**Assets, Liabilities & Equity:**

There are three types of things or categories in accounting:

Assets - this is something you own. Your life is filled with assets, from your car to your comb, everything you have is an asset. And if someone owes you money that is an asset too.

Liability - this is what you owe, and like assets, your life is still filled with liabilities. Your credit card, rent, or mortgage payment, car insurance, etc.

Equity - This is the value of your car, comb, clothes, et al, all added together, and then you subtract the total of what you owe.

Accountants, like lawyers, electricians or any profession want what they do to seem specialized, so they clutter it up with special words, and try to put things in strange relationships.

As an example accountants like this formula

\[ \text{Assets} = \text{Liabilities} + \text{Equity} \]

But everyday people are more apt to put it this way

\[ \text{Equity} = \text{Assets} - \text{Liabilities} \]

It just makes more sense to everyday people to say... what I am worth (Equity) is what I have (Assets) minus what I owe (Liabilities).

The reason, well one reason, accountants put it the other way is that it balances. The total of assets shown on one side of the equals sign, does equal the total of what you owe and what you are worth. That is where the financial document, the Balance Sheet, comes from. It is a listing of what the business owns and owes and what the business is worth.

Another reason accountants like the first equation is what I like to call business thinking. Even if you are a sole-proprietor you need to think of the business as being separate from yourself. The business buys things, the business sells things, the business owes money.

So if you can think of it this way the first equation makes more sense. Equity, your ownership share of the business, is what the business owes you. If the business owes you, then Equity is a liability to the business.

So now it should make a little more sense when you use business thinking.

The business owns things (Assets) and the business owes money for credit cards and other debt (Liabilities), and the business owns or owes what is left (Equity).

Don’t just skim this concept. It is critical in understanding business accounting.
To re-state the problem: The business wants to buy a desk for $500.00 as before but, it wants to pay $100.00 in cash, and charge the balance due equally between two different credit cards.

If you got it, good for you, take a break and go have the adult beverage of your choice.

If not then let’s look at the process I use:

1. I know furniture will debit (increase) by 500.00 (the value of the desk). An increase of an asset value is always a debit which means everything else has to be a credit.
2. I know cash will go down (credit) by the 100.00 down payment.
3. I know I will owe (credit) a total of 400.00 split between two credit cards

And to double check remember that all debits for the transaction has to equal the total of all credits for the Transaction.

Ok now let’s check the balance sheet.

Before the purchase:
Assets (3,000) = Liabilities (0) + Equity (3,000)

After the purchase:
Assets (3,400) = Liabilities (400) + Equity (3,000)

Where:
Assets = Cash (2,900) + Furniture (500) = 3,400
Liabilities = Credit card 1 (200) + credit card 2 (200) = 400

And do it like normal folks if it makes it easier to understand, assets - liabilities = Equity
3,400 - 400 = 3,000

So at this point we know that assets normally carry a debit balance and liabilities carry a credit balance. Pretty easy at this point.
Buying & Selling Retail Inventory:

So when we buy a widget with the intent of reselling it, we stock it as inventory.

In the journal I show from this point on, when I show an account as Inv:widget, that means the asset account Inventory and the sub-account widget. The Colon (:) signifies that widget is a sub-account.

<table>
<thead>
<tr>
<th>Date</th>
<th>Account</th>
<th>Debit</th>
<th>Credit</th>
<th>Memo</th>
</tr>
</thead>
<tbody>
<tr>
<td>Jan 10</td>
<td>Inv:widget</td>
<td>200.00</td>
<td></td>
<td>Buy 200 @ 2</td>
</tr>
<tr>
<td></td>
<td>Credit Card #1</td>
<td></td>
<td>200.00</td>
<td></td>
</tr>
</tbody>
</table>

Buying the widget increased the asset value of inventory and because widget is a sub-account the cost per widget is easily calculated.

And now let’s sell 50 widgets for $4.95 each (a cash transaction).

<table>
<thead>
<tr>
<th>Date</th>
<th>Account</th>
<th>Debit</th>
<th>Credit</th>
<th>Memo</th>
</tr>
</thead>
<tbody>
<tr>
<td>Jan 22</td>
<td>Checking</td>
<td>247.50</td>
<td></td>
<td>Sell 50 widgets</td>
</tr>
<tr>
<td></td>
<td>Sales</td>
<td></td>
<td>247.50</td>
<td></td>
</tr>
<tr>
<td></td>
<td>COGS</td>
<td>100.00</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Inv:widget</td>
<td>100.00</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Let’s walk through this journal entry:

Line one shows we received cash and it was deposited to the checking account in the amount of $247.50.

Line two shows the sales amount was credited to the Sales income account.

Line three shows we sent the COST of 50 widgets to the COGS expense account (50 * $2 ea).

Line four shows we took the COST of 50 widgets out of the asset account Inv:widget.

I’ve repeated the memo on the inv:widget line for a reason. When I run a report on widgets it will show the buy of 100 and the sell of 50, and the memo next to the transaction will make it plain to me what happened.

If you want you can repeat the memo line on each line of the journal it makes no difference.

Now if we look at the P&L for just this entry it will look something like this:

Income:

Sales     $247.50   [remember this is a credit]

Expenses:

COGS    $100.00    [remember this is a debit]

Net Profit (Loss)    $147.50    [a credit if a profit, a debit shown in () if a loss]