**Step 1**

Slide 1: In tis presentation we will look at the first step of the accounting cycle which is analyzing transactions

Slide 2: Here’s a review of the nine steps (Read)

Slide 3: In this step, we want to figure out how many accounts are involved, we want to know whether these accounts are Assets, Liabilities, Owners’ Equity, Revenue or Expense Accounts, and we want to determine whether these accounts are increasing or decreasing.

Slide 4: Here are a few common transactions businesses would likely encounter.

Slide 5: (Read)

Slide 6: (Read)

Slide 7: In the last two slides, we dealt with Balance Sheet accounts (cash, stock, prepaid insurance). Before we continue, we need to see how revenue and expense accounts – from the Income Statement – affect the Accounting Equation. Net Income affects Retained Earnings, and as we saw in the Introduction, Retained earnings affect Owners’ Equity.

Slide 8: Here we have two scenarios – one where Revenue increases and one where Expense increase. We can see in Scenario 1 that an increase in Revenue of $1,000, increases Net Income by 1,000. This in turn increases, by itself, Retained Earnings and ultimately owners’ Equity by 1,000. Conversely, if we have only expenses of 1,000, Net Income is decreased by 1,000, which by itself decreases Retained Earnings and owners’ Equity by 1,000. Let’s go to transaction C and apply some of what we just learned.

Slide 9: (Read)

Slide 10: (Read)

Slide 11: (Read)

Slide 12: (Read)

Slide 13: (Read)

Slide 14: (Read)

Slide 15: (Read)

Slide 16: (Read)

Slide 17: (Read)

Slide 18: (Read)

Slide 19: Here we have a spreadsheet summarizing all the transactions. If you wish, you can print out a spreadsheet blank and practice yourself. In the accompanying area, there is also a larger version of this completed spreadsheet to review and/or check your work.

Slide 20: Here, we use the preceding spreadsheet to prepare the financial statements. We prepare the Income Statement first by subtracting the expenses from revenue in order to arrive at net Income. Since we have an excess of revenues over expenses, we have positive Net Income or a profit.

Now that we have Net Income, we can prepare the second statement, the statement of retained earnings. Using the same formula we saw on slide 7, we can complete the statement. Since this business just began in transaction A, there are no beginning retained earnings. We add the net income and subtract the 1,000 in dividends to arrive at 6,400 in Retained Earnings. Companies have the choice of distributing Net Income to the owners of the business or keeping – retaining – some of that net income. What we have here is the likely case where some is retained and some is distributed.

We prepare the Balance Sheet next, now that we have Retained Earnings. We are listing Assets on the left side of the statement and Liabilities and Equity on the right hand side. We can see – as we would expect – that the two sides are in balance.

The fourth statement – cash flow statement – will be covered in a later presentation.

Slide 21: While this spreadsheet is an acceptable way to keep records, you could imagine it would be cumbersome with more accounts and transactions. Can you imagine the size of spreadsheet Amazon would need with millions of items and millions of transactions each day!?!

Next time, we will learn in Step 2 how to use debits and credits to aid us in our Recording phase of the accounting process.