# Accounting Notes

## Account Types

The main account type categories are:

#### Assets

* Assets are items that have value over an extended period.
  + This value remains over multiple reporting periods.
* Assets include cash, accounts receivable, property and investments.
* The default transaction type is debit.

#### Liabilities

* Liabilities are what an organization owes to someone else.
  + It reports on an organization’s debt.
* Liabilities include payable accounts and mortgages.
* The default transaction type is credit.

#### Owner’s Equity (for a sole proprietorship)

* Owner’s equity is a cumulative account (there is only one is this account category) that shows the total profit or loss an organization has from when the organization first started.
* The calculation of Owner’s Equity is based on more than just the Owner’s Equity (OE) account. The calculation is: OE = OE + Revenues - Expenses.
* The default transaction type is credit.

**Revenues**

* These accounts report on revenue or income coming into the organization for the period.
* The default transaction type is credit.

**Expenses**

* These accounts report on expenses, such as utilities, that an organization incurs during the period.
* The default transaction type is debit.
* The default transaction type is credit.

Revenue and expense accounts are considered temporary accounts because they are cleared out at the end of each reporting period (a month end activity). Taking all revenues for the period and subtracting all expenses for the period leaves the profit (or loss) for that month. This profit (or loss) is then added to the owner’s equity account. The revenue and expense accounts are zeroed out for the next period.

## Accounting Rules

For our course, we will focus on two accounting rules:

1. In every transaction, the debits equal the credits.
   1. This will be validated in Part 2 of Assignment 3.
2. The accounting equation: Assets (A) = Liabilities (L) + Owner’s Equity (OE)
   1. Understanding this equation will help you understand why we are processing transactions the way we are in Assignment 3.
   2. You will **not** need to validate this rule in any assignment.

When creating a transaction for an accounting activity (e.g., paying Shaw for internet services), you’ll use the double entry accounting method, meaning that every transaction has at least one debit and one credit (although there can be more of each).

This keeps the first rule correct: In every transaction, the debits equal the credits.

The second rule ensures every transaction keeps the accounting equation true: Assets (A) = Liabilities(L) + Owner’s Equity (OE).

Owner’s Equity can be expressed in the equation:

* OE = OE + Revenues (RE) – Expenses (EX)

For a double entry accounting system, the terms “debit” and “credit” need to be defined. Traditionally, a debit means subtraction and a credit means an addition. But this isn’t the whole story.

* Each account type is given a default transaction type (either debit or credit); it is the default that indicates whether a debit is an addition or subtraction.
* For example, assets have a default transaction type of debit. This means that:
  + To increase an asset value, the asset would have a debit in a transaction
  + To decrease an asset value, the asset would have a credit in a transaction

Using the example of the Shaw internet expense, the transaction for this activity is as follows **if you pay the bill right away**:

Dr: Internet Expense 60.00

Cr: Cash 60.00

Pay Shaw for internet access.

This means that the expense account’s value increases, and cash (asset account) decreases (debits equal credits). The accounting equation remains balanced (A = L + OE) because assets are decreased, and owner’s equity is decreased as well because the expenses increase   
(OE = OE + RE - EX).