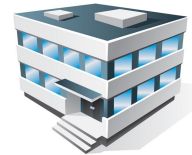


What does a person need to start a business?

- product / service
- money
- building / work space
- land
- name for the business
- employees



RESOURCES



To start any type of profit 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 Funds)

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.

<i>Assets</i>		<i>Liabilities</i>	+	<i>Owner's Equity</i>
ECONOMIC RESOURCES	=	CLAIMS OF CREDITORS		CLAIM OF OWNER
\$100 000		\$30 000		\$70 000
		<i>borrowed</i>		<i>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.**

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 + Owner's 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:

Assets (Economic Resources)

- land
- building
- cash
- equipment
- supplies
- vehicle

Liabilities (Claims of Creditors)

- Bank Loan
- Mortgage Payable
- Accounts Payable

Owner's Equity (Claims of Owner(s))

- Personal Investment (Capital)

SOME TERMS TO KNOW

(relating to the Accounting Equation)

Cash: currency, cheques, money orders, and bank deposits (Assets)

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 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?

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
60000 + 15000 + 8000 + 7000		20000 + 10000		?
90000	=	30000	+	<u>60000</u>

$$OE = A - L$$

$$OE = 90000 - 30000$$

$$OE = 60000$$

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.

Economic Resources	=	Borrowed	+	Invested
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>

$$OE = A - L$$

$$OE = 6600 - 3600$$

$$OE = \$3000$$

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.

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

ASSETS		LIABILITIES	
Cash	\$ 1000	Bank Loan	\$ 8500
Land	52000	Mortgage	130000
Building	124000	Accounts Pay.	3000
M. Equipment	9500		
Truck	8000		
O. Equipment	900		
Total Assets.....	\$ 195 400	Total Liabilities.....	\$ 141 500

Assets \$ 195 400 = Liabilities \$ 141 500 + Owner's Equity \$ 53 900

$$OE = A - L$$

$$OE = 195400 - 141500$$

$$OE = 53900$$

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

ASSETS

$$\begin{array}{r}
 \underline{\$ 1000} + \underline{\$ 52000} + \underline{\$ 124000} + \underline{\$ 9500} + \underline{\$ 8000} + \underline{\$ 900} \\
 = \underline{\$ 195400}
 \end{array}$$

LIABILITIES

+

OWNER'S EQUITY

$$\begin{array}{r}
 \underline{\$ 8500} + \underline{\$ 130000} + \underline{\$ 3000} + \underline{\$ 53900} \\
 = \underline{\$ 141500}
 \end{array}$$

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 AI'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.

- 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.

ASSETS	=	LIABILITIES	+	OWNER'S EQUITY
_____ \$ _____		_____ \$ _____		_____
_____		_____		_____
_____		_____		_____
_____		_____		_____
_____		_____		_____
_____		_____		_____
_____		_____		_____
Total Assets... \$ _____		Total Liabilities... \$ _____		\$ _____

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)

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

ASSETS	LIABILITIES
_____ \$ _____	_____ \$ _____
_____ \$ _____	_____ \$ _____
_____ \$ _____	_____ \$ _____
_____ \$ _____	_____ \$ _____
_____ \$ _____	_____ \$ _____
_____ \$ _____	_____ \$ _____
_____ \$ _____	_____ \$ _____
Total Assets..... \ni <u> </u>	Total Liabilities..... \ni <u> </u>

Assets \$ _____ = Liabilities \$ _____ + Owner's Equity \$ _____