


Chapter 3, Module 4

Slide 1

Chapter 3 Module 4

AMIS 211
Introduction to Financial Accounting

Professor Marc Smith

 **FISHER**
COLLEGE OF BUSINESS

Hi everyone. Welcome back.

Now that we know the basics of making Journal Entries and what debits and credits are; let's go ahead and try an Example.

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

Go to the next slide with me.

Slide 2

Chapter 3 Module 4: Example #5

EXAMPLE #5

Gives a series of transactions and has 2 requirements:

- 1. Make the journal entry to record each transaction**
- 2. Give the effects of each transaction on the financial statement elements**

And, let's look at Example #5.

Let's just read it together.

“It says Betty DiRose Inc. sells computer systems. And the following transactions have occurred during the month of June.”

And, you can see all of the transactions we are going to deal with.

There are two Requirements to this problem.

For each transaction, we 1) want to make the Journal Entry to record it. We know what an Entry looks like. We have already seen that.

And, 2),--and perhaps much more important—something that is going to be a big part of Exam 1:

What is the effect of each Entry on our accounting items? How does each of these transactions impact the different financial statements?

That is going to be a big thing that we really want to get out of this.

Go to the next slide with me.

Slide 3

Chapter 3 Module 4: Financial Statements

INCOME STATEMENT:
Revenues - Expenses = Net Income

BALANCE SHEET:
Assets = Liabilities + Equity

NOTE: The income statement effects the balance sheet because net income increases retained earnings, an equity account

And, let's just do a quick little review of two major financial statements that we have talked about: the Income Statement and the Balance Sheet.

Now, remember what is on the Income Statement: Revenues minus (-) Expenses equals (=) Net Income.

And, on the Balance Sheet is our fundamental accounting equation: Assets equal (=) Liabilities plus (+) Equity (A = L + E).

So, we want to know for every transaction:

How does that transaction affect the Revenues, Expenses and Net Income (i.e. the Income Statement) and the Assets, Liabilities and Equity (i.e. the Balance Sheet)?

One important point to remember: when the Income Statement is affected—the effect on Net Income also impacts Equity—specifically Retained Earnings.

That is how the two financial statements link up together.

The effect on Net Income is the effect on Equity.

Go to the next slide with me.

Slide 4

<i>Chapter 3 Module 4: 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

And, before we actually get started with the Example, here is a little refresher.

There is our Debit and Credit Rules—things that we really need to know.

And, as we go through this Example, it might help you to have that handy. Be able to refer to the rules as we make the Entries and analyze their effects.

And then, at some point, you need to be able to come back through this problem and do it by yourself without having to refer to this chart.

But, as we are first doing it, if you want to have the chart ready and handy; by all means, make sure it is available.

Let's go to the next slide.

Slide 5

<i>Chapter 3 Module 4: Example #5</i>						
June 1:						
Cash			245,000		
	Common stock			245,000	
Cash		=		Asset		
Common Stock		=		Equity		
Rev	-	Exp	=	NI	A	=
NE		NE		NE	↑245,000	NE
						+ E
						↑245,000

And, let's take a look at the first transaction.

Here is what it says: "On June 1st, we sold 7,000 shares of common stock for \$245,000 cash."

All right, let's make the Entry to record it.

What did the company get?

We got cash, right? The Stockholders gave us money.

Cash is an Asset. That Asset account is going up. We now have it in our hands.

Look back at your chart.

When an Asset increases, record it with a debit.

Remember: Double-Entry Accounting requires us to have at least one debit and at least one credit.

So, at the same time we are getting the cash, we also have an increase in our equity. We have more Owners. We sold more stock.

When Equity goes up—refer back to your chart—you record that with a credit.

So, the Entry we are going to make is this.

Debit to: Cash; Credit: Common Stock.

Okay, we want to be able to make the Entry.

But, like I said a few minutes ago, we really want to be able to analyze the effects of the Entry on the Income Statement and Balance Sheet.

I think the best and easiest way to do this is: let's first identify the different accounts that we have in the transaction.

Cash is what type of account?

Cash is an Asset.

Common Stock is what type of account?

We should know this as well. It is an Equity account.

So, we have an Asset and an Equity effected.

Now, what we are going to want to do is: determine increase, decrease, or no effect on the Income Statement items: Revenues minus (-) Expenses equals (=) Net Income; and the Balance Sheet items: Assets equals (=) Liabilities plus (+) Equity ($A = L + E$).

You can tell in this particular situation we are changing an Asset and an Equity so that is what is going to be effected.

Note there that the “NE” stands for No Effect.

There is No Effect (NE) on Revenues and Expenses.

There are no Revenues or Expenses in that Journal Entry. How can they be affected?

There is no change to the Income Statement. All are NE (No Effect).

We have an Asset that is increased: Cash. We have an increase of \$245,000 in Assets and a \$245,000 increase in Equity: Common Stock.

I want you to take a look at this slide (Slide 5).

Just look at it.

And, I want you to tell me:

What makes you feel comfortable that we have done it correct? What makes you feel comfortable that we have got it right?

The Balance Sheet balances, right?

The effect on the Assets side is the same effect on the Liabilities plus (+) Equity side. Both sides of that equation are increasing by the same amount: \$245,000. The Balance Sheet still balances.

That is going to have to be true—every time. Every transaction must result in the Balance Sheet equation holding true.

A always equals (=) L plus (+) E.

Let's go to the next slide and do the next one.

Slide 6

Chapter 3 Module 4: Example #5**June 3:**

Cash **100,000**
Notes Payable **100,000**

Cash = **Asset**
Notes Payable = **Liability**

Rev	-	Exp	=	NI		A	=		L	+	E
NE		NE		NE		↑100,000			↑100,000		NE

On June 3rd, we raised additional funds by borrowing \$100,000 from the High Street Bank on a 10-Year Note.

The Entry we are going to make to record this:

We got Cash. So, you are going to debit Cash.

And, you are going to credit your Note Payable.

You are going to reflect the fact that you now owe the bank this \$100,000.

Go back to your chart.

When your Liabilities go up—when you now owe more—when your Liabilities is increasing, record it with a credit.

I have kind-of given it away, haven't I?

The Cash is an Asset, as we know. And, the Notes Payable is a Liability.

Any time it says Payable, you have a Liability.

So how does this transaction affect the Income Statement and Balance Sheet?

Once again, there is No Effect (NE) on the Income Statement. There are no Revenues or Expenses up there.

We have an increase to our Assets—we now have Cash.

And, we have an increase to our Liabilities—we now owe the bank this \$100,000.

And, of course, A still equals (=) L plus (+) E.

Fun, isn't it?

Or, something like that.

Let's go the next slide and let's do the next one together.

Slide 7

<i>Chapter 3 Module 4: Example #5</i>						
June 5:						
Land			75,000		
Cash				75,000	
Land	=		Asset			
Cash	=		Asset			
Rev	-	Exp	=	NI	A	=
NE		NE		NE	NE	
					L	+
					NE	
						E
						NE

June the 5th:

We purchased land for \$75,000 cash.

We went out and we bought land. We now have more land. Land is an Asset. You record that increase with a debit.

At the same time, you spent the cash. Cash is going down. Hence, you need to record that with a credit.

You can see there (on Slide 7) the Entry to record it: Debit: Land; Credit: Cash.

We have already heard it once but let's go through it again.

We know land is an Asset account. And, we know Cash is an Asset account.

So, to determine the effects of this transaction:

I have No Effect (NE) for everything.

How come?

There is No Effect (NE) on the Income Statement. There are no Revenues and there are no Expenses. Hence, there is No Effect (NE) on the Income Statement.

But: what about the Balance Sheet?

Why is there No Effect (NE) on all of those as well?

You have two Assets—one Asset: Land is going up; but at the same time, the other Asset: Cash is going down; this nets to no effect (NE). There is no overall change. There is just a shifting of \$10,000 from Cash to Land.

And, of course, there is no Liabilities or Equity in the Journal Entry. Hence, there is No Effect (NE) on those items.

Do we still balance?

Well, yeah, right? We have changed nothing.

There is no change on the Asset side; there is no change on the Liability plus (+) Equity side. Everything still balances.

Let's do one more.

Let's go to the next slide.

Slide 8

Chapter 3 Module 4: Example #5**June 10:**

Inventory 10,000
Accounts Payable 10,000

Inventory = Asset
Accounts Payable = Liability

Rev	-	Exp	=	NI		A	=	L	+	E
NE		NE		NE		↑10,000		↑10,000		NE

June the 10th: we purchased inventory for \$10,000 on account—meaning we did not pay any Cash right now; we will pay later.

To record this, you will debit the Inventory to reflect that you now own it.

You will credit the Accounts Payable reflecting that we now owe this Supplier \$10,000.

Inventory is an Asset. Accounts Payable is a Liability.

To determine the effects of this transaction:

Well, there they are (on Slide 8).

There is No Effect (NE) on the Income Statement. There are no Revenues or Expenses.

Assets—specifically Inventory—have increased.

Liabilities—specifically Accounts Payable—have also increased.

One final word about this and then we will stop here.

A big thing that you are going to have to do on Exam 1, and then carry that forward through the rest of the quarter, is: determine the effects of transactions on the Income Statement and Balance Sheet.

And, I just think it so helpful to us if we actually write out which types of accounts we are dealing with.

For example: Inventory, here, is an Asset; Accounts Payable is a Liability.

That tells us which specific types of accounts have been affected.