan Payable</u>	<u>Accounts Payable</u>	+	<u>J. Emery, Capital</u>
\$60 000	+ \$15 000	+ \$9 000	+ \$7 000		\$20 000	+ \$10 000		\$60 000
\$90 000				=	\$30 000		+	\$60 000

On a balance sheet, **Accounts Payable** are broken down so that it shows where the account is from.

In the case of J. Emery Real Estate, the business acquired some assets on credit from an auto dealer, a furniture dealer and an office equipment supplier. Let's assume that these separate accounts are owing: to Bell Furniture Co., \$3000; to Ryan Equipment Co., \$2000; and to Westtown Motors Ltd., \$5000.

J. Emery Real Estate Balance Sheet as at September 30th, 2015	
ASSETS	LIABILITIES
Cash..... \$60 000.00	Bank Loan Payable..... \$20 000.00
Automobile..... 15 000.00	Accounts Payable:
Furniture..... 8 000.00	Bell Furniture Co. \$3 000.00
Office Equipment..... <u>7 000.00</u>	Ryan Equipment Co. 2 000.00
	Westtown Motors Ltd. <u>5 000.00</u> <u>10 000.00</u>
	Total Liabilities..... \$30 000.00
	OWNER'S EQUITY
	J. Emery, Capital..... <u>60 000.00</u>
Total Assets..... <u>\$90 000.00</u>	Total Liabilities & Owner's Equity..... <u>\$90 000.00</u>

Homework

Do problem 1-4 b)

3. Norman Liebenson, owner of the Saskatchewan Garden Maintenance Company, started his business with the following economic resources and debts: Cash, \$1000; Land, \$52 000; Building, \$124 000; Bank Loan Payable, \$8500; Mortgage Payable, \$130 000; Maintenance Equipment, \$9500; Accounts Payable, \$3000, Truck, \$8000; and Office Equipment, \$900.

Assume accounts payable are: Guthrie Home Hardware Ltd., \$1000; and P&P Equipment Supplies, Inc., \$2000.

ASSETS		LIABILITIES	
① Cash	\$ 1000 ✓	① Bank Loan	\$ 8500
⑤ Land	52000 ✓	③ Mortgage	130000
⑥ Building	124000 ✓	② A/P:	
② M. Equip	9500 ✓	Guthrie Home..	1000
④ Truck	8000 ✓	P&P Equipment..	2000
③ O. Equip.	900 ✓		
Total Assets..... \$ <u>195400</u>		Total Liabilities..... \$ <u>141500</u>	

OE \$ 53900

Saskatchewan Maintenance Garden Company
 Balance Sheet
 as at September 13, 2017

ASSETS		LIABILITIES	
Cash	\$ 1000.00	Bank Loan	\$ 8500.00
Maintenance Equipment	9500.00	Accounts Payable:	
Office Equipment	900.00	Guthrie Home Hardware \$1000.00	
Truck	8000.00	P&P Equipment 2000.00	3000.00
Land	52000.00	Mortgage	130000.00
Building	124000.00	Total Liabilities	\$141500.00
		OWNER'S EQUITY	
		N. Liebenson, Capital	53900.00
Total Assets	\$195400.00	Total Liabilities + owner's Equity	\$195400.00

Page 19-20 Problem 1-5a, 1-5b & 1-6

ASSETS		LIABILITIES	
Cash.....	\$60 000.00	Bank Loan Payable.....	\$20 000.00
Automobile.....	15 000.00	Accounts Payable:	
Furniture.....	8 000.00	Bell Furniture Co.	\$3 000.00
Office Equipment.....	<u>7 000.00</u>	Ryan Equipment Co.	2 000.00
		Westown Motors Ltd.	<u>5 000.00</u> <u>10 000.00</u>
		Total Liabilities.....	\$30 000.00
		OWNER'S EQUITY	
		J. Emery, Capital.....	<u>60 000.00</u>
Total Assets.....	<u>\$90 000.00</u>	Total Liabilities & Owner's Equity.....	<u>\$90 000.00</u>

P 1-5a
 Developing the Accounting Equation:

Assets		=	Liabilities		+ Owner's Equity
Cash	\$ 17 000		Accounts Payable:		Ruth
Office Equipment	3 400		Hay Stationery Limited	\$ 5 400	Forrester
Land	50 000		Lennox Heating Co.	3 200	
Building	100 000		Star Equipment Co.	3 700	
Furniture	8 000		Total Accounts Payable .	<u>\$12 300</u>	
			Mortgage Payable	90 000	
Total Assets	<u>\$178 400</u>	=	Total Liabilities	<u>\$102 300</u>	+ <u>\$????</u>

Calculation of Owner's Equity:
 $A = L + OE$ $OE = A - L$ $OE = \$178\,400 - \$102\,300$
 $OE = \$76\,100$

P1-5b
 Ruth Forrester's Photo Service
 Balance Sheet
 as at December 31, 10

OE = \$70 100

P1-5b

Ruth Forrester's Photo Service
Balance Sheet
as at December 31, 19--

ASSETS		LIABILITIES	
Cash	\$17 000	Accounts Payable:	
Office Equipment	3 400	Hay Stationery Limited	\$5 400
Land	50 000	Lennox Heating Co.	3 200
Building	100 000	Star Equipment Co.	3 700
Furniture	8 000	Mortgage Payable	90 000
		Total Liabilities	<u>\$102 300</u>
		OWNER'S EQUITY	
		Ruth Forrester, Capital	76 100
Total Assets	<u>\$178 400</u>	Total Liabilities and Owner's Equity	<u>\$178 400</u>

P 1-6

Pacific Travel Agency
Balance Sheet
as at May 1, 19--

P 1-6

Pacific Travel Agency
Balance Sheet
as at May 1, 19--

ASSETS		LIABILITIES	
1 Cash	\$18 500	Bank Loan Payable (on demand)	\$ 11 000
4 Land	32 000	Accounts Payable:	
5 Building	85 700	Beth Printers Co.	700
2 Furniture	15 600	Mortgage Payable	100 000
3 Office Equipment	3 300	Total Liabilities	\$111 700
Total Assets		OWNER'S EQUITY	
	\$155 100	Bert Conway, Capital.....	43 400
		Total Liabilities and Owner's Equity	\$155 100

5

Accuracy of a Financial Statement

Julienne LeBlanc, a junior accountant, was asked to review the asset section of the Highland Landscaping Company's balance sheet. She found the following list of assets:

ASSETS	
② Accounts Receivable	\$5 000.00
⑦ Building	89 500.00
⑥ Land	104 000.00
Accounts Payable	16 600.00
④ Landscaping Equipment ...	78 700.00
① Cash	3 500.00
③ Office Equipment	21 200.00
⑤ Truck	27 500.00
Total Assets	<u>\$346 000.00</u>

Assets = 329 400.00
 Liabilities = 107 200.00
 OE = 222 200.00

a) List the errors in accounting concepts that Julienne will most likely find.

- Accounts Payable is not an asset
- does not follow liquidity order

b) Name the term that describes how the assets should have been listed in the balance sheet: liquidity order

c) What is the major error in this portion of the balance sheet?

Accounts payable is not an asset

d) Let's assume that Highland Landscaping Company has the following other liabilities: a debt to Smith Farms, Ltd. to be paid within 60 days, \$9 400; Mortgage payable, \$67 000; equipment on account with Kershaw Equipment, Ltd. to be paid within 30 days, \$7 200; and a bank loan worth \$23 600.

Create a new balance sheet for the business as of September 16th, 2015.

Highland Landscaping Company
Balance Sheet
as at September 16, 2015

ASSETS		LIABILITIES	
Cash	\$ 3500.00	Bank Loan	\$ 23600.00
Accounts Receivable	5000.00	Accounts Payable:	
Office Equipment	2 1200.00	Kershaw Equipment	\$ 7200.00
Landscaping Equipment	7 8700.00	Smith Farms Ltd.	9400.00
Truck	2 7500.00	Mortgage Payable	67000.00
Land	104000.00	Total Liabilities	\$ 107200.00
Building	89500.00		
		OWNER'S EQUITY	
		B. Carter, Capital	222200.00
		Total Liabilities and owners Equity	
Total Assets	\$ 329 400.00		\$ 329 400.00

Due on Monday

Smith's Style is a Beauty Salon that has been established as a sole proprietorship and is owned by Brittany Smith. The business provides services such as: hair cutting, dying & styling, as well as massage, manicures & pedicures.

Smith's styles began with the following assets & liabilities: Cash - \$75 000; Automobile - \$24 000; Building - \$123 000; Land - \$12 000; Accounts payable to: Maritime Beauty Ltd. - \$3 400; Sally's Beauty Ltd. - \$2 900; & Body Care Equipment Company - \$34 000; Mortgage Payable - \$65 000; Furniture - \$40 000; Office Equipment - \$21 600; Beauty Products - \$8 700; Bank Loan (on demand) of \$9 000.

a) Evaluate the balance sheet (on back) to find the errors. You should be able to find 7 errors. List them below.

1.

2.

3.

4.

5.

6.

7.

b) Use the blank balance sheet to create a new PROPER balance sheet for Smith's Style as of September 18th, 2015.

INTRODUCING ACCOUNTING THEORY

- In this course you will encounter several concepts and principles of accounting theory.
- **CONCEPTS** are the basic ideas that act as a foundation for all accounting theory. They provide the foundation for **Generally Accepted Accounting Principles (GAAPs)** (broad rules or guidelines for preparing financial statements)

ENTITY CONCEPT: one aspect of accounting theory that views the business as being separate, distinct, and apart from its owners.

REVIEW

- to start a business economic resources are required (Assets)
- some economic resources come from creditors creating a legal claim against the economic resources until the debts are paid. (Liabilities)
- some resources provided by owner(s) who also have a claim against the resources. (Owner's Equity)
- resources should be separate from the personal belongings of the owner(s) of the business (ENTITY CONCEPT).

Key Terms:

Sole Proprietorship

Partnership

Corporation

Debtor

Creditor

Debt

Credit

Assets

Liabilities

Owner's Equity

Accounting Equation

GAAPs

Entity Concept

KEY FOR CHAPTER 1 QUESTIONS

1. In general terms, what does a person require in order to start any business? What is this term in the language of accounting?

In general terms, a person requires *economic resources* to start a business. In the language of accounting, economic resources are called *assets*. (Note: Some students may wish an explanation for “economic.” In simple terms, the word “economic” suggests that the resources are scarce in the sense that one has to buy them. In other words, there is a price attachment to each resource required to establish any business.)

2. Through what sources may a beginning business acquire assets?

A beginning business may acquire assets through two sources: (i) borrowing, and (ii) investment of the owner.

3. Are human resources (labour) listed as part of the assets of any business? Explain your answer.

No. Human resources (labour) are not listed as part of the assets of any business because the accounting system takes care of the services provided by humans through the payroll accounting system.

4. Explain the difference between a debtor and creditor.

A debtor may be defined as the person who has borrowed or who has been given credit. On the other hand, a creditor is the one who has given credit; that is, the one who has granted the loan or who has approved the amount of time for the borrower to pay back the loan.

5. What is a concept in accounting theory?

It is one of the basic ideas that act as the foundation of all accounting theory. All other accounting theory is built upon and expands from these concepts.

6. What is a generally accepted accounting principle (GAAP) in accounting theory?

A generally accepted accounting principle, usually referred to as a GAAP, is a broad guideline or rule used by accountants to produce general-purpose financial statements to interested parties outside the business.

7. What are the fundamental elements of the accounting equation?

The fundamental elements of the accounting equation are $A = L + OE$ (Assets = Liabilities + Owner's Equity).

8. Explain the meaning of the accounting equation for a new business.

The accounting equation for a new business shows the economic resources, called assets, and the claims against those assets, called liabilities and owner's equity.

9. What is an asset? Give five examples.

An asset is an economic resource of the business. In more simple terms, an asset represents what a business owns. Five examples are: cash, land, a building, equipment, an automobile.

10. What is a liability? Give three examples.

A liability represents the claim of a creditor against the total assets of the business. In more simple terms, a liability represents a debt of the business. Three examples are: bank loan payable, accounts payable, mortgage payable.

11. What does owner's equity mean?

Owner's equity is the claim of the owner against the total assets of the business.

12. Dena McGinnis, a plumber, has assets of \$7830 and liabilities of \$2185. What is her owner's equity? Explain your answer in terms of the accounting equation.

The equity of Dena McGinnis must be \$5645 because the assets (\$7830) must equal the total of the liabilities and the owner's equity. Since the liabilities total \$2185, owner's equity must equal assets minus liabilities ($\$7830 - \$2185 = \$5645$).

13. Which element comes before the other on the right side of the accounting equation? Explain your answer.

The claims of the creditors (liabilities) come before the claim of the owner on the right side of the equation. The reason is to recognize the legal fact that liabilities take precedence over the claim of the owner. If the business were to fail, that is, if it were incapable of paying its debts, the law states that the claims of creditors must be satisfied before the claim of the owner against the total assets of the firm.

14. What two similarities exist between the accounting equation and the balance sheet?

Two similarities between the accounting equation and the balance sheet are: (i) the elements in the equation and the balance sheet are placed on similar sides, that is, assets appear on the left while liabilities and owner's equity appear on the right; and (ii) the totals of both sides must be equal, that is, the total of the left side of the equation and the balance sheet must be the same as the total on the right side of the equation and balance sheet.

15. Through what common methods may a balance sheet be prepared in practice?

A balance sheet may be prepared in practice in a printed format through several common methods as follows: office typewriter, word processor, typesetting and printing machine, and through a computer.

16. Name the two main parts of any balance sheet. Which one comes before the other?

The two main parts of any balance sheet are the heading and the body. The heading always comes before the body of the balance sheet.

17. Explain the order of listing assets in a balance sheet.

Assets are usually listed in the order of liquidity, that is, in the order of converting assets into cash. This order would suggest that Cash would be shown as the first asset because Cash is the most liquid asset. All non-liquid assets such as Land, Building, Furniture, and Office Equipment would come after Cash. (In the next chapter, students will be introduced to two other assets that are converted into cash.)

18. Explain the order of listing liabilities in a balance sheet.

Liabilities are usually listed on a balance sheet in the order of debt maturity, that is, in the order that these debts must be paid on a time basis.

19. What is the general rule for showing dollar signs on a balance sheet?

Dollar signs on a balance sheet are placed opposite the first amount in a column and opposite the final amount in a column. In addition, a dollar sign may be placed opposite important subtotals such as Total Liabilities.

20. Explain the meaning of a demand loan from a bank.

A demand loan from a bank means that the borrower must be prepared to pay the loan when the bank wants payment. In other words, if the bank requests (demands) payment at any time, then the borrower is obliged to give payment to the bank. This may mean negotiating the loan again at that bank or going elsewhere to raise the funds to pay back the loan. Such a loan is granted only when the borrower agrees to sign a promissory note called a demand note.

21. In accounting, what does a single line ruled across a money column indicate? What does a double line indicate?

A single line ruled across a money column indicates that some form of calculation is required in the column. On a balance sheet, this calculation is usually an addition of the dollar amounts shown above the single line. On the other hand, a double ruled line indicates completion, that is, the particular section of the financial statement has been completed.

22. How does the owner's equity section heading of a balance sheet vary according to the type of business ownership?

The owner's equity section of a balance sheet varies as to the form of ownership: (i) owner's equity is appropriate for a single (sole) proprietorship; (ii) partners' equity is used for a partnership form of business ownership; and (iii) shareholders' equity or stockholders' equity is commonly used for a business corporation.

23. Explain why legibility of writing is important in accounting.

Legibility of writing, especially in the writing of dollar amounts, is very important in accounting practice. Dollar amounts and other written material must be read by others involved in the processing of accounting information. Therefore, it is most important that the others can read your writing.

24. Explain how a correction of an error may be made when the "hand method" is used in accounting practice.

Correction of errors in accounting are made in accordance with the method used in processing accounting information. In the "hand method," a correction may be made by ruling a straight line through the entire incorrect amount or word and then rewriting the correct amount or word above. In some practices, the correction may also require written initials of the person performing the correction. It must be stated that errors are never erased in accounting practice regardless of the method used to process the accounting data. The reason here is to avoid any misunderstanding of the error and the correction.

KEY FOR CHAPTER 1 MULTIPLE-CHOICE QUESTIONS

1. d. a, b, c are examples of common forms of business ownership
2. c. generally accepted accounting principle
3. c. Economic resources
4. d. $A = L + OE$. Note that this form establishes the correct sides where A, L, and OE are located; that is, A originates on the left side while L and OE are placed on the right side.
5. b. a person or business to whom our business owes money
6. d. a business is an economic unit and is separate and distinct from its owner(s)
7. b. the creditors of the business because the law requires it
8. c. an amount owing to an outside person or business
9. d. $\$45\,600 - \$23\,800 = \$21\,800$
10. a. Cash, Accounts Receivable, Equipment, Truck
11. c. A bank loan is always considered a liability.
12. d. A balance sheet gives information about a period of time. Obviously, this statement is incorrect because a balance sheet reports details concerning assets and claims against assets as at a particular date.
13. a. coin, bill, cheques and money orders
14. d. all of the above
15. a. how much the owner has invested into the business
16. d. assets, liabilities, and owner's equity
17. d. name of the company, name of the statement, date
18. b. owned by the business
19. d. a GAAP
20. c. the employees of the business

Barb's Baked Goods
Balance Sheet
as at September 19, 2017

ASSETS		LIABILITIES	
Cash	\$ 6 000.00	Bank Loan Payable	\$ 1 500.00
Furniture	1 030.00	Accounts Payable:	
Office Equipment	240.00	Cameron's Kitchen	
Kitchen Equipment	750.00	Equipment Ltd.	\$ 290.00
Tools + Utensils	87.00	Home Hardware Ltd.	120.00
Automobile	13 000.00	Mortgage Payable	7 400.00
Land	7 000.00	Total Liabilities	\$ 9 310.00
Building	89 000.00		
		OWNER'S EQUITY	
		Barb Hughes, Capital	9 697.00
		Total Liabilities and	
		Owner's Equity	\$ 9 697.00
Total Assets	\$ 19 007.00		