ELEMENTS OF FINANCIAL STATEMENTS

Types of Major Accounts/Element

An account is the basic storage of information in accounting. It is a record of the increases and decreases in a specific item of asset, liability, equity, income or expense. An account may be depicted though a "T-account".

The Five Major Accounts/ Elements of Financial Statements

1. Assets- the resources you control that have resulted from past events and can provide you with future economic benefits, which may include: (a) Sold or exchanged for other assets; (b) Use singly or in combination with other assets to produce goods for sale; (c) Used to settle a liability; (d) distributed.

2. Liabilities- are your present obligations that have resulted from past events can require you to give up resources when settling them.

3. (Owner's) Equity/net assets/ Capital- assets minus liabilities.

4. Income- are increases in economic benefits during the period in the form of inflows or enhancements of assets or decreases of liabilities that result in decrease in equity, other than those relating to investments by the business owners. Income includes both revenue and gains.

a) Revenue arises in the course of ordinary activities of a business and is referred to by a variety of different names including sales, fees, interest, dividends, royalties, and rent.

b) Gains represent other items that meet the definition of income and may or may not rise in the course of the ordinary activities of an economic entity.

Example:

Your business is selling barbeque. The income you derive from selling barbeque is called revenue because selling barbeque is your main business (ordinary business activity).

One day, you decided to replace your old beach umbrella. The umbrella has a carrying amount/ book value of ₱2,000 in the accounting books. You were able to sell the old umbrella for ₱2,200.

The difference between the selling price of ₱2,200 and the book value represents gain. This is because selling of umbrella is your main business (not your ordinary business activity).

*Any second-hand assets parted with or received should be recorded using the book value not the fair value.

5. Expenses- are decrease in economic benefits during the period in the form of outflows or depletions of assets or increases of liabilities that result in decreases in equity, other than those relating to distributions to the business owners.

Expenses include both expenses and losses.

a) Expenses arise in the course of ordinary activities of a business.
b) Losses represent other items that meet the definition of expenses and may, or may not, arise in the course of the ordinary activities of the entity.

Example:

In your barbeque business, the cost of the barbeque you have sold (cost of goods sold) is an expense.

If you were able to sell the old umbrella carrying amount of ₱2,000 for ₱1,600, the difference now of ₱400 represents a loss.

CLASSIFICATION OF THE FIVE MAJOR ACCOUNTS
The five major accounts are classified according to the financial statement where they appear as follows:

BALANCE SHEET ACCOUNTS	**INCOME STATEMENT ACCOUNTS**
Assets	Income
Liabilities	Expenses
Equity	

COMMON ACCOUNT TITLES
The following are the common account titles and their descriptions:

BALANCE SHEET ACCOUNTS

ASSETS
• Cash- includes money or its equivalent that is readily available for unrestricted use, e.g., cash on hand and cash in bank.
• Accounts receivable- receivables supported by oral or informal promises to pay.
• Allowance for bad debts- the aggregate of estimated losses from uncollectible accounts receivable. Another term is “allowance for doubtful accounts”
• Notes Receivables- receivables supported b written or formal promises to pay in the form of promissory notes.
• Inventory- represents the goods that are held for sale by a business. For manufacturing business, inventory also includes goods undergoing the process of production and raw materials that will be consumed in the production process.

• Prepaid supplies- represent the cost of unused office and other supplies.
• Prepaid rent- rent paid in advance
• Prepaid insurance- cost of insurance paid in advance.
• Land- the lot which the building of the business has been constructed or a vacant lot which is to be used as future plant site. Land is not depreciable.
• Building- the structure owned by a business for use on its operations.
• Accumulated depreciation-building- the total amount of depreciation expenses recognized since the building was acquired and made available for use.
• Equipment- consist of various assets such as:
a) Machineries and other factory equipment
b) Transportation equipment
c) Office Equipment
d) Computer equipment
e) Furniture and fixtures
• Accumulated depreciation-equipment- the total amount of depreciation expenses recognized since the equipment since the equipment was acquired and made available for use.

*Collectively, land, building, and equipment are referred to as "Property, Plant, and Equipment" or "Capital Assets", "Fixed Assets".

LIABILITIES
• Accounts Payable- obligations supported by oral or informal promises to pay by the debtor.
• Notes Payable- obligations supported by written or formal promises to pay by the debtor in form of promissory notes.
• Interest Payable- interest incurred but not yet paid. Interest payable arises from interestbearing liabilities. For example, you will incur interest on our bank loan.
• Salaries Payable- salaries already earned by employees but not yet paid by the business.
• Utilities payable- utilities (electricity, water, telephone, internet, cable TV, etc.) already used but not yet paid.
• Unearned income- items related to income that were collected in advance before they are earned. After the earning process is completed, these items are transferred to income.
*The word "receivable" connotes an asset while the word "payable" connotes a liability.
*The word "prepaid" connotes an asset while the word "unearned" connotes a liability.
EQUITY (Capital, Net Assets or Net worth)
• Owner's Capital (or Owner's Equity)- the residual amount after deducting liabilities from assets.
• Owner's Drawings- this account is used to record the temporary withdrawals of the owner during the period. At the end of the accounting period, any balance in this account is closed to the "Owner's capital account"

INCOME STATEMENT ACCOUNTS

INCOME
• Service fees- revenues earned from rendering services
• Sales- revenues earned from the sale of goods
• Interest income- revenues earned from the issuance of interest-bearing receivables.
• Gains- income earned from the sale of assets (except inventory) or from enhancements of assets or decreases in liabilities that are not classified as revenue.
EXPENSES
• Cost of sales (Cost of goods sold)- represents the value of inventories that have been sold during the accounting period.
• Freight-out- represents the seller's costs of delivering goods to customers. Other terms for freight-out are "delivery expense", "transportation-out", and "carriage outwards"
• Salaries expense- represents the salaries earned by employees for the services they have rendered during the accounting period.
• Rent Expense- represents rentals that have been used up during the accounting period.
• Utilities Expense- represents the cost of utilities that have been used during the accounting period.
• Supplies expense- represents the cost of supplies that have been used during the period.
• Bad debts expense- the amount of estimated losses from uncollectible receivables during the period. Other term is "doubtful accounts payable."
• Depreciation expense- the cost of depreciable asset that has been allocated to the current accounting period.
Formula: (Purchase price-Salvage value) / useful life
*Other formulas will be discussed under the topic "Adjusting Entries"
• Advertising expense- represents the cost of promotional or marketing activities during the period.
• Insurance expense- represents the cost of insurance pertaining to the current accounting period.
• Taxes and Licenses- represent the cost of business and local taxes required but the government for the conduct of business.
• Transportation and travel expense- represent the necessary and ordinary cost of employees getting from one workplace to another which is reimbursable by the business.
• Interest Expense- represents the cost of borrowing money. It is the price that a lender charges a borrower for the use of lender's money.
• Miscellaneous expense- represents various small expenditures which do not warrant separate presentation.
• Losses- expenses which may or may not arise from the ordinary course of business activities.
*"earned" relates to income while "incurred" relates to expenses.
*"unused" portion of a cost is an asset while "used" portion is an expense.