


Chapter 3, Module 2 - Accounts

Slide 1

Chapter 3 Module 2

AMIS 211
Introduction to Financial Accounting

Professor Marc Smith

 **FISHER**
COLLEGE OF BUSINESS

Hi everyone. Welcome back.

In this chapter, we are going to start introducing some really important topics relating to recording transactions.

So, let's go ahead and jump right into it.

Let's go ahead to the first slide.

Slide 2

Chapter 3 Module 2: Accounts

Account - place where all increases and decreases in financial statement items are recorded

For our class, we analyze these accounts using what is called a T-account (see next slide)

And, let's start with just a basic definition.

This is a definition of a word that we have already used a lot in the first couple of chapters but let's put a definition to it.

Account:

An account is the place where we record all increases and decreases in financial statement items.

Now, we have a whole bunch of accounts, right?

We have Asset accounts such as Cash and Accounts Receivable (A/R) and Land.

We have Liability accounts such as Accounts Payable (A/P) and Notes Payable.

We have Equity accounts: Common Stock and Retained Earnings.

We have Revenue Accounts. For example: Sales Revenue or Rental Revenue.

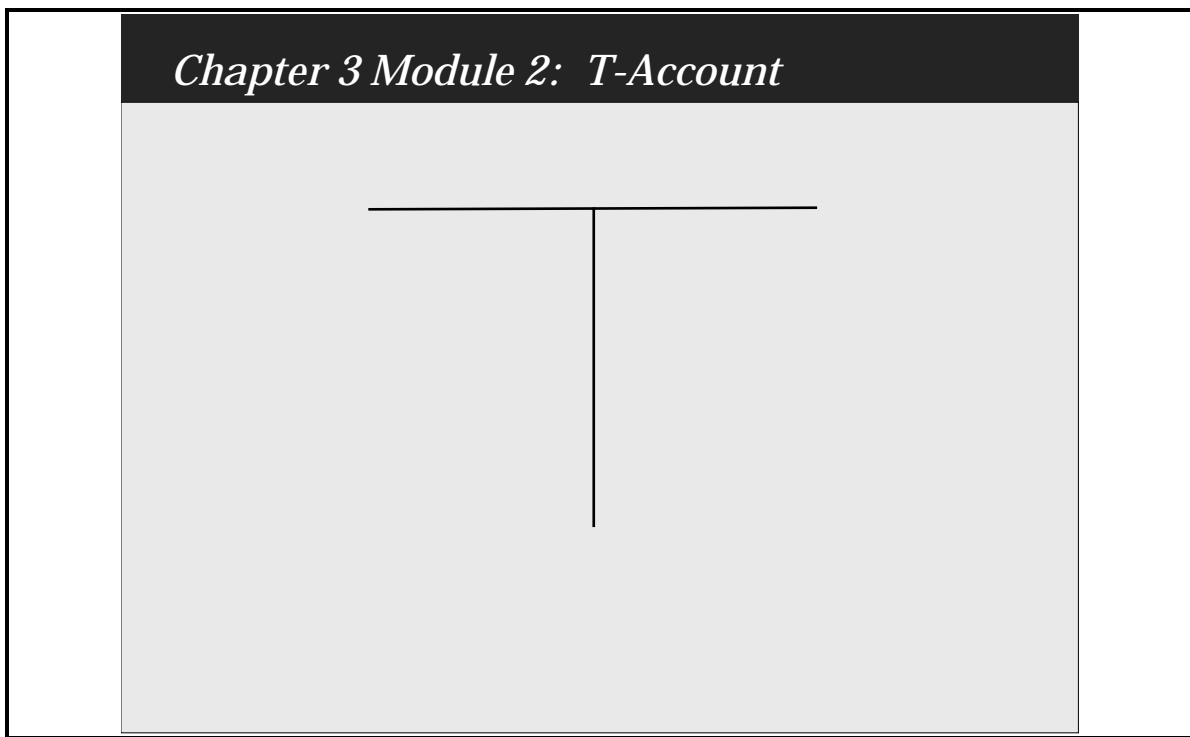
And, we have our Expense accounts: Salaries Expense, Utilities Expense, Cost of Goods Sold (CGS).

So, each item on the financial statements is represented by an account. And, this account is where we record all of the increases and decreases in those items.

Now, in a classroom the way in which we teach these, or learn, these accounts is by using what we refer to as a T-Account.

And, if you would just go to the next slide with me...

Slide 3



And, let's take a look at what a T-Account looks like. And, there it is (on Slide 3). It is called a T-Account because it looks like a "T."

We have a "T" here.

And, I want you to just look at it.

And, in fact, if you have the slides printed out or in front of you, just sort of keep this little “T” or just draw a “T” to yourself, and keep that in mind.

Let’s go to the next slide.

Slide 4

Chapter 3 Module 2: T-Account

Notice that the T-account has three distinct parts:

- 1) Top (heading) → place account name here**
- 2) Left side**
- 3) Right side**

Debit	&	Credit
DEBIT	-	LEFT
CREDIT	-	RIGHT

And, if you look at the T-Account, notice that it has three (3) distinct parts to it.

The three (3) parts are:

It has 1) the very top or the Heading. That is where we are going to place the Account Name. For example: Cash.

Then, once we get into the “T” part, we have the 2) Left Side of the “T,” and we have the 3) Right Side of the “T.”

And, this kind-of brings us to two really important words in Accounting.

Two words that cause an awful lot of confusion; mainly because they are

words that are used in different contexts in different areas; but, in Accounting, the two words are “debit” and “credit.”

And, in Accounting, the word “debit”—it simply means “left.” That is it. All debit means is: the left side of the T-Account.

The word “credit”: you can probably guess what it means. It means “right.” That is all.

Debit-left; Credit-right; it is nothing more, nothing less.

So, for those people who are either working for a bank or used to dealing with the bank, put what the bank tells you about these words out of your mind.

You hear the word “credit” and you say, “Oh good! The bank is putting money into my account—they are crediting my account.”

Or, you hear the word “debit” and you say, “Oh, no! The bank is taking money from me. They are taking it away from my account.”

Uh-uh! Debit-left; credit-right. That is it.

It is very important because we use these words all quarter long. And, I do not want to see you have trouble all quarter long with the basic definition.

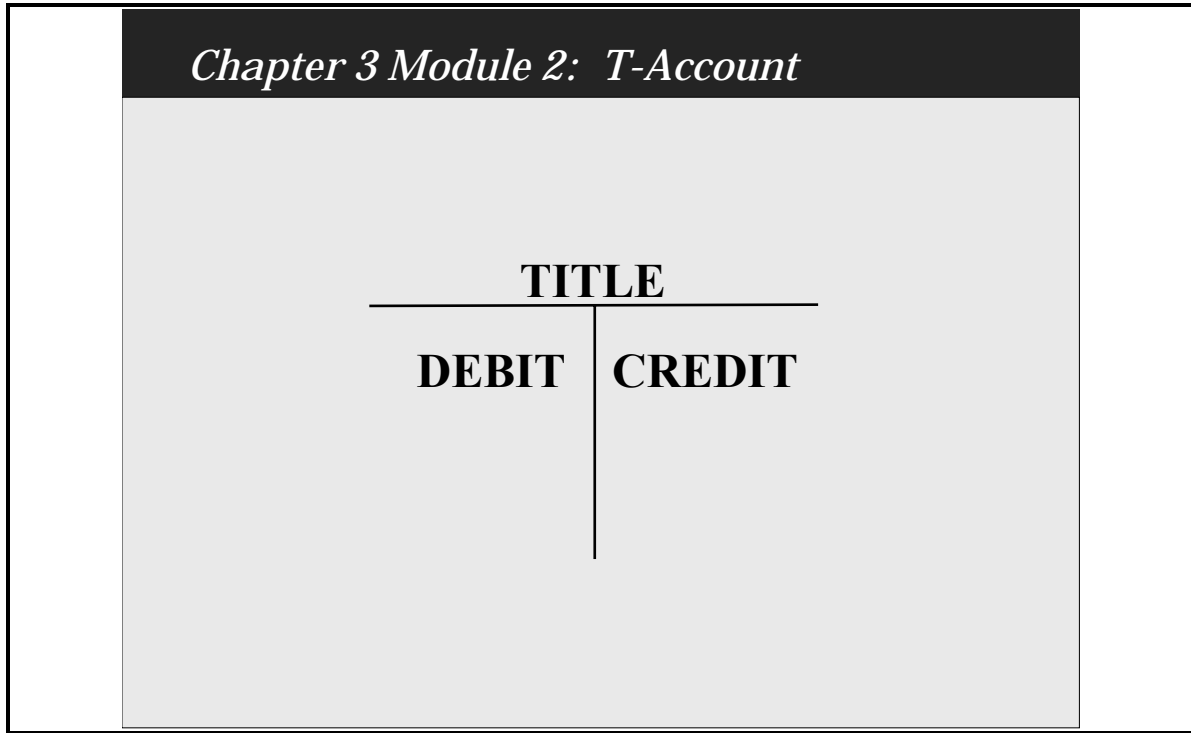
Debit means: left.

Credit means: right.

And, that is all.

Go to the next slide with me.

Slide 5



There is our T-Account again.

And, you can see how we are going to make use of it.

The top part is the Title and we are going to put the name of the account there: Cash, or Sales Revenue, or Accounts Receivable (A/R) or whatever.

The left side of that T-Account is called the Debit side.

The right side of that T-Account is called the Credit side.

Now, let's go to the next slide and I think what we are going to see here is something very, very important.

Slide 6

<i>Chapter 3 Module 2: Debit & Credit Rules</i>			
Account Type	Increase	Decrease	Normal Balance
<i>Asset</i>	Debit	Credit	Debit
<i>Liability</i>	Credit	Debit	Credit
<i>Equity</i>	Credit	Debit	Credit
<i>Revenue</i>	Credit	Debit	Credit
<i>Expense</i>	Debit	Credit	Debit

These are the Debit and Credit Rules.

Now, debit means left and credit means right; that is all.

We are going to combine these left and right—these debits and credits—with our different account types—the Assets, Liabilities, Equity, Revenues and Expenses; to get the increase/decrease rules.

Let's just look at this chart together.

And, for a few moments, just forget about that last column labeled: Normal Balance.

Let's look at the Increase and Decrease columns.

Remember: an account is a place where we record increases and decreases.

Assets:

When they go up—when they increase—you record that on the left side, or debit side, of the T-Account.

So, if you were to receive cash—if you got cash—your Assets would be increasing, right? You have more cash. You put that on the debit side.

When your Assets go down—say, you pay your bills—when Assets decrease, you would just look at the chart. A decrease to an Asset is recorded with a credit—on the right-hand side of the T-Accounts.

The Liabilities, Equity, and Revenue simply follow the opposite rules.

For Liabilities, Equity, and Revenue; they are increased on the credit side. All of the increases will be found on the right-hand side of the T-Account.

They are decreased on the left-hand side or the debit side of the T-Account.

Expenses—the last major account type—goes back and follows the same set of rules as your Assets—increase on the debit and decrease on the credit side of the T-Account.

Take a look at that last column: Normal Balance.

What the Normal Balance tells us is: on which side of the T-Account the Beginning and Ending Balance will be. That is all it is telling us—on which side of the T-Account the Beginning Balance and Ending Account Balance will be.

So, for Assets and Expenses, the Beginning and Ending Balance for those accounts will always be on the left—or the debit side.

For Liabilities, Equity, and Revenue, the Beginning Balance will always be on the right, or credit side, of the T-Account.

Now, what is an easy way to remember the Normal Balance of an account?

If you just sort of look at the table...

The Normal Balance is the exact same as the increase column.

So, whatever causes an account to increase is also the account's Normal Balance.

I cannot emphasize enough: **This slide (Slide 6) is vital to you.** This is one of those things that you just must know. And, the sooner you know it; and the sooner you can apply it; the easier your life is going to be.

One piece of advice:

What a lot of students do is: when they get their Exam, they will take a couple of moments and just write down some key ideas. This is one of the key things to maybe jot down on say, the back page of your test, as soon as you get it. That way as you are working through the Exam and say, you get to question 27 which asks you about debits and credits and what increases certain accounts, you do not necessarily have to remember it, but you can refer back to where you had written it down at the beginning of the test. It makes it easier on you to then apply those rules.

It might be something to think about doing.

No matter how you handle it, you must know what is on this slide (Slide 6). It is crucial. And, the sooner you know it, the easier your life is going to be.

Let's go ahead to the next slide.

Slide 7

Chapter 3 Module 2: T-Account

Enter the following 4 transactions into the cash T-account (looking only at the effect on the account cash)

- **sold common stock for \$245,000 cash**
- **borrowed \$100,000 from the bank**
- **purchased land for \$75,000 cash**
- **purchased inventory costing \$20,000 on account**

And, let's just do an example—a basic example—using T-Accounts.

And, it asks us to do this: Enter the following 4 transactions into the Cash T-Account.

For this little exercise, we are only going to look at the effects on the account: Cash. Nothing else.

So, how does each of these little bullet points affect the account: Cash.

Let's just read them together real quickly.

The four little bullet points are: 1) we sold common stock for \$245,000 cash; 2) we borrowed \$100,000 cash from the bank; 3) we purchased land for \$75,000 cash; and then, 4) we purchased inventory costing \$20,000 on account.

Let's enter these four (4) transactions into our Cash T-Account.

Go to the next slide with me.

Slide 8

<i>Chapter 3 Module 2: T-Account</i>	
Cash	
245,000	75,000
100,000	
270,000	

I have set it up for you. There is the Cash T-Account.

The first transaction: 1) we sold common stock for \$245,000.

First question: Answer it to yourself.

Cash is what type of account?

It is an Asset, right. Cash is an Asset. So, it is going to follow the debit and credit rules for Assets that we saw a couple of slides ago.

First bullet point: 1) we sold the stock for \$245,000.

Did we get cash or did we pay it?

We got it, right? We sold stock to owners. So, they gave us cash. So, cash is going up. When an Asset, such as cash, increases, that is always entered on the debit or left-hand side of the T-Account.

How about the second transaction?

2) We borrowed \$100,000 from the bank.

Once again, our cash has gone up, right? The bank has given us \$100,000. So, once again, that \$100,000 should be recorded on the debit, or left-hand, side of the T-Account.

How about the third one?

3) We purchased land for \$75,000 cash.

In this case, we spent the money. We spent the cash to get the land. Our cash has decreased. When an asset decreases, that decrease is shown on the credit side of the T-Account.

The fourth one is kind-of a trick one.

4) We purchased inventory for \$20,000 on account.

How much cash did we spend?

We did not spend any, right? We bought it on account meaning: we bought the inventory; we will pay the cash later.

So, as of right now, we have not spent any cash. Hence, that \$20,000 would not go into the Cash T-Account. It won't go in there until we actually PAY that bill.

Now, that we have entered all of the transactions that affect Cash, we can figure out the Ending Balance.

We simply add all of the increases: \$245,000 plus (+) \$100,000. We subtract the \$75,000 decrease.

And, you can see there below that second line (on Slide 8), the Ending Balance on the debit side—the Normal Balance of an Asset is a debit—is \$270,000.

That is the basics of a T-Account.

Let's see if we can apply it to an Example together.

And, let's take a look at Example #4 from the Web site problem.

Go to the next slide.

Slide 9

<i>Chapter 3 Module 2: T-Account</i>	
Cash	
X	
25,000	17,000
42,000	

Now, here is what Example #4 says:

“Assume the following information: Ending Cash is \$42,000. The debits to Cash were \$25,000. The credits were \$17,000. Calculate the Beginning Cash Balance.”

Let's enter this into our T-Account.

The Ending Balance is given. Cash is an Asset, so that Ending Balance is on the debit side. It is right there.

The debits to Cash are always on the left side of the T-Account: \$25,000.

The credits are always on the right side of the T-Account: \$17,000.

Again, Cash is an Asset. Normal Balance is a debit.

So, the Beginning Balance—right where I have the “x” (on Slide 9) on the debit side.

Now, we can solve for our “x”—the Beginning Balance.

Go to the next slide.

Slide 10

<i>Chapter 3 Module 2: Example #4</i>						
X	+	25,000	-	17,000	=	42,000
X	=	beginning cash balance		=	\$34,000 debit	

We just set up an Algebra equation.

Add (+) the increases ($x + \$25,000$); subtract (-) the credits, or decreases, (\$17,000); and set it equal to (=) the Ending Balance (\$42,000).

And, you can solve for the Beginning Cash Balance: a \$34,000 debit-side balance.

This is just working a T-Account.

Let's go to the next slide.

Slide 11

<i>Chapter 3 Module 2: T-Account</i>	
Accounts Payable	
25,000	X
	17,000
	42,000

And, let's do Requirement 2 of the problem.

Requirement 2 says: "Keep all of the numbers the same—keep all of the information the same that we just dealt with—except assume it relates to Accounts Payable (A/P) rather than to Cash."

How does that change what we need to do?

Accounts Payable (A/P) is what type of account?

It is a Liability.

And, a Liability has a Normal Balance of a credit.

So, that Ending Balance, here (on Slide 11) will be on the right side—or the credit side—of the Liability account.

Debit still means left. So, those \$25,000 of debits are still on the left side of the T-Account.

And, credits still always mean right. So, the \$17,000 is still on the right-hand side of the T-Account.

Except, for a Liability, the Normal Balance is on the credit side—refer back to the chart if you need to—the Normal Balance will thus be above the \$17,000 of credits on the right-hand side.

If you go to the last slide with me...

Slide 12

<i>Chapter 3 Module 2: Example #4</i>						
X	+	17,000	-	25,000	=	42,000
X	=	beginning A/P balance	=	\$50,000 credit		

Once again, we set up our Algebra equation.

This is a just little different.

We add (+) the increases—this time we add (+) the \$17,000. We subtract (-) the \$25,000 of debits, which is a decrease to a Liability. We set it equal to (=) the Ending Balance (\$42,000).

This allows us to solve for “x.”

The Beginning Accounts Payable Balance is a \$50,000 credit.

You will want to be good with T-Accounts.

T-Accounts are something that you will use all quarter long.

And, if you get good at working with them, I think you will find them to be a great tool as you get these other concepts down.