



Accounting

Chapter 17.2

What You Will Learn...

- Purpose of Accounting
- Basic Accounting Equation
- 3 Main Financial Statements



Review...

- Purpose of a financial plan:
 - Outline of essential financial facts and used as a guide/roadmap
- What does an effective financial plan do:
 1. Identifies assets
 2. Determines needed capital
 3. Describes start-up and operating expenses
 4. Describes records management
 5. Forecasts the future
 6. Describes growth

Discuss...

- *What do you already know about accounting?*
- *What comes to mind when you think of the word “accounting”?*

What is Accounting?

- **Accounting:** The systematic process of recording and reporting the financial position of a person or organization
 - Collect
 - Record
 - Report
- **Accountant:** Maintains and reviews business records
 - Small firms

Auditing

- **Audit:** Review of accounting records and procedures
- “Big Four” - Operate World Wide
 - Pricewaterhouse Coopers
 - Deloitte & Touche
 - Ernst & Young
 - KPMG



Deloitte.



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Importance of Accounting

- *“The language of business”*
 - Vital in communicating how well a business is doing
- Just like a foreign language...
 - Different words
 - Different meanings
- *Everyone involved in business should understand accounting basics*

Rules for Accountants

- **Generally Accepted Accounting Principles (GAAP):** Set of rules all accountants use to prepare reports
- All businesses must follow GAAP rules

Financial Claims in Accounting

- **Assets:** Property and other items of value; owned by business
 - **Current Assets:** Used up or converted into cash in normal business cycle
 - **Fixed Assets:** Items of value that are held more than one year

Current or Fixed Assets?

- Land
 - Fixed
- Merchandise
 - Current
- Cash
 - Current
- Equipment
 - Fixed
- Office Supplies
 - Current
- Buildings
 - Fixed

Financial Claims in Accounting

- **Accounts Receivable:** Total amount of money owed to a business
 - Money received in payments after goods/ services are sold on credit
- **Equity:** Financial claim to all assets; present value of an asset less all claims against it

Financial Claims Cont.

- **Liabilities:** Creditor's claims to the assets of the business; company debts
 - **Accounts Payable:** Short-term liabilities that a business owes to creditor's
 - Wages, taxes, salaries, etc.
- **Owner's Equity:** Owner's claim to the assets of a business

The Accounting Equation

- **Accounting Equation:** Rule that all assets must be equal to the sum of all liabilities plus owner's equity

$$\text{Assets} = \text{Liabilities} + \text{Owner's Equity}$$

- Ensures that all accounting records will be correct
- Must always balance

The Accounting Equation

Assets = Liabilities + Owner's Equity



Right Side: The value of everything owned by a business

The Accounting Equation

Assets = Liabilities + Owner's Equity



Left Side: The rights to those assets

A Company Has...

- Assets = \$100,000
- Liabilities against those assets = \$40,000
- What are the owner's rights to the assets (Owner's Equity)?

$$A = L + OE$$

$$100,000 = 40,000 + OE$$

$$OE = \$60,000$$

Financial Statements

- **Financial Statements:** Documents that summarize business transactions that occur during the accounting period
 1. Income Statement
 2. Balance Sheet
 3. Statement of Cash Flows

Income Statement

- **Income Statement:** Report of the revenue, expenses, and net income/loss over an accounting period
- How much money did you make/lose?

Revenue – Expenses = Net Income/Loss

Net Income or Net Loss?

- If Revenue $>$ Expenses
 - Net Income (+)

- If Expenses $>$ Revenue
 - Net Loss (-)

Balance Sheet

- **Balance Sheet:** Report of the balances in all assets, liability, and owner's equity accounts at the end of an accounting period
- Reflects the accounting equation
 - Determine if liabilities (claims against assets) are increasing too much

Statement of Cash Flows

- **Cash Flows:** Money that is available to a business at any given time
- **Statement of Cash Flows:** Report that shows incoming and outgoing money during an accounting period
- Firms can run out of cash even when they've made a profit (sales on credit)

Accounting Today

- Computerized Systems
 - Peachtree, QuickBooks, Oracle
- Spreadsheets
 - Microsoft Excel



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Summary

- What is the set of rules accountants abide by called?
 - GAAP (Generally Accepted Accounting Principles)
- What is the accounting equation?
 - $A = L + OE$
- What are the 3 main financial statements?
 - Income Stmt., Balance Sheet, Stmt. of Cash Flows

Prepare a Personal Balance Sheet

- List all of your assets. Price your assets at the cost that you paid for them.
- List your liabilities (debts).
- Figure out how much you have in owner's equity.
- Compare your financial status with someone else in the class.
 - Write a paragraph explaining the similarities/differences.
 - Write 2 financial goals for yourself based on your balance sheet.

Resources

- Textbook (Teacher-Edition): Brown, B. J., & Clow, J. E. (2008). *Introduction to business*. Woodland Hills, CA: The McGraw-Hill Companies.
- Google Images