



# Introduction to Basic Accounting

Wayne Lippman | Lippman & Associates CPA's Inc



1

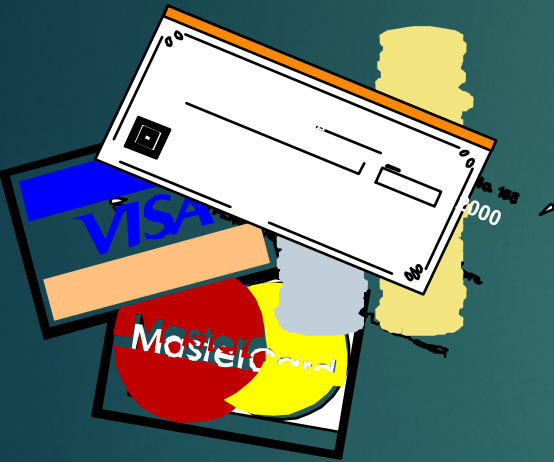
# ACCOUNTING IN ACTION



# ILLUSTRATION 1-1

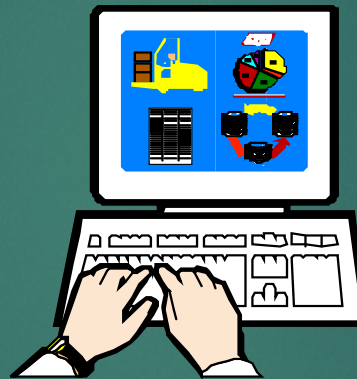
## THE ACCOUNTING PROCESS

### Identification



Select economic events  
(transactions)

### Recording



Record, classify,  
and summarize

### Communication



Prepare  
accounting reports

SOFTBYTE  
Annual Report



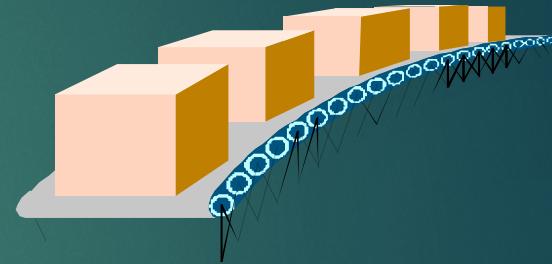
Analyse and interpret  
for users

# ILLUSTRATION 1-2

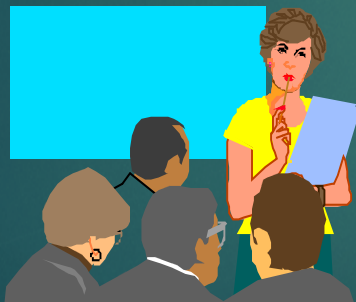
## QUESTIONS ASKED BY INTERNAL USERS



Is cash sufficient to pay bills?



What is the cost of manufacturing each unit of product?



Can we afford to give employees

pay raises this year?



Which product line is the most profitable?

<http://waynelippman.com>



## ILLUSTRATION 1-3

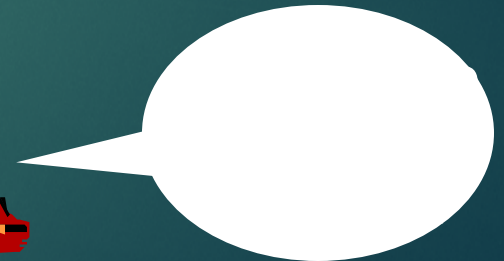
# QUESTIONS ASKED BY EXTERNAL USERS



Is the company earning satisfactory income?



How does the company compare in size and profitability with its competitors?



Will the company be able to pay its debts as they come due?

Wayne Lippman CPA.

<http://waynelippman.com>

# BOOKKEEPING VERSUS ACCOUNTING

## Accounting

1. Includes bookkeeping
2. Also includes much more



## Bookkeeping

1. Involves only the recording of economic events
2. Is just one part of accounting





# THE ACCOUNTING PROFESSION

- **Public accountants** offer their expertise to the general public through the services they perform.
- **Private accountants** are employees of individual companies and are involved in a number of activities, including cost and tax accounting, systems, and internal auditing.
- **Not-for-profit accounting** includes reporting and control for government units, foundations, hospitals, labour unions, colleges/universities, and charities.

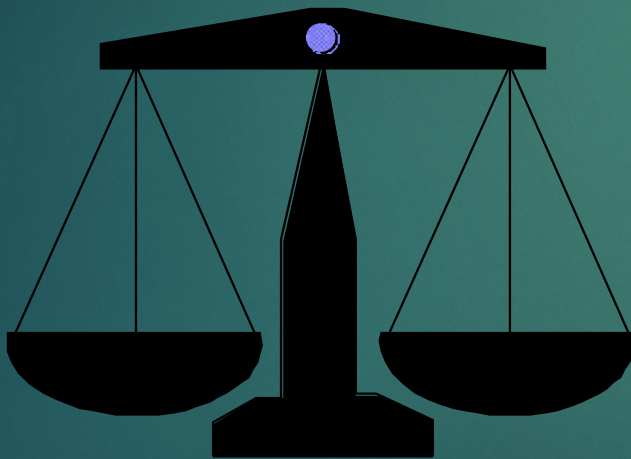


# ILLUSTRATION 1-4

## ETHICS

### Ethics

- Standards of conduct



### To Solve Ethical Dilemma

1. Recognize situation and ethical issues involved
2. Identify and analyse elements
3. Identify alternatives and weigh effects on stakeholders



# GAAP

## Generally Accepted Accounting Principles

- Primarily established by the Canadian Institute of Chartered Accountants

## Cost Principle

- The **cost principle** dictates that **assets are recorded at their cost**.
- Cost is the value exchanged at the time something is acquired.
- Cost is used because it is both relevant and reliable.

# ASSUMPTIONS



- 1. Going Concern** - assumes organization will continue into foreseeable future.
- 2. Monetary Unit** - only transaction data that can be expressed in terms of money is included in the accounting records.
- 3. Economic Entity** - includes any organization or unit in society.



# BUSINESS ENTERPRISES

- A business owned by one person is generally a **proprietorship** (owner's equity).
- A business owned by two or more persons associated as partners is a **partnership** (partners' equity).
- A business organized as a separate legal entity under corporation law and having ownership divided into transferable shares is called a **corporation** (shareholders' equity).



# ILLUSTRATION 1-5

## BASIC ACCOUNTING EQUATION

### The Basic Accounting Equation

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



# ASSETS AS A BUILDING BLOCK

- **Assets** are resources owned by a business.
- They are things of value used in carrying out such activities as production and exchange.



# LIABILITIES AS A BUILDING BLOCK

- **Liabilities** are claims against assets.
- They are existing debts and obligations.





# OWNER'S EQUITY AS A BUILDING BLOCK

- **Owner's Equity** is equal to total assets minus total liabilities.
- Owner's Equity represents the ownership claim on total assets.
- Subdivisions of Owner's Equity:
  1. Capital
  2. Drawings
  3. Revenues
  4. Expenses

# INVESTMENTS BY OWNERS AS A BUILDING BLOCK

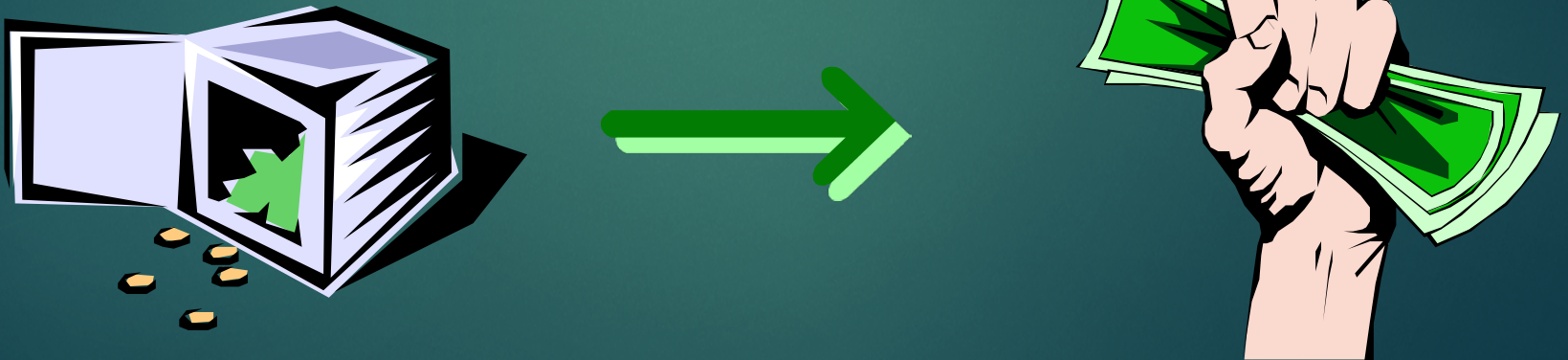
- **Investments** by owner are the assets put into the business by the owner.
- These investments in the business increase owner's equity.






# DRAWINGS AS A BUILDING BLOCK

- **Drawings** are withdrawals of cash or other assets by the owner for personal use.
- Drawings decrease total owner's equity.



# REVENUES AS A BUILDING BLOCK



- **Revenues** are the gross increases in owner's equity resulting from business activities entered into for the purpose of earning income.
- Revenues may result from sale of merchandise, performance of services, rental of property, or lending of money.
- Revenues usually result in an increase in an asset.



# EXPENSES AS A BUILDING BLOCK



- **Expenses** are the decreases in owner's equity that result from operating the business.
- Expenses are the cost of assets consumed or services used in the process of earning revenue.
- Examples of expenses include utility expense, rent expense, and supplies expense.

# ILLUSTRATION 1-6

## INCREASES AND DECREASES IN OWNER'S EQUITY

### INCREASES

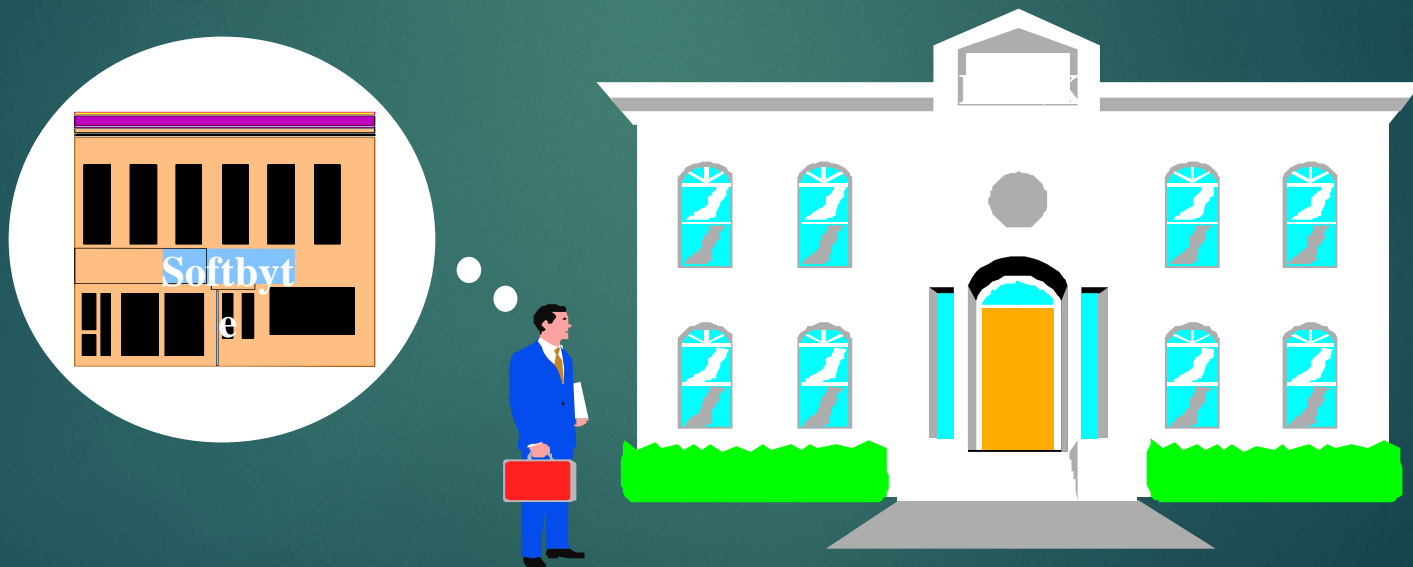
### DECREASES





# TRANSACTION ANALYSIS

**Marc Doucet** decides to open a computer programming service.



# TRANSACTION ANALYSIS

## TRANSACTION 1

On September 1, he invests \$15,000 cash in the business, which he names **Softbyte**.

| Trans. # | Assets |          |           | = | Liabilities      | +      | Owner's Equity     |
|----------|--------|----------|-----------|---|------------------|--------|--------------------|
|          | Cash   | Supplies | Equipment |   | Accounts Payable |        | M. Doucet, Capital |
| (1)      | 15,000 |          |           | = |                  | 15,000 | Investment         |

There is an increase in the asset **Cash**, **\$15,000**, and an equal increase in the owner's equity, **M. Doucet, Capital**, **\$15,000**.



# TRANSACTION ANALYSIS

## TRANSACTION 2

**Softbyte** purchases computer equipment for **\$7,000** cash.

| Trans. # | Assets  |          |           | = | Liabilities      | + | Owner's Equity     |
|----------|---------|----------|-----------|---|------------------|---|--------------------|
|          | Cash    | Supplies | Equipment |   | Accounts Payable |   | M. Doucet, Capital |
|          | 15,000  |          |           |   |                  |   | 15,000 Investment  |
| (2)      | (7,000) |          | 7,000     |   |                  |   |                    |
| Balance  | 8,000   | +        | 7,000     | = |                  |   | 15,000             |

**Cash** is decreased **\$7,000**, and the asset **Equipment** is increased **\$7,000**.

# TRANSACTION ANALYSIS

## TRANSACTION 3

**Softbyte** purchases computer paper and supplies expected to last several months from **Chuah Supply Company** for **\$1,600** on account.

| Trans. # | Assets |          |           | = | Liabilities      | + | Owner's Equity     |   |        |
|----------|--------|----------|-----------|---|------------------|---|--------------------|---|--------|
|          | Cash   | Supplies | Equipment |   | Accounts Payable |   | M. Doucet, Capital |   |        |
| Balance  | 8,000  |          | 7,000     |   |                  |   | 15,000             |   |        |
| (3)      |        | 1,600    |           |   | 1,600            |   |                    |   |        |
| Balance  | 8,000  | +        | 1,600     | + | 7,000            | = | 1,600              | + | 15,000 |

The asset **Supplies** is increased **\$1,600**, and the liability **Accounts Payable** is increased by the same amount.



# TRANSACTION ANALYSIS

## TRANSACTION 4

**Softbyte** receives \$1,200 cash from customers for programming services it has provided.

| Trans. # | Assets |          |           | = | Liabilities      | + | Owner's Equity     |                 |
|----------|--------|----------|-----------|---|------------------|---|--------------------|-----------------|
|          | Cash   | Supplies | Equipment |   | Accounts Payable |   | M. Doucet, Capital |                 |
| Balance  | 8,000  | 1,600    | 7,000     |   | 1,600            |   | 15,000             |                 |
| (4)      | 1,200  |          |           |   |                  |   | 1,200              | Service Revenue |
| Balance  | 9,200  | 1,600    | 7,000     | = | 1,600            | + | 16,200             |                 |

**Cash** is increased **\$1,200**, and  
**M. Doucet, Capital** is increased **\$1,200**.

# TRANSACTION ANALYSIS

## TRANSACTION 5

**Softbyte** receives a bill for **\$250** for advertising its business but pays the bill on a later date.

| Trans. # | Assets |          |           | = | Liabilities      | + | Owner's Equity            |
|----------|--------|----------|-----------|---|------------------|---|---------------------------|
|          | Cash   | Supplies | Equipment |   | Accounts Payable |   | M. Doucet, Capital        |
| Balance  | 9,200  | 1,600    | 7,000     | = | 1,600            | + | 16,200                    |
| (5)      |        |          |           |   | 250              |   | (250) Advertising Expense |
| Balance  | 9,200  | 1,600    | 7,000     |   | 1,850            |   | 15,950                    |

**Accounts Payable** is increased **\$250**, and **M. Doucet, Capital** is decreased **\$250**.



# TRANSACTION ANALYSIS

## TRANSACTION 6

**Softbyte** provides programming services of \$3,500 for customers and receives cash of \$1,500, with the balance payable on account.

| Trans. # | Assets |                    |          |           | = | Liabilities      | + | Owner's Equity        |
|----------|--------|--------------------|----------|-----------|---|------------------|---|-----------------------|
|          | Cash   | Account Receivable | Supplies | Equipment |   | Accounts Payable |   | M. Doucet, Capital    |
| Balance  | 9,200  | 0                  | 1,600    | 7,000     | = | 1,850            |   | 15,950                |
| (6)      | 1,500  | 2,000              |          |           |   |                  |   | 3,500 Service Revenue |
| Balance  | 10,700 | 2,000              | 1,600    | 7,000     |   | 1,850            |   | 19,450                |

**Cash** is increased **\$1,500**; **Accounts Receivable** is increased **\$2,000**; and **M. Doucet, Capital** is increased **\$3,500**.

# TRANSACTION ANALYSIS

## TRANSACTION 7

Expenses paid in cash for September are store rent, **\$600**, salaries of employees, **\$900**, and utilities, **\$200**.

| Trans. # | Assets |                    |          |           | = | Liabilities      | + | Owner's Equity       |
|----------|--------|--------------------|----------|-----------|---|------------------|---|----------------------|
|          | Cash   | Account Receivable | Supplies | Equipment |   | Accounts Payable |   | M. Doucet, Capital   |
| Balance  | 10,700 | 2,000              | 1,600    | 7,000     |   | 1,850            |   | 19,450               |
| (7)      | (600)  |                    |          |           |   |                  |   | (600) Rent Exp.      |
|          | (900)  |                    |          |           |   |                  |   | (900) Salaries Exp.  |
|          | (200)  |                    |          |           |   |                  |   | (200) Utilities Exp. |
| Balance  | 9,000  | 2,000              | 1,600    | 7,000     | = | 1,850            | + | 17,750               |

**Cash** is decreased **\$1,700** and **M. Doucet, Capital** is decreased the same amount.



# TRANSACTION ANALYSIS

## TRANSACTION 8

**Softbyte** pays its advertising bill of **\$250** in cash.

| Trans. # | Assets |                    |          |           | = | Liabilities      | + | Owner's Equity     |
|----------|--------|--------------------|----------|-----------|---|------------------|---|--------------------|
|          | Cash   | Account Receivable | Supplies | Equipment |   | Accounts Payable |   | M. Doucet, Capital |
| Balance  | 9,000  | 2,000              | 1,600    | 7,000     |   | 1,850            |   | 17,750             |
| (8)      | (250)  |                    |          |           |   | (250)            |   |                    |
| Balance  | 8,750  | 2,000              | 1,600    | 7,000     | = | 1,600            | + | 17,750             |

**Cash** is decreased **\$250** and **Accounts Payable** is decreased the same amount.

# TRANSACTION ANALYSIS

## TRANSACTION 9

The sum of **\$600** in cash is received from customers who have previously been billed for services in Transaction 6.

| Trans. # | Assets |                    |          |           | = | Liabilities      | + | Owner's Equity     |
|----------|--------|--------------------|----------|-----------|---|------------------|---|--------------------|
|          | Cash   | Account Receivable | Supplies | Equipment |   | Accounts Payable |   | M. Doucet, Capital |
| Balance  | 8,750  | 2,000              | 1,600    | 7,000     |   | 1,600            |   | 17,750             |
| (9)      | 600    | (600)              |          |           |   |                  |   |                    |
| Balance  | 9,350  | 1,400              | 1,600    | 7,000     | = | 1,600            | + | 17,750             |

**Cash** is increased **\$600** and **Accounts Receivable** is decreased by the same amount.



# TRANSACTION ANALYSIS

## TRANSACTION 10

**Marc Doucet** withdraws \$1,300 in cash from the business for his personal use.

| Trans. # | Assets  |                    |          |           | = | Liabilities      | + | Owner's Equity           |
|----------|---------|--------------------|----------|-----------|---|------------------|---|--------------------------|
|          | Cash    | Account Receivable | Supplies | Equipment |   | Accounts Payable |   | M. Doucet, Capital       |
| Balance  | 9,350   | 1,400              | 1,600    | 7,000     |   | 1,600            |   | 17,750                   |
| (10)     | (1,300) |                    |          |           |   |                  |   | (1,300) Doucet, Drawings |
| Balance  | 8,050   | 1,400              | 1,600    | 7,000     | = | 1,600            | + | 16,450                   |

**Cash** is decreased \$1,300 and **M. Doucet, Capital** is decreased by the same amount.

# FINANCIAL STATEMENTS

After transactions are identified, recorded, and summarized, **four financial statements** are prepared from the summarized accounting data:

1. An **income statement** presents the revenues and expenses and resulting net income or net loss of a company for a specific period of time.
2. A **statement of owner's equity** summarizes the changes in owner's equity for a specific period of time.



# FINANCIAL STATEMENTS

In addition to the income statement and statement of owner's equity, two additional statements are prepared:

**3. A balance sheet** reports the assets, liabilities, and owner's equity of a business enterprise at a specific date.

**4. A cash flow statement** summarizes information concerning the cash inflows (receipts) and outflows (payments) for a specific period of time.

The **notes** are an integral part of the financial statements.

# ILLUSTRATION 1-10

## FINANCIAL STATEMENTS AND THEIR INTERRELATIONSHIPS

| SOFTBYTE                               |        |          |
|--|--------|----------|
| Income Statement                       |        |          |
| For the Month Ended September 30, 2002 |        |          |
| Revenues                               |        |          |
| Service revenue                        |        | \$ 4,700 |
| Expenses                               |        |          |
| Salaries expense                       | \$ 900 |          |
| Rent expense                           | 600    |          |
| Advertising expense                    | 250    |          |
| Utilities expense                      | 200    |          |
| Total expenses                         |        | 1,950    |
| Net income                             |        | \$ 2,750 |

Net income of **\$2,750** shown on the income statement is added to the beginning balance of owner's capital in the statement of owner's equity.

# ILLUSTRATION 1-10

## FINANCIAL STATEMENTS AND THEIR INTERRELATIONSHIPS

| SOFTBYTE                               |              |                         |
|--|--------------|-------------------------|
| Statement of Owner's Equity            |              |                         |
| For the Month Ended September 30, 2002 |              |                         |
| M. Doucet, Capital, September 1        |              | \$ -                    |
| Add: Investments                       | \$ 15,000    |                         |
| Net income                             | <u>2,750</u> | 17,750                  |
|  |              | <u>\$ 17,750</u>        |
| Less: Drawings                         |              | <u>1,300</u>            |
| M. Doucet, Capital September 30        |              | <u><u>\$ 16,450</u></u> |

Net income of \$2,750 is carried forward from the income statement to the statement of owner's equity. The owner's capital of **\$16,450** at the end of the reporting period is shown as the final total of the owner's equity column of the Summary of Transactions (Illustration 1-9 in text).



# ILLUSTRATION 1-10

## FINANCIAL STATEMENTS AND THEIR INTERRELATIONSHIPS

Owner's capital of **\$16,450** at the end of the reporting period – shown in the statement of owner's equity – is also shown on the balance sheet. Cash of **\$8,050** on the balance sheet is reported on the cash flow statement.

| SOFTBYTE                              |                  |
|---------------------------------------|------------------|
| Balance Sheet                         |                  |
| September 30, 2002                    |                  |
| <u>Assets</u>                         |                  |
| Cash                                  | \$ 8,050         |
| Accounts receivable                   | 1,400            |
| Supplies                              | 1,600            |
| Equipment                             | 7,000            |
| Total assets                          | <u>\$ 18,050</u> |
| <u>Liabilities and Owner's Equity</u> |                  |
| Liabilities                           |                  |
| Accounts payable                      | \$ 1,600         |
| Owner's Equity                        |                  |
| M. Doucet, Capital                    | 16,450           |
| Total liabilities and owner's equity  | <u>\$ 18,050</u> |

# ILLUSTRATION 1-10

## FINANCIAL STATEMENTS AND THEIR INTERRELATIONSHIPS

Cash of **\$8,050** on the balance sheet and cash flow statement is shown as the final total of the cash column of the Summary of Transactions (Illustration 1-9 in text).

| SOFTBYTE                                  |                   |                        |
|---|-------------------|------------------------|
| Cash Flow Statement                       |                   |                        |
| For the Month Ended September 30, 2002    |                   |                        |
| Cash flows from operating activities      |                   |                        |
| Cash receipts from customers              | \$ 3,300          |                        |
| Cash payments to suppliers and employees  | <u>(1,950)</u>    | \$ 1,350               |
| Net cash provided by operating activities |                   |                        |
| Cash flows from investing activities      |                   |                        |
| Purchase of equipment                     | <u>\$ (7,000)</u> |                        |
| Net cash used by investing activities     |                   | (7,000)                |
| Cash flows from financing activities      |                   |                        |
| Investments by owner                      | \$ 15,000         |                        |
| Drawings by owner                         | <u>(1,300)</u>    |                        |
| Net cash provided by financing activities |                   | <u>13,700</u>          |
| Net increase in cash                      |                   | \$ 8,050               |
| Cash, September 1                         |                   | <u>-</u>               |
| Cash, September 30                        |                   | <u><u>\$ 8,050</u></u> |

# USING THE INFORMATION IN THE FINANCIAL STATEMENTS



▶ **Annual Reports**

▶ **Non-financial  
information**

▶ **Financial  
information**



# More Questions?

Contact Wayne Lippman @ Lippman & Associates CPA's Inc.

<http://www.waynelippman.com>

[www.linkedin.com/in/waynelippman](http://www.linkedin.com/in/waynelippman)

<http://waynelippman.blogspot.com>

<http://waynelippman.blogspot.com>

<https://www.facebook.com/lippman.associates.CPAs>

<https://plus.google.com/u/0/118159954061832735774>

<https://twitter.com/waynelippman>