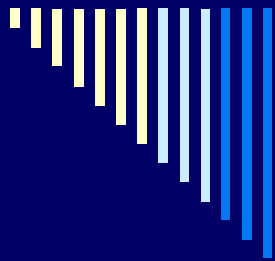


Basic Accounting: Concepts, Techniques, and Conventions



The Need for Accounting

Managers, investors, and other internal groups want the answers to two important questions:

How well did
the organization
perform?

Where does
the organization
stand?



The Need for Accounting

Accountants answer these questions with three major financial statements:

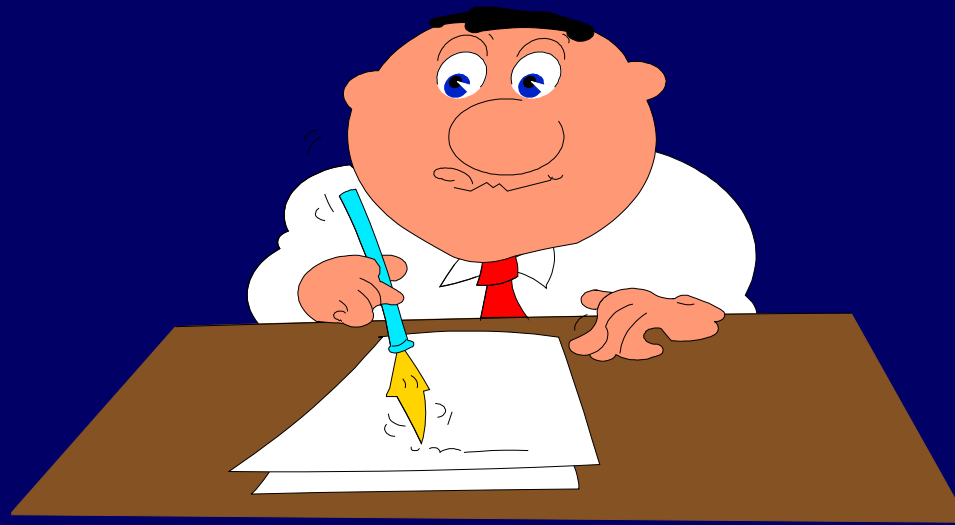
Income
statement

Balance
sheet

Statement of
cash flows

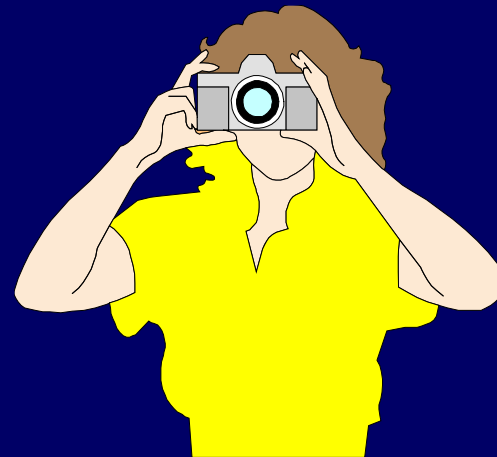
The Need for Accounting

A *transaction* is any event that affects the financial position of an organization and requires recording.



Balance Sheet

The *balance sheet* (also called *statement of financial position* or *statement of financial condition*) is a snapshot of the financial status of an organization at a point in time.





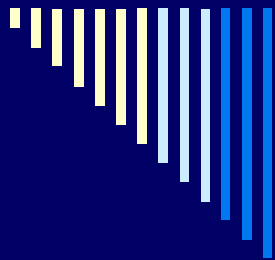
Balance Sheet

Assets = Liabilities + Owners' equity

Assets are economic resources that are expected to benefit future activities of the organization.

Liabilities are the entity's economic obligations to nonowners.

Owners' equity is the excess of the assets over the liabilities.



Balance Sheet

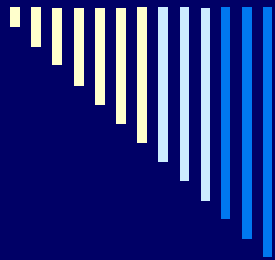
The owners' equity of a corporation is called *shareholders' equity*.

Shareholders' equity

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graph TD; A[Shareholders' equity] --> B[Paid-in capital]; A --> C[Retained earnings];
```

Paid-in
capital

Retained
earnings



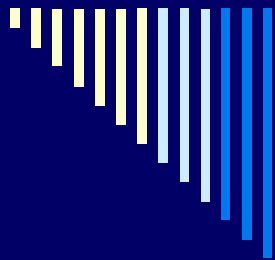
King Hardware Transactions

Initial investment by owners: \$100,000 cash

Acquisition of inventory: \$75,000 cash

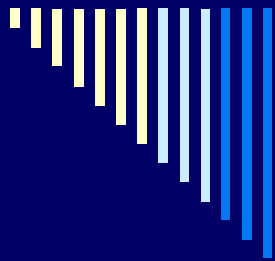
Acquisition of inventory on
open account: \$35,000

Merchandise costing \$100,000 was
sold on open account for \$120,000.



King Hardware Transactions

		Assets	=	Liabilities	+	Stockholders' equity
1)	Cash	+100,000				+100,000
2)	Cash	- 75,000				
	Inventory	+ 75,000				
3)	Inventory	+ 35,000		+ 35,000		
4a)	Receivable	+120,000				+120,000
4b)	Cost	<u>-100,000</u>		<u> </u>		<u>-100,000</u>
	Subtotal	+155,000		+ 35,000		+120,000

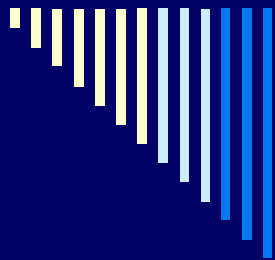


King Hardware Transactions

Cash collections of accounts receivable: \$15,000

Cash payments of accounts payable: \$20,000

On March 1, paid \$3,000 cash for store rent for March, April, and May. Rent is \$1,000 per month.



King Hardware Transactions

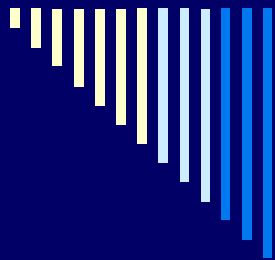
		Assets	=	Liabilities	+	Stockholders' equity
5)	Cash	+ 15,000				
	Receivable	- 15,000				
6)	Cash	- 20,000		- 20,000		
7)	Cash	- 3,000				
7a)	Prepaid	+ 3,000				
7b)	Expense	<u>- 1,000</u>		<u> </u>		<u>- 1,000</u>
Total		- 21,000		- 20,000		- 1,000
Totals (1-4)		<u>+155,000</u>		<u>+ 35,000</u>		<u>+120,000</u>
		134,000		134,000		



Revenues and Expenses

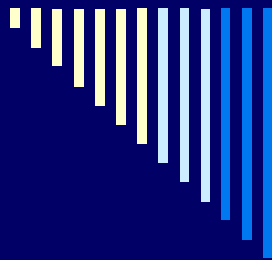
Revenues are increases in ownership claims arising from the delivery of goods or services.

Expenses are decreases in ownership claims arising from delivering goods or services or using up assets.

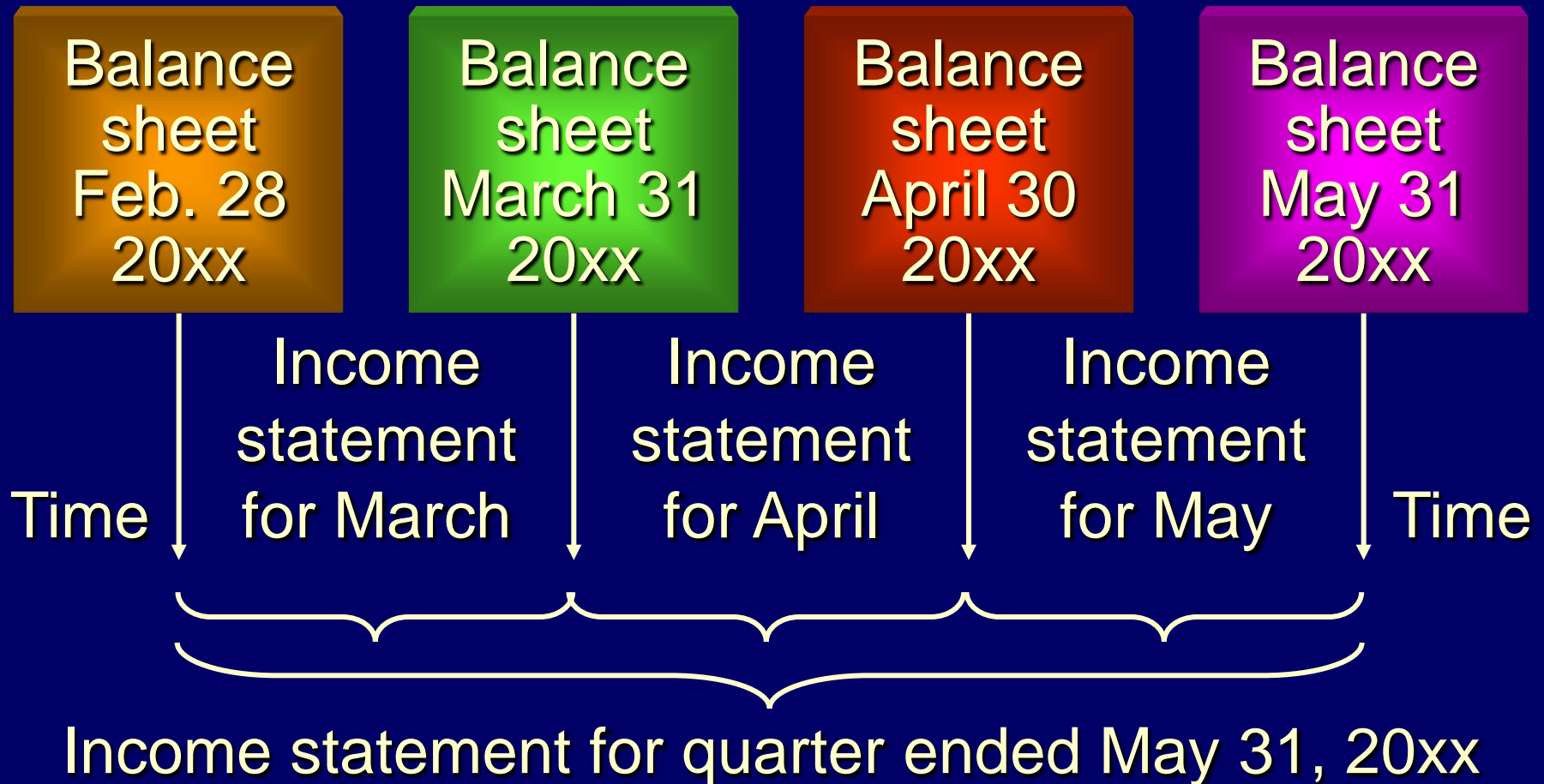


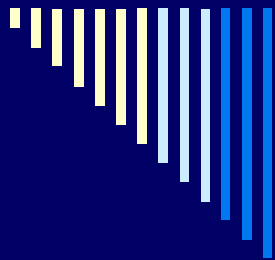
Relationship Between Balance Sheet and Income Statement

The income statement measures the performance of an organization by matching its accomplishments (revenue from customers, which is usually called *sales*) and its efforts (*cost of goods sold* and other expenses.)



Relationship Between Balance Sheet and Income Statement





The Analytical Power of the Balance Sheet Equation

The balance sheet equation can highlight the link between the income statement and balance sheet.

Assets (A) = Liabilities (L) + Stockholders' equity (SE)

$A = L + \text{Paid-in capital} + \text{Retained income}$

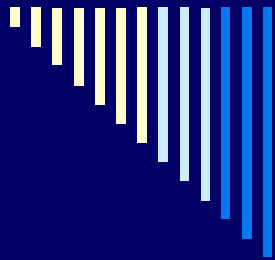
$A = L + \text{Paid-in capital} + \text{Revenue} - \text{Expenses}$



Accrual Basis and Cash Basis

The *accrual basis* of accounting recognizes revenues and expenses when they occur regardless of when cash is received or disbursed.

The *cash basis* of accounting recognizes revenue and expense when cash is received and disbursed.



Accrual Basis and Cash Basis

The major deficiency of the cash basis of accounting is that it is incomplete.

It fails to match efforts and accomplishments in a manner that properly measures economic performance and financial position.