Introduction to Business Accounting

Chapter 4 - Analyzing Transactions

WORKBOOK

Slide 1

The Accounting Equation & Transactions

Recall the Accounting Equation:

Assets	=	Liabilities	+	Owner Equity
Cash + Accounts Receivable + Equipment	=	Accounts Payable	+	R. Neal, Capital

Let's start a business!!

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Slide 2

The Accounting Equation & Transactions

At the start of R. Neal's Plumbing business, he makes a $15,000 investment in his business. Let's see how that is recorded on the accounting equation.

Assets			=	Liabilities +	Owner Equity
	Accounts			Accounts	R. Neal,
Cash +	Receivable +	Equipment	=	Payable +	Capital
+$15,000					+$15,000 Investment

Notice that Assets now total $15,000 which still balances with total Liabilities and Equity of $15,000.

Slide 3

The Accounting Equation & Transactions

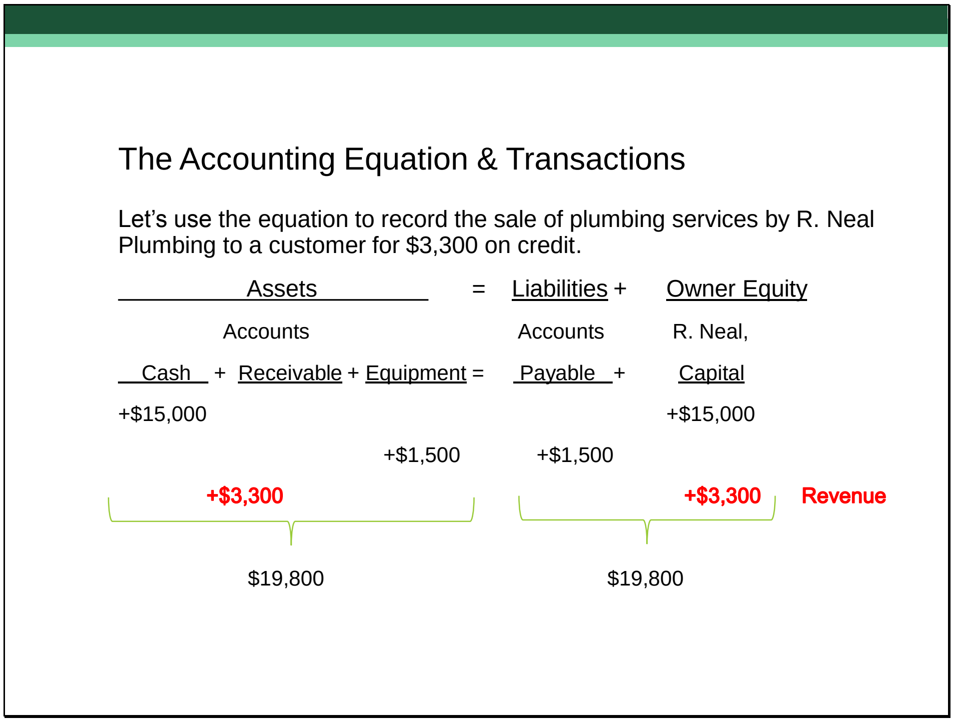
Now let's use the equation to record his purchase of equipment on credit for $1,500.

Assets			=	Liabilities +	Owner Equity
Cash +	Accounts Receivable +	Equipment	=	Accounts Payable +	R. Neal, Capital
+$15,000					+$15,000
		+$1,500		**+$1,500**	

Purchase

$$\underbrace{\text{Assets}}_{\$16,500} = \underbrace{\text{Liabilities + Owner Equity}}_{\$16,500}$$

Slide 4


The Accounting Equation & Transactions
Let's use the equation to record the sale of plumbing services by R. Neal Plumbing to a customer for $3,300 on credit.
Assets = Liabilities + Owner Equity
Accounts
Accounts
R. Neal,
Cash + Receivable + Equipment = Payable + Capital
+$15,000
+$15,000
+$1,500
+$1,500
+$3,300
+$3,300
Revenue
$19,800
$19,800

Slide 5

The Accounting Equation & Transactions

Now let's record the receipt of cash from the customer and the payment by Mr. Neal for his equipment 30 days later.

Assets			=	Liabilities	+	Owner Equity	
Cash	+ Accounts Receivable	+ Equipment	=	Accounts Payable	+	R. Neal, Capital	
+$15,000						+$15,000	
		+$1,500		+$1,500			
	+$3,300					+$3,300	
+$3,300	**-$3,300**						**Collect**
-$1,500				**-$1,500**			**Payment**
$16,800	$0	$1,500		$0		$18,300	

$\underbrace{\text{Assets}}_{\$18,300}$ $\qquad$ $\underbrace{\text{Liabilities + Owner Equity}}_{\$18,300}$

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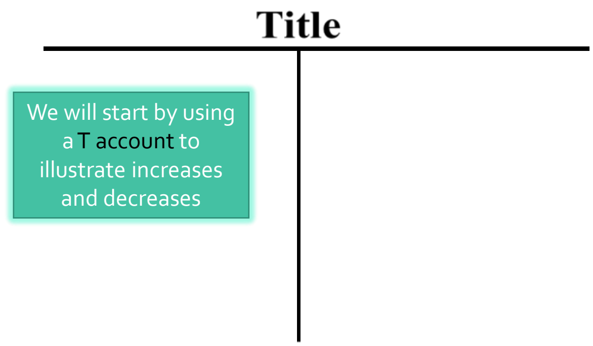
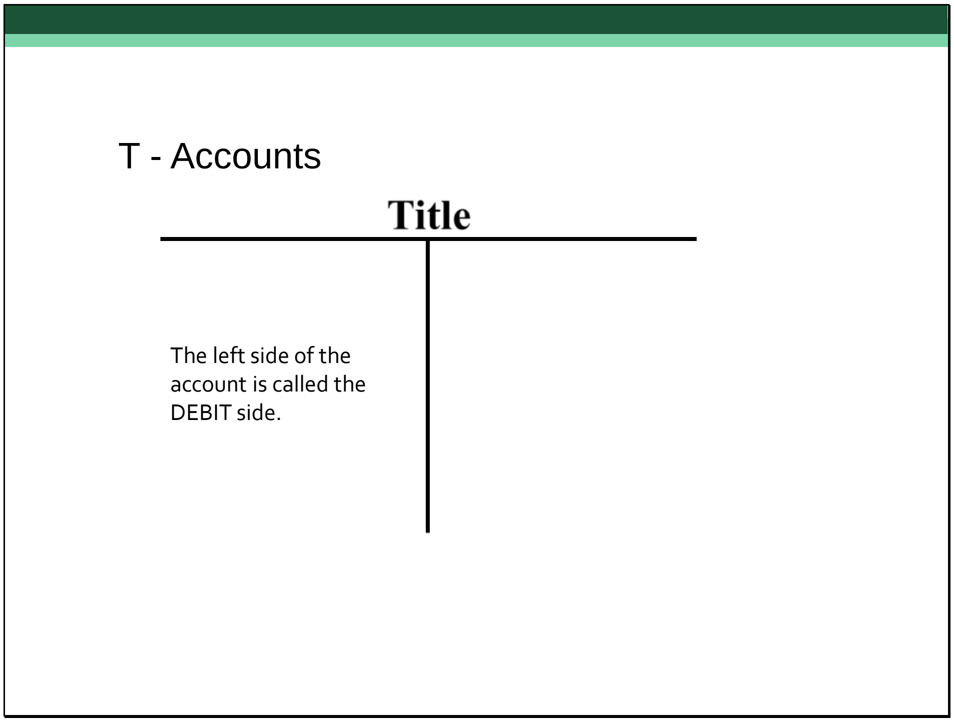
Accounts

In reality, we don't use the accounting equation to record transactions. Instead, we use accounts.

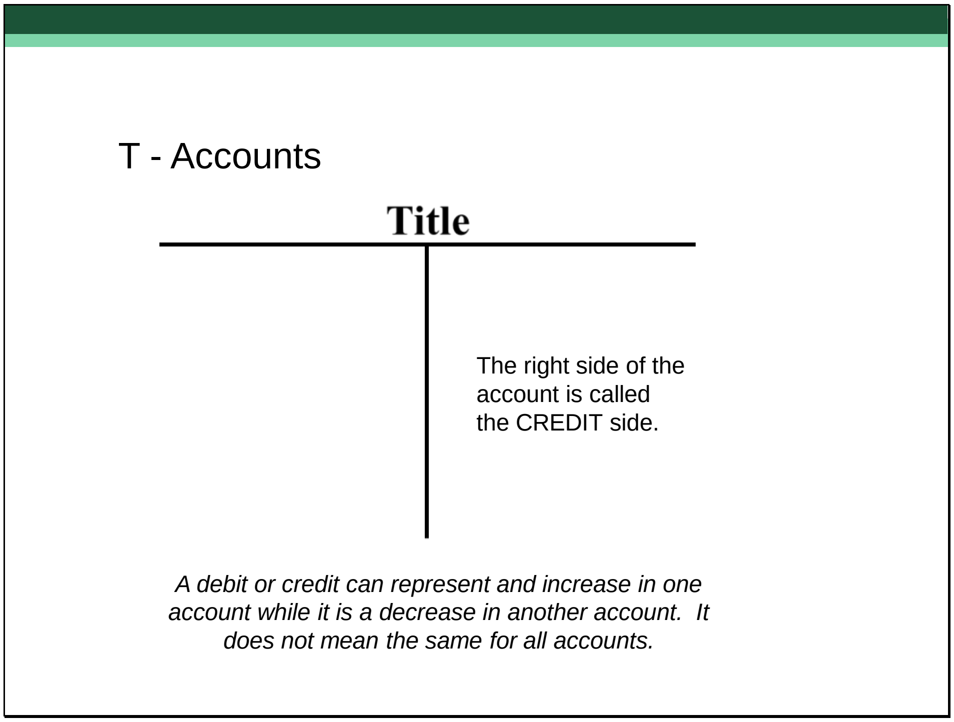
- An account is a separate record that shows the increases and decreases in each category of asset, liability, equity, revenue and expense.



Slide 7


T - Accounts
Title
The left side of the account is called the DEBIT side.

Slide 8


T - Accounts
Title
The right side of the account is called the CREDIT side.
A debit or credit can represent and increase in one account while it is a decrease in another account. It does not mean the same for all accounts.

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Ledgers and Accounts

The General Ledger is a group of accounts used by a business entity.

The Chart of Accounts is a list of all the accounts in the ledger

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Chart of Accounts

XYZ Chart of Accounts	
Balance Sheet Accounts	Income Statement Accounts
Assets	Revenue
10 Cash	70 Fees Earned
12 Accounts Receivable	72 Rent Revenue
14 Office Supplies	Expenses
16 Prepaid Insurance	80 Wages Expense
18 Buildings	82 Rent Expense
19 Accumulated Depreciation - Buildings	84 Depreciation Expense
20 Office Equipment	86 Utilities Expense
Liabilities	88 Office Supplies Expense
40 Accounts Payable	80 Insurance Expense
42 Wages Payable	82 Miscellaneous Expense
44 Unearned Rent	
Stockholders' (Owner's) Equity	
60 Capital Stock	
62 Retained Earnings	
64 Dividends	

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Types of Accounts

Tangible Assets

- Cash
- Accounts receivable
- Buildings, land & Equipment
- Supplies & inventory
- Furniture & Fixtures
- Investments

Intangible assets are a form of asset that is represented only on paper. You cannot touch it.

- Copyrights
- Trademarks
- Patents

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Types of Accounts

Short Term Liabilities are owed to a creditor in less than one year time.

- Accounts payable
- Wages payable
- Rent payable
- Taxes payable
- Current portion of Long Term Debt

Long Term Liabilities are owed to a creditor in greater than one year time.

- Bonds payable – money owed to bond holders
- Loans payable – money owed to banks
- Unearned rent – money prepaid by renters for future month's rent

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Types of Accounts

Stockholders' (owner's) Equity is the stockholders' (owner's) right to the assets after all liabilities have been paid. Also called net assets. It is made up of investments and retained earnings less any withdrawals or dividends.

Retained Earnings is the account where all previous net income or loss is recorded at the end of each year.

Dividends (draw) are the distributions of earnings to stockholders (owner's).

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Types of Accounts

Revenues are the increase to stockholders' (owner's) equity as a result of selling services or products to customers.

- Fees earned
- Commissions earned
- Rent earned
- Sales
- Interest earned

Expenses

- Utility expense
- Rent expense
- Interest expense
- Supplies expense
- Repair and maintenance
- Salary expense
- Depreciation

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Double-Entry System

All accounting systems use a system known as double-entry accounting which is based on the accounting equation.

This system requires:

- Every business transaction to be recorded in at least two accounts
- The total debits and total credits must be equal for each transaction

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Transactions – Double-Entry System

Balance Sheet – Debit and Credit Rules

Balance Sheet Accounts							
ASSETS Asset Accounts		=	LIABILITIES Liability Accounts		+	STOCKHOLDERS' EQUITY Stockholders' Equity Account	
Debit increases (+)	Credit decreases (-)		Debit decreases (-)	Credit increases (+)		Debit decreases (-)	Credit increases (+)

Note that an asset account increases with a debit whereas a liability and equity account increase with a credit.

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Transactions – Double-Entry System

Income Statement – Debit and Credit Rules

(based on relationship with stockholders' [owner's] equity)

Income Statement Accounts				
Revenue Accounts			Expense Accounts	
Debit decreases (-)	Credit increases (+)		Debit increases (+)	Credit decreases (-)

All Revenue accounts increases with a credit whereas all expense accounts increase with a credit.

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Transactions – Double-Entry System

Dividends – Debit and Credit Rules

(based on effect on stockholders' [owner's] equity)

Dividends	
Debit increases (+)	Credit decreases (-)

Because dividends reduce owner's equity, they increase with a debit and decrease with a credit.

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Transactions – Normal Balances

A Normal Balance refers to whether an account normally has a debit balance or a credit balance. The normal balance should always be based on what increases an account.

Illustration using a T account:

	Cash	
Beginning Balance	$10,000	
	4,000	$2,500
	1,000	750
	$15,000	$3,250
Ending Balance	$11,750	

Since cash is an asset, it's normal balance is a debit

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Knowledge Check

What is the normal balance of ….

An asset account?

An expense account?

A revenue account?

A liability account?

An equity account?

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Knowledge Check

What is the normal balance of ….

An asset account? Debit

An expense account? Debit

A revenue account? Credit

A liability account? Credit

An equity account? Credit

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Transactions – Normal Balance

Balance Sheet

Balance Sheet Accounts							
ASSETS Asset Accounts		=	LIABILITIES Liability Accounts		+	STOCKHOLDERS' EQUITY Stockholders' Equity Account	
Debit increases (+)	Credit decreases (-)		Debit decreases (-)	Credit increases (+)		Debit decreases (-)	Credit increases (+)
BALANCE				BALANCE			BALANCE

The **BALANCE** indicates the Normal Balance for the account.

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Transactions – Normal Balance

Income Statement

Income Statement Accounts					
Revenue Accounts			Expense Accounts	
Debit decreases (-)	Credit increases (+)		Debit increases (+)	Credit decreases (-)
	BALANCE		BALANCE	

The **BALANCE** indicates the Normal Balance for the account.

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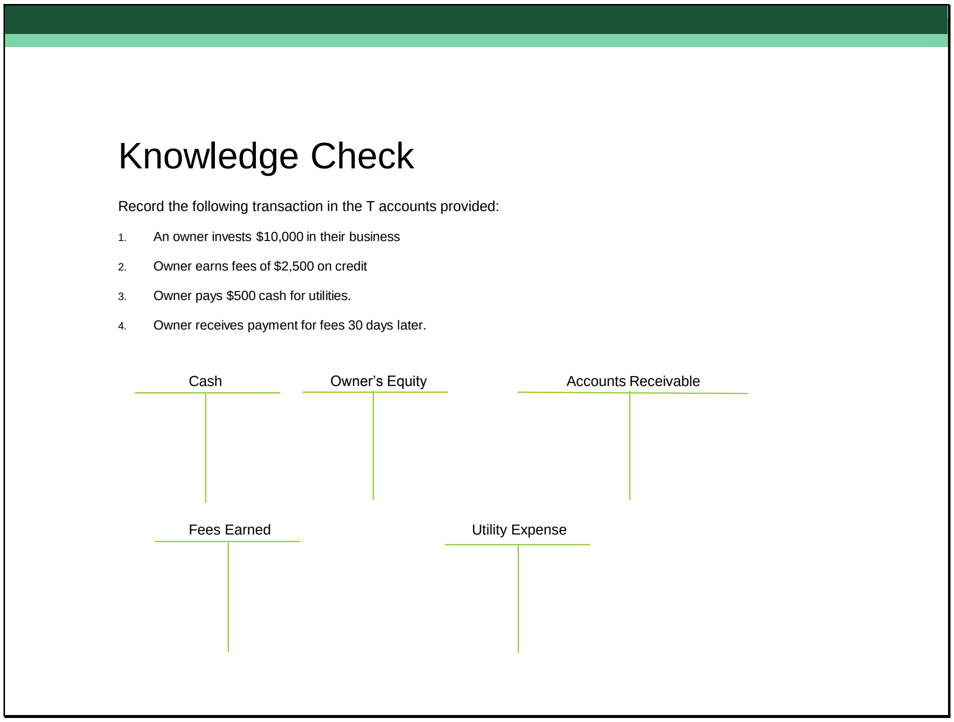
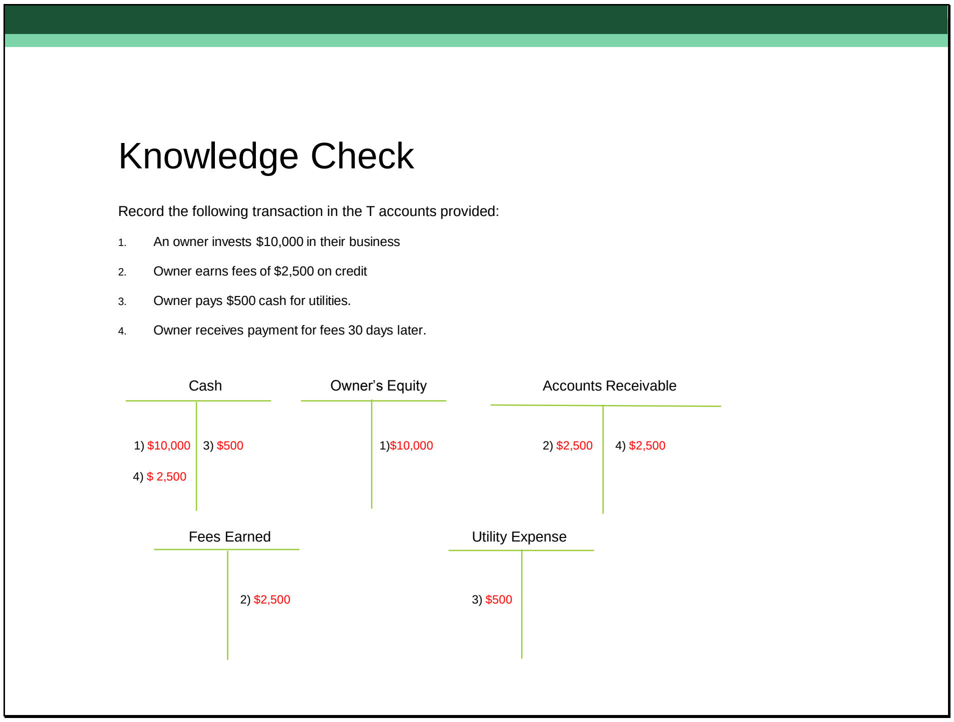

Knowledge Check
Record the following transaction in the T accounts provided:
1. An owner invests $10,000 in their business
2. Owner earns fees of $2,500 on credit
3. Owner pays $500 cash for utilities.
4. Owner receives payment for fees 30 days later.
Cash
Owner's Equity
Accounts Receivable
Fees Earned
Utility Expense

Slide 25


Knowledge Check
Record the following transaction in the T accounts provided:
1. An owner invests $10,000 in their business
2. Owner earns fees of $2,500 on credit
3. Owner pays $500 cash for utilities.
4. Owner receives payment for fees 30 days later.
Cash
1) $10,000
3) $500
4) $ 2,500
Owner's Equity
1)$10,000
Accounts Receivable
2) $2,500
4) $2,500
Fees Earned
2) $2,500
Utility Expense
3) $500

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Journalizing Transactions

A Journal is a log in which every transaction is initially entered.

Journalizing is the process of recording a transaction in a journal.

A Journal Entry is the entry that is placed in a journal for each transaction.

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Transactions – Journalizing

The following transaction will be used to illustrate the process of Journalizing.

An owner borrows $50,000 from a bank and then uses $30,000 to buy equipment.

General Journal GJ1

Date	Account Title and Description	Ref.	Debit	Credit
20X1				
Aug. 1	Cash		50,000	
	Notes Payable			50,000
	Borrowed $50,000			
3	Equipment		30,000	
	Cash			30,000
	Purchased equipment			

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Transactions – Journalizing

Transaction A: XYZ paid $20,000 cash for building purchase on March 15.

Step 1 – the date of the transaction is entered into the Date column

XYZ Journal – Page 5					
Date		Description	Post. Ref.	Debit	Credit
Step	1				

XYZ Journal – Page 5					
Date		Description	Post. Ref.	Debit	Credit
March	15				

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Transactions – Journalizing

Step 2 – The title of the account to be debited is recorded at the left-hand margin under the Description column and the amount to be debited is entered in the Debit column.

XYZ Journal – Page 5					
Date		Description	Post. Ref.	Debit	Credit
		Step 2		Step 2	

XYZ Journal – Page 5					
Date		Description	Post. Ref.	Debit	Credit
March	15	Buildings		20,000	

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Transactions – Journalizing

Step 3 – The title of the account to be credited is listed below and to the right of the debited account title, and the amount to be credited is entered in the Credit column.

XYZ Journal – Page 5					
Date		Description	Post. Ref.	Debit	Credit
		Step 3			Step 3

XYZ Journal – Page 5					
Date		Description	Post. Ref.	Debit	Credit
March	15	Buildings Cash		20,000	 20,000

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Transactions – Journalizing

Step 4 – A brief description should be entered below the credited account.

XYZ Journal – Page 5					
Date		Description	Post. Ref.	Debit	Credit
		Step 4			

XYZ Journal – Page 5					
Date		Description	Post. Ref.	Debit	Credit
March	15	Buildings Cash Purchased storage garage.		20,000	 20,000

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Transactions – Journalizing

Step 5 – The Post. Ref. (Posting Reference) column is left blank when the journal entry is initially recorded. This column is used later when the journal entry amounts are transferred to the accounts in the ledger.

XYZ Journal – Page 5					
Date		Description	Post. Ref.	Debit	Credit
			Step 5		

XYZ Journal – Page 5					
Date		Description	Post. Ref.	Debit	Credit
March	15	Buildings Cash Purchased storage garage.	18 10	20,000	 30,000

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Affect of Journals on the Accounts

Accounting System Impact
(of the above transaction)

Assets		=	Liabilities	+	Owner's Equity	
Buildings						
March 15 20,000						
Cash						
	March 15 20,000					

The account BUILDINGS has an increase
And
The account CASH has a decrease By an EQUAL amount

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Transactions – Journalizing

Transaction B: On March 17, XYZ received payment for services performed in the amount of $10,000.

- Step 1 – the date of the transaction is entered into the Date column

XYZ Journal – Page 6					
Date		Description	Post. Ref.	Debit	Credit
Step	1				

XYZ Journal – Page 6					
Date		Description	Post. Ref.	Debit	Credit
March	17				

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Transactions – Journalizing

Step 2 – The title of the account to be debited is recorded at the left-hand margin under the Description column and the amount to be debited is entered in the Debit column.

XYZ Journal – Page 6					
Date		Description	Post. Ref.	Debit	Credit
		Step 2		Step 2	

XYZ Journal – Page 6					
Date		Description	Post. Ref.	Debit	Credit
March	17	Cash		10,000	

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Transactions – Journalizing

Step 3 – The title of the account to be credited is listed below and to the right of the debited account title, and the amount to be credited is entered in the Credit column.

XYZ Journal – Page 6					
Date		Description	Post. Ref.	Debit	Credit
		Step 3			Step 3

XYZ Journal – Page 6					
Date		Description	Post. Ref.	Debit	Credit
March	17	Cash Fees Earned		10,000	 10,000

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Transactions – Journalizing

Step 4 – A brief description must be entered below the credited account.

XYZ Journal – Page 6					
Date		Description	Post. Ref.	Debit	Credit
		Step 4			

XYZ Journal – Page 6					
Date		Description	Post. Ref.	Debit	Credit
March	17	Cash Fees Earned Received fees from client.		10,000	 10,000

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Transactions – Journalizing

Step 5 – The Post. Ref. (Posting Reference) column is left blank when the journal entry is initially recorded. This column is used later when the journal entry amounts are transferred to the accounts in the ledger.

XYZ Journal – Page 6					
Date		Description	Post. Ref.	Debit	Credit
			Step 5		

XYZ Journal – Page 6					
Date		Description	Post. Ref.	Debit	Credit
March	17	Cash Fees Earned Received fees from client.	10 70	10,000	 10,000

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Transactions – Journalizing

Accounting System Impact
(of the above transaction)

Assets		=	Liabilities	+	Owner's Equity	
Cash					Fees Earned	
March 17 10,000						March 17 10,000

The account CASH has an increase
And
The account FEES EARNED has an increase
By an EQUAL amount

Slide 40

Transactions – Journalizing

Transaction C: On March 21, XYZ ordered and received office supplies of $500 which will be paid for in 30 days.

Step 1 – the date of the transaction is entered into the Date column

XYZ Journal – Page 10					
Date		Description	Post. Ref.	Debit	Credit
Step	1				

XYZ Journal – Page 10					
Date		Description	Post. Ref.	Debit	Credit
March	21				

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Transactions – Journalizing

Step 2 – The title of the account to be debited is recorded at the left-hand margin under the Description column and the amount to be debited is entered in the Debit column.

XYZ Journal – Page 10					
Date		Description	Post. Ref.	Debit	Credit
		Step 2		Step 2	

XYZ Journal – Page 10					
Date		Description	Post. Ref.	Debit	Credit
March	21	Office Supplies		500	

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Transactions – Journalizing

Step 3 – The title of the account to be credited is listed below and to the right of the debited account title, and the amount to be credited is entered in the Credit column.

XYZ Journal – Page 10					
Date		Description	Post. Ref.	Debit	Credit
		Step 3			Step 3

XYZ Journal – Page 10					
Date		Description	Post. Ref.	Debit	Credit
March	21	Office Supplies Accounts Payable		500	 500

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Transactions – Journalizing

Step 4 – A brief description must be entered below the credited account.

XYZ Journal – Page 10					
Date		Description	Post. Ref.	Debit	Credit
		Step 4			

XYZ Journal – Page 10					
Date		Description	Post. Ref.	Debit	Credit
March	21	Office Supplies Accounts Payable Ordered office supplies on account.		500	 500

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Transactions – Journalizing

Step 5 – The Post. Ref. (Posting Reference) column is left blank when the journal entry is initially recorded. This column is used later when the journal entry amounts are transferred to the accounts in the ledger.

XYZ Journal – Page 10					
Date		Description	Post. Ref.	Debit	Credit
			Step 5		

XYZ Journal – Page 10					
Date		Description	Post. Ref.	Debit	Credit
March	21	Office Supplies Accounts Payable Ordered office supplies on account.	14 40	500	 500

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Transactions – Journalizing

Accounting System Impact
(of the above transaction)

Assets		=	Liabilities		+	Owner's Equity	
Office Supplies			Accounts Payable				
March 21 500				March 21 500			

The account CASH has an increase
And
The account ACCOUNTS PAYABLE has an increase
By an EQUAL amount

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Transactions – Journalizing

Transaction D: On March 31, XYZ paid rent of $1,000 and utilities of $300.

Step 1 – the date of the transaction is entered into the Date column

XYZ Journal – Page 14					
Date		Description	Post. Ref.	Debit	Credit
Step	1				

XYZ Journal – Page 14					
Date		Description	Post. Ref.	Debit	Credit
March	31				

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Transactions – Journalizing

Step 2 – The title of the account to be debited is recorded at the left-hand margin under the Description column and the amount to be debited is entered in the Debit column.

XYZ Journal – Page 14					
Date		Description	Post. Ref.	Debit	Credit
		Step 2		Step 2	

XYZ Journal – Page 14					
Date		Description	Post. Ref.	Debit	Credit
March	31	Rent Expense Utilities Expense		1,000 300	

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Transactions – Journalizing

Step 3 – The title of the account to be credited is listed below and to the right of the debited account title, and the amount to be credited is entered in the Credit column.

XYZ Journal – Page 14					
Date		Description	Post. Ref.	Debit	Credit
		Step 3			Step 3

XYZ Journal – Page 14					
Date		Description	Post. Ref.	Debit	Credit
March	31	Rent Expense Utilities Expense Cash		1,000 300	 1300

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Transactions – Journalizing

Step 4 – A brief description should be entered below the credited account.

XYZ Journal – Page 14					
Date		Description	Post. Ref.	Debit	Credit
		Step 4			

XYZ Journal – Page 14					
Date		Description	Post. Ref.	Debit	Credit
March	31	Rent Expense Utilities Expense Cash Paid monthly expenses.		1,000 300	 1300

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Transactions – Journalizing

Step 5 – The Post. Ref. (Posting Reference) column is left blank when the journal entry is initially recorded. This column is used later when the journal entry amounts are transferred to the accounts in the ledger.

XYZ Journal – Page 14					
Date		Description	Post. Ref.	Debit	Credit
			Step 5		

XYZ Journal – Page 14					
Date		Description	Post. Ref.	Debit	Credit
March	31	Rent Expense Utilities Expense Cash Paid monthly expenses.	82 86 10	1,000 300	 1300

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Transactions – Journalizing

Accounting System Impact
(of the above transaction)

Assets		=	Liabilities		+	Owner's Equity (Expenses)	
Cash						Rent Expense	
	March 31 1,300					March 31 1,000	
						Utilities Expense	
						March 31 300	

The account CASH has a decrease
And
The account Rent Expense has an increase
The account Utilities Expense has an increase
(which are added together)
By an EQUAL amount

Questions

and

Answers

Review Questions:

1. What is the normal balance in an Equipment account?
   A. Debit
   B. Credit

2. What is the normal balance in the Rent expense account?
   A. Debit
   B. Credit

3. True or False: When recording a withdrawal for an owner, you debit owner's equity and credit cash.
   A. True
   B. False

4. True or False: A patent is a tangible asset.
   A. True
   B. False

5. When you pay off accounts payable you:
   A. Debit cash
   B. Credit accounts payable
   C. Credit cash
   D. Debit revenue

Answer Key:

1. A
   Debit is the normal balance in an Equipment account.

2. A
   Debit is the normal balance in the Rent expense account.

3. B
   False. When recording a withdrawal for an owner, you debit owner's withdrawals and credit cash.

4. B
   False. A patent is an intangible asset.

5. C
   When you pay off accounts payable you credit cash and debit accounts payable.