Got to love that accounting equation

A company's financial position indicates the amount of resources that they have, and also the claims against those precious resources at any time. Claims can also be referred as equities. So, a company can be known as a combination of economic resources and equities. Economic Resource=Equities. No mater what type of business your in, every type of company has two different types of equities. They are creditor's equity and owner's equity. In another way Economic Resources= Creditors Equities +Owners Equity. When using accounting language, the economic resources a company has at a particular time is called their assets? On the other hand the amount of creditor's equity a company has is known as their liabilities. So here is the standard equation of accounting or better known as the accounting equation: Assets=Liabilities + Owner's Equity. Similar to an algebraic equation, both sides of the equation has to be equal. This equation comes in handy when analyzing the financial effects of your everyday business activities. Let's talk about a very important concept of any business. Assets are known as the economic resources that a business has that are expected to generate money for them in the future. Some examples are real estate and any other property that a business own so that they can rent out to people. If a business is owed money than it goes into what is known as accounts receivable which are monetary items. However, there are some assets that are not physical. Some examples are copyrights, trademarks, and patents, but they are still extremely valuable to a business. Next, liabilities are the obligations that a business has such as paying cash, provide future services to individuals, or transferring assets to another entity. These are known as the debt of a business or the money that they have to owe in the near future. All of these are recorded in the accounts payable. As I'm sure you know, having a lot of debt is not fun and liabilities/debt are claims that are seen by the law. The law gives creditor (People that money is owed to) the right to push the sale of a company's assets if they don't pay their debt on time. Creditors have a ton of rights over owners and they have to be paid in full even before the owners receive anything. It is very possible for a debt to consume up all a company's resources. Next, owner's equity refers to the claim that owners of a business make in regards to the assets they have. It is the residual interest or the remaining assets of a company after deducting the amount of entity liabilities. Here is the equation for owner's equity. Owner equity=Assets-Liabilities. The owner's equity within a particular corporation is referred as stockholders equity, so the equation then looks like this. Assets=Liabilities +Stockholder's Equity. The stockholders equity has two distinct parts which are the contributed capital and retained earnings. Stockholder's Equity=Contributed Capital + Retained Earnings. The amount than an individual stockholder puts into a business is known as the contributed capital. Contributed capital is usually divided into two separate parts known as par value and "par value" and "additional paid in capital." The retained earnings are the amount of equity that is earned by stockholders from the income generating activities of a business that are kept for future uses by a business. Retained earnings are affected by three types of transactions which are revenues, expenses, and dividends. The increase and decrease in a stock are known as revenues and expenses respectively and these come from operating a business whether online or offline. If you're online than an operating expense that you will have if you have your own website is your domain name and hosting service. Another example is if a customer agrees to pay you in the near future for a service that the company will perform. The money is recorded in the accounts receivable (asset account) which increase the asset value but decrease the stock holder's equity amount which is an example of revenue. However, if a company promises to provide a service in the future than this is known as an expense. When this happens the assets decrease (accounts receivable) and the liabilities (accounts payable) is increased, which makes pretty good sense right? When the revenues exceed the expenses this is known as the net income which is good, and on the other hand when expenses are greater than revenues than this is known as net loss which means that you're losing business or your business costs more to operate than what you make. Dividends are the distribution of assets to stockholders which refer to the past earnings. Do not confuse expenses with dividends, because they both are reducing the retained earnings amount. Retained earnings are the collected net income or revenues minus expenses. The financial statements are the main way for communicating information about a business to those who have some type of interest in it. What helps me is to think of these statements as a type of model for business because they show how a business is doing in financial terms. However, like a variety of methods and models, financial statements are not perfect and have their flaws. There are four main financial statements, and they are income statement, the statement of retained earnings, the balance sheet, and the statement of cash flows. What the income statement does is summarize the revenues earned or the money made, and the expenses or the money that is deducted from a business. Many accountants consider it the most important financial report because it makes it clear whether a business has met its profitability goal. The next one is the statement of retained earnings, and it displays the retained earnings over a period of time. The time that the retained earnings will be zero is when a company first started out in their accounting period. A lot of companies use the statement of stockholder equity as a substitute of retained earnings. This is a more detailed statement because it displays not only the aspects of retained earnings but it also shows the changes in the stockholders equity accounts. Next, the financial situation of a business on a particular date, usually on the end of the month or the year is the balance sheet. The balance sheet displays the value of a business according to their assets and the claims against those assets which are the liabilities and the stockholders equity. Last, the statement of cash flows is geared towards a company's liquidity measures. They are basically the flow and outflow of cash in a company. The net cash flow is the subtraction between the inflow and outflow of money. The statement of cash flows also display the money generated by simply operating a business, and it also displays the investing and financing transactions that occurs during a particular accounting period.

About the Author

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