



# Introduction to Accounting Elements

## ASSETS

An asset is a present economic resource controlled by the entity as a result of past events that has the potential to produce future economic benefit.

### Examples of Assets

Inventory	<p>Is the goods purchased by a business for the purpose of resale at a marked-up price.</p> <p>So:</p> <ol style="list-style-type: none"><li>1. <i>It is an economic resource controlled by a business</i></li><li>2. <i>It results from a past event – the purchase of it</i></li><li>3. <i>Has the potential to produce future economic benefit – when the business sells the inventory to a customer (they will receive cash from the customer).</i></li></ol>
Accounts Receivable	<p>Are people/other businesses who owe us money because we sold inventory to them on credit.</p> <p>So:</p> <ol style="list-style-type: none"><li>1. <i>It is an economic resource controlled by a business</i></li><li>2. <i>It results from a past event – when we sold them stock on credit</i></li><li>3. <i>Has the potential to produce future economic benefit – when the person/business pays the amount owing there will be a cash inflow.</i></li></ol>

## **LIABILITIES**

A liability is a present obligation of the entity to transfer an economic resource as a result of past events.

### **Examples of Liabilities**

Accounts Payable	Are suppliers who we owe money to because we purchased inventory from them on credit. So: 1. There is a <i>present obligation</i> to pay the supplier the amount owing 2. <i>There will be a transfer of an economic resource</i> – cash paid 3. <i>As a result of past events</i> – when we purchased the inventory

## **OWNER'S EQUITY**

Owner's Equity is the residual interest in the assets of the entity after deducting all its liabilities.

We kind of think of Owner's Equity as being 'what the owner is worth' in the business.

There are only ever three things you will find classified as Owner's Equity:

1. Capital – which is the amount of money (or other assets) the owner puts into the business. Usually this is when they are starting the business, but an owner can contribute more of their personal money/assets at later stages if the business needs it.
2. Net Profit – revenue earned by the business minus the expenses incurred.
3. Drawings – assets the owner takes out of the business for their personal use (usually cash, but can also be other assets).

### Activity 1: School Assets

For the next 5 minutes you should go around the school and identify as many items that you could classify as an asset as possible. **List** them all here.

# Accounting Equation

The assets, liabilities and owner's equity of a business form the ACCOUNTING EQUATION.

The main presentation of the Accounting Equation is:

$$A = L + OE$$

However, this equation can be rearranged to find out the missing values of L and OE if need be.

$$L = A - OE$$

or

$$OE = A - L$$

## Activity 2: Accounting Equation

Using the Accounting Equations above, **complete** the table below for the missing figures.

Assets	Liabilities	Owner's Equity
	\$9,000	\$5,500
\$20,500	\$12,800	
\$600,000		\$250,000
	\$39,302	\$54,104
\$118,000	\$64,000	
\$295,710		\$99,500

## **Balance Sheets (presenting Assets, Liabilities and Owner's Equity)**

The assets, liabilities and owner's equity need to be presented in a formal report. This report is called a **BALANCE SHEET**.

A Balance Sheet shows what the business looks like at a particular point in time.

To prepare a Balance Sheet we need to be able to divide the assets and liabilities further to give more information to the users of the Balance Sheet. As such we divide assets into current assets and non-current assets. We also divide liabilities into current liabilities and non-current liabilities.

<b>Current Assets</b>	Economic resources that are expected to be converted to cash, sold or consumed by a business <b>within the next 12 months.</b>	Examples include cash at bank, inventory and accounts receivable
<b>Non-Current Assets</b>	Economic resources that are expected to be used by the business for a number of years and are not held for resale.	Examples include vehicles, machinery and computers
<b>Current Liabilities</b>	Obligations that are expected to be settled <b>within 12 months.</b>	Examples include accounts payable and the part of a loan owing that is due in the next 12 months
<b>Non-Current Liabilities</b>	Obligations that are not required to be settled within the next 12 months.	Examples include the part of a loan owing that is not due in the next 12 months

**Example:**

The *Vermont Lolly Shop* is owned by Fred Smith.

On **30<sup>th</sup> June 2018** the business had the following economic resources: Cash at Bank \$2000, Inventory of lollies \$9000, Amounts owing by customers (accounts receivable) \$200, Shop fittings \$8000, Lolly machine \$1500.

The business also had the following present obligations: Amounts owing to suppliers (accounts payable) \$3200, Loan from NAB (all due for repayment on 1/7/2020) \$5000.

Using the above information we can prepare a Balance Sheet.

*Vermont Lolly Shop*

*Balance Sheet as at 30 June 2018*

<b><u>Current Assets</u></b>			<b><u>Current Liabilities</u></b>		
Cash at Bank	2 000		Accounts Payable		3 200
Accounts Receivable	200		<b><u>Non-Current Liabilities</u></b>		
Inventory	9 000	11 200	Loan - NAB		5 000
<b><u>Non-Current Assets</u></b>			<b><u>Owner's Equity</u></b>		
Shop fittings	8 000		Capital		12 500
Lolly machine	1 500	9 500			
<b>Total Assets</b>		<b>20 700</b>	<b>Total Equities</b>		<b>20 700</b>

1. At the top of each Balance Sheet you must put:
  - (a) the name of the business (not the owner's name)
  - (b) the title of the report
  - (c) the date that it is prepared
2. The totals of each side of the Balance Sheet **must be equal**.

In this situation we were only given information as to the assets and liabilities of *Vermont Lolly Shop*. To determine the balancing figure, which is the capital amount (under Owner's Equity), the accounting equation is used.

$$\begin{aligned} \text{OE} &= \text{A} - \text{L} \\ \text{OE} &= 20\,700 - 8\,200 \\ \text{OE} &= \mathbf{12\,500} \end{aligned}$$

### Activity 3: Balance Sheets

Sally owns **Knox Milk Bar**. She has provided you with the following list of assets and liabilities as at 30<sup>th</sup> November 2018.

Cash at Bank	\$10,000
Display Cabinets	\$1,800
Milk Fridges	\$2,500
Accounts Payable	\$1,300
Loan - ANZ Bank	\$3,000 (\$500 to be paid by end of year)
Inventory	\$4,000
Accounts Receivable	\$700

- (a) **Classify** the above assets and liabilities into current and non-current.  
(b) Using the accounting equation, **calculate** the owner's equity (capital) figure.

- (c) **Prepare** a classified Balance Sheet as at 30<sup>th</sup> November 2018.



Activity 4: Classification

**Classify** each of the following items as a current asset, non-current asset, current liability, non-current liability or owner's equity.

1. Accounts Payable \_\_\_\_\_
2. Cash on hand \_\_\_\_\_
3. Equipment \_\_\_\_\_
4. Premises \_\_\_\_\_
5. Inventory of supplies \_\_\_\_\_
6. Wages owing to employees \_\_\_\_\_
7. Capital \_\_\_\_\_
8. Accounts Receivable \_\_\_\_\_
9. Mortgage owing on premises \_\_\_\_\_
10. Bank overdraft \_\_\_\_\_
11. Vehicles \_\_\_\_\_
12. Loan due in 9 months \_\_\_\_\_
13. Machinery \_\_\_\_\_
14. Bank \_\_\_\_\_
15. Loan (all due in 5 years) \_\_\_\_\_

*Activity 5: Balance Sheet consolidation*

Noel Season is the owner of *Noel's Plumbing* and has provided the following list of assets and liabilities as at 1 February 2017.

Accounts Payable	\$8,500	Cash at Bank	\$3,000
Inventory of Fittings	\$12,000	Premises	\$90,000
Wages owing	\$400	Loan – NAB (all due Dec 2016)	\$20,000
Tools	\$12,000	Company Vans	\$30,000
Accounts Receivable	\$1,500	Capital	?
Mortgage (due 2027 and repayable \$8,000 per year)	\$80,000		

(a) **Prepare** a Balance Sheet for Noel's Plumbing as at 1<sup>st</sup> February 2017.

(b) Referring to your answer to part 'a', **explain** your treatment of:

<b><i>Inventory of Fittings:</i></b>
<b><i>Loan – NAB:</i></b>

(c) **State** one reason why a Balance Sheet is titled 'as at'


# Balance Sheets (in the real world)

*Business:*

ASSETS	LIABILITIES
	OWNER'S EQUITY

**PROFIT = REVENUES – EXPENSES**

**Revenue:**

**Expenses:**