

## CONCEPT: FUNDAMENTAL ACCOUNTING EQUATION

This equation is the foundation of the financial accounting system:

$$\text{Assets} = \text{Liabilities} + \text{Equity}$$

- **Assets** – Anything tangible or intangible \_\_\_\_\_ by the company
  - *Current Assets* – Cash or any asset convertible to cash in less than \_\_\_\_\_
  - *Long-term (Fixed) Assets* – Assets expected to be used for more than \_\_\_\_\_ (i.e. land or machinery)
- **Liabilities** – Money that the company \_\_\_\_\_ to others
  - *Current Liabilities* – must be paid in under \_\_\_\_\_ (i.e. accounts payable or short-term debt)
  - *Long-term Liabilities* – Payable in over \_\_\_\_\_ (i.e. bonds payable)
- **Equity** has two main components:
  - The money that stockholders paid into the company when the company \_\_\_\_\_ raised capital
  - The \_\_\_\_\_ accumulated and \_\_\_\_\_ over the course of the company's lifespan
    - **Paid-in Capital** – the amount that stockholders have \_\_\_\_\_ in the corporation
    - **Retained Earnings** – income from \_\_\_\_\_ that has not been distributed as dividends
    - **Revenues** – \_\_\_\_\_ of resources (generally cash) from delivering goods or services to customers
    - **Expenses** – \_\_\_\_\_ of resources from receiving goods or services from outsiders
    - **Dividends** – payments to shareholders that are taken from \_\_\_\_\_
      - **DIVIDENDS ARE \_\_\_\_\_ AN EXPENSE!**
    - **Income/Loss** – the net amount of revenue minus expenses will result in income or loss.
      - Income and Profit are synonymous; Revenue is not the same as Income!

**EXAMPLE:** Equity when purchasing a home

The home costs \$150,000 and you make a \$30,000 down payment. The remainder is a mortgage from the bank.	You pay back \$20,000 of the principal on the mortgage.
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**PRACTICE:** A company has assets totaling \$50,000 and equity of \$20,000. What are their liabilities?

- a) \$0
- b) \$20,000
- c) \$30,000
- d) \$70,000

**PRACTICE:** A company has liabilities of \$25,000 and assets of \$35,000. What is the company's equity?

- a) \$10,000
- b) \$20,000
- c) \$30,000
- d) \$60,000

**PRACTICE:** If a company has liabilities of \$65,000 and equity of \$25,000, what are the company's assets worth?

- a) \$25,000
- b) \$40,000
- c) \$60,000
- d) \$90,000