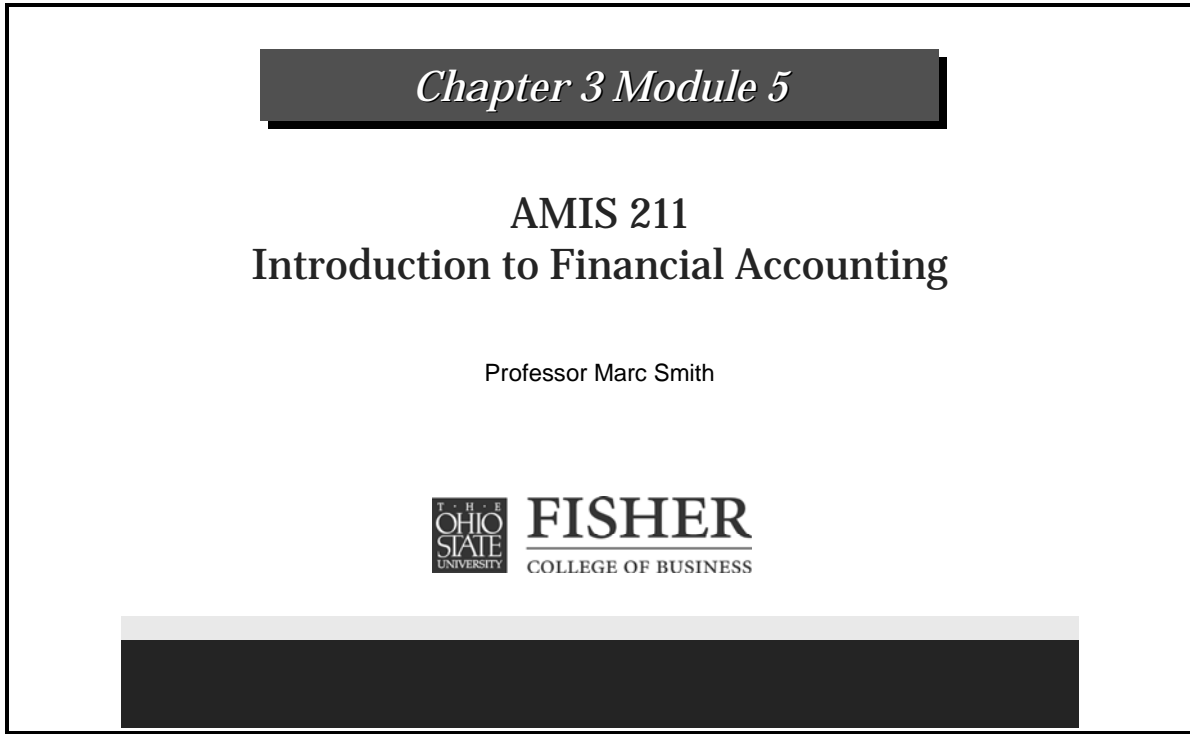


Chapter 3, Module 5

Slide 1

A rectangular box with a black border containing the slide content. At the top is a dark grey horizontal bar with the text "Chapter 3 Module 5" in white, italicized font. Below this, the text "AMIS 211" and "Introduction to Financial Accounting" is centered in a black serif font. Underneath is "Professor Marc Smith" in a smaller black serif font. At the bottom center is the logo for Fisher College of Business at Ohio State University, featuring a square with "T · H · E OHIO STATE UNIVERSITY" and "FISHER COLLEGE OF BUSINESS" to its right. At the very bottom of the box is a dark grey horizontal bar.

Hi Everyone. Welcome back.

Let's just pick up right where we left off. And, continue with this Example #5 and do some more transactions together.

Let's jump right into it.

Go to the next slide with me.

Slide 2

<i>Chapter 3 Module 5: 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, there again (on Slide 2)—we will never get away from it—is our schedule of Debit and Credit Rules.

It is something that we just need to be comfortable with.

I have put it here just as a reminder: “Hey look! That is what we need to know.”

If you need to have it front of you as we go through this, by all means, do so.

Let’s go to the next slide and jump back into Example #5 where we left off.

Slide 3

*Chapter 3 Module 5: Example #5***June 11:**

Cash **15,000**
Sales Revenue **15,000**

Cash = **Asset**
Sales Revenue = **Revenue**

Rev	-	Exp	=	NI	A	=	L	+	E
↑15,000		NE		↑15,000	↑15,000		NE		↑15,000

June the 11th:

Now this one is going to be kind of a challenging one. Notice that there are two June the 11th transactions.

Let's just start with the first one.

It says that we sold a computer system for \$15,000 cash. We sold some of our inventory for \$15,000.

When you sell your product—when you sell your inventory—you record Sales Revenue.

So, the Journal Entry we are going to make is: a debit to Cash for what we received: \$15,000; a credit to: Sales Revenue. We will reflect the fact that the Revenue has now been earned and record it at the selling price of the goods.

The account Cash, as we know, is an Asset.

The Sales Revenue account is a Revenue—it tells is in the name.

When we go to analyze the effects; this one will also be a little bit tricky.

We have the Income Statement affected—because: we have a Revenue.

Revenues are going up. When the Revenues increase, so does the Net Income. When you increase your Revenues, you increase your Net Income. And, when the Net Income changes, so does the Equity.

You should get into the habit of this: taking the change in Net Income and simply moving it right over to Equity.

If Net Income goes up \$15,000, so does Retained Earnings because Retained Earnings is affected by Net Income and Retained Earnings is part of Equity.

To finish it out, we now have Cash; so, our Assets have also increased by \$15,000.

And, you look at it and you can see we still balance.

The Balance Sheet: the A still equals (=) the L plus (+) E ($A = L + E$).

But, we are not done with this June 11th transaction.

Go to the next slide.

Slide 4

Chapter 3 Module 5: Example #5**June 11:**

Cost of Goods Sold 8,000
Inventory 8,000

Cost of Goods Sold = Expense
Inventory = Asset

Rev	-	Exp	=	NI	A	=	L	+	E
NE		↑8,000		↓8,000	↓8,000		NE		↓8,000

Whenever you earn Sales Revenue—whenever you sell your inventory and record Sales Revenue, you must also “match”—the buzzword there: “matching”—you must also “MATCH” the Expense to the same period.

When we record Sales Revenue, we are also going to need to record the Cost of Goods Sold (CGS)—the Expense.

And, you can see there in the problem it tells us: the cost of the computer system sold was \$8,000.

So, you need to debit the Cost of Goods Sold to record the Expense.

Remember: you can go back to your chart.

Expenses increase with debits. When they happen, they are recorded with debits.

And, you need to record a credit to your Inventory account. You no longer own the Inventory. It was sold. It belongs to somebody else now.

You need to reduce the Inventory from your Balance Sheet. You do that with a credit.

Identifying these accounts:

We do know Cost of Goods Sold is an Expense; Inventory is an Asset.

So, when we look at the effects of this transaction: we can see we have an increase to our Expenses.

We have an Expense from selling the product that we did not have yesterday.

But, when Expenses go up, Net Income goes down. We are subtracting away more in that equation.

When you increase Revenues, you increase Net Income.

When you increase Expenses, you decrease Net Income.

But when you decrease Net Income, you also decrease Retained Earnings. Let's carry it right over to your Equity portion of the Balance Sheet. So, we have an \$8,000 decrease to Equity.

And, of course, an \$8,000 decrease to Assets. We no longer own the Inventory. It is gone. It is decreased.

The June 11th transaction can be pretty challenging.

When you sell your product, you need to record both Sales Revenue and Cost of Goods Sold (CGS).

Go to the next slide with me.

Slide 5

Chapter 3 Module 5: Example #5**June 15:**

Equipment	9,600
Cash	5,000
Accounts Payable	4,600

Equipment	=	Asset
Cash	=	Asset
Accounts Payable	=	Liability

Rev	-	Exp	=	NI		A	=	L	+	E
NE		NE		NE		↑4,600		↑4,600		NE

And, let's look at the June 15th transaction:

Here is what it says:

We purchased equipment for \$9,600; \$5,000 was paid in cash, the balance—the \$4,600—is due in 60 days.

To record it: you debit the Equipment for what you purchased: \$9,600.

You credit your Cash. The cash that was spent was \$5,000.

And, credit the Accounts Payable to reflect the fact that we now owe somebody this \$4,600.

To identify our accounts:

Equipment is an Asset; Cash is also an Asset; and Accounts Payable is a Liability.

Looking at our effects:

We notice no Revenues or Expenses; hence, there is No Effect (NE) on Net Income.

We have here a \$4,600 increase to Assets.

Why?

You have two Assets here, right? You have one Asset: Equipment going up \$9,600. But, at the same time, we have another Asset: Cash going down \$5,000.

Overall, this is a \$4,600 increase in Assets.

We also have a \$4,600 increase in Liabilities due to the fact that we now owe that balance within 60 days.

Of course, there is No Effect (NE) on Equity. There is no common stock. And, Net Income was not affected (NE).

Very good.

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

Slide 6

Chapter 3 Module 5: Example #5**June 17:**

Building 20,000
Accounts Payable 20,000

Remember the historical cost concept!

Building = Asset
Accounts Payable = Liability

Rev	-	Exp	=	NI	A	=	L	+	E
NE		NE		NE	↑20,000		↑20,000		NE

June the 17th:

We purchased a building for \$20,000. The building was appraised or valued at \$45,000. The sales agreement stated that Betty would pay the \$20,000 next month.

When you buy something and have to pay for it later, we know that is an Account Payable.

And, what we bought was a building.

So, the Entry we are going to make is: Debit: Building; Credit: Accounts Payable for \$20,000.

Why is it the \$20,000?

Why is it not the \$45,000? Why not use that?

Well, because of the Historical Cost Concept, right?

The Cost Concept says: you record Assets at their cost—NOT their market value—NOT what they are worth.

Assets are always shown at cost.

So, the \$45,000 is completely irrelevant.

So, I will ask you a question:

Why was it given in the problem?

I think there are two schools of thought on this.

One school is: the “to trick and fool us” school of thought. The other one is: to ensure that you know the Historical Cost Concept: Assets are recorded at cost; not value.

I guess it depends on where we stand as to what school of thought we will buy into.

But, in any event, the value here is irrelevant. The Assets are recorded at cost.

To identify this:

The Building is an Asset of course; Accounts Payable is a Liability.

The effect on our financial statements:

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

There is a \$20,000 increase to Assets from the Building. And, a \$20,000 increase to Liabilities due to the Account Payable.

Very good.

Let's go to the next slide.

Slide 7

Chapter 3 Module 5: Gains

Gains:

A gain is recorded when you sell an asset *other than inventory* for more than its cost. You are not in the business of selling these assets - they are not your inventory!

The gain is equal to the selling price – cost

A gain is classified as a revenue account

And, before we do the next transaction, we need to take a step back for a second.

And, we need to talk about a gain.

A gain results when you sell an asset other than inventory for an amount more than its cost.

Notice: this relates to assets that are sold that are NOT inventory.

Inventory is what we are in business to do or to sell.

When you sell inventory, you saw just a little bit ago how to record it—the June 11th transaction—you record both Sales Revenue—at the sales price—and Cost of Goods Sold (CGS)—the cost of the product sold.

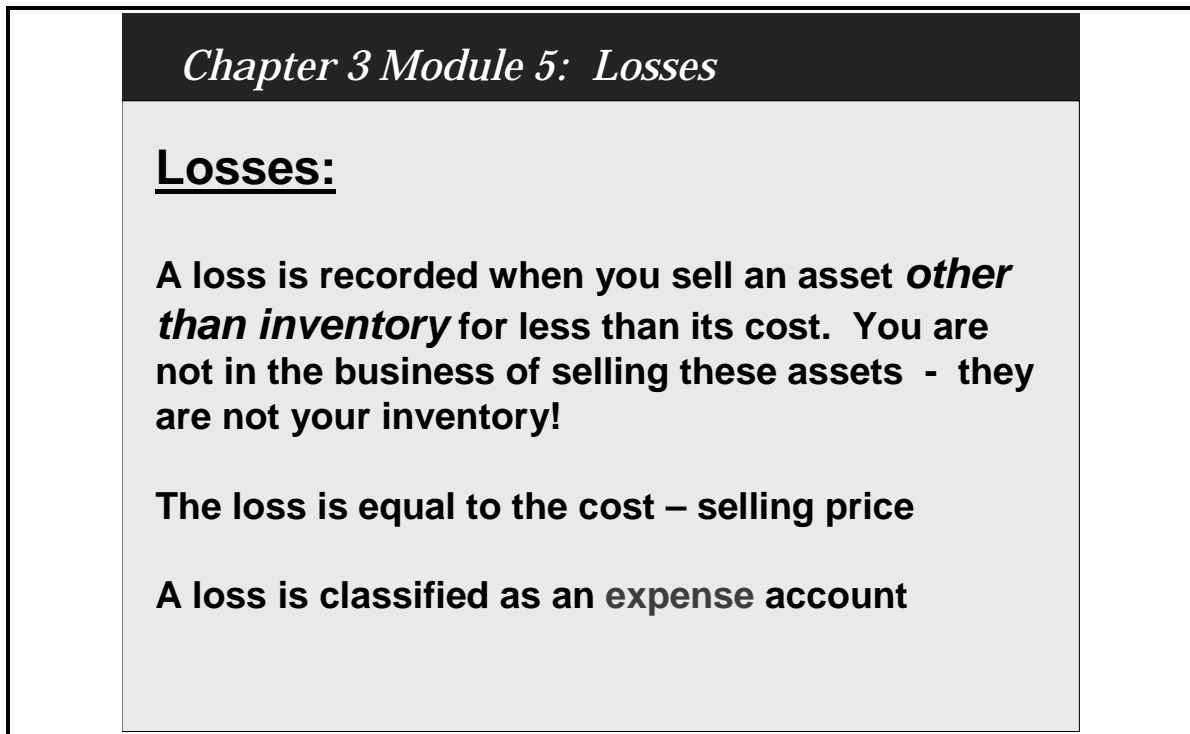
But, whenever you sell any other asset—it is not something we do on a regular basis—whenever you sell some other asset, you just would record a gain if you sell it for more than its cost.

This gain is calculated simply by taking the selling price and subtracting the cost.

Note that this gain is considered to be a Revenue account. Whenever you see Gain on Sale of Some Asset; that is a Revenue account.

Well, if have talked about gains, go to the next slide...

Slide 8

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Chapter 3 Module 5: Losses

Losses:

A loss is recorded when you sell an asset *other than inventory* for less than its cost. You are not in the business of selling these assets - they are not your inventory!

The loss is equal to the cost – selling price

A loss is classified as an expense account

We also need to talk about losses.

Loss is very similar to gains.

Except: a loss occurs when you sell an asset other than inventory for an amount less than its original cost.

Remember: if you sell inventory, the treatment is: to record both Sales Revenue and Cost of Goods Sold (CGS).

The loss—if it were to happen—can be calculated by taking the cost, which in this case would be larger, and subtracting the selling price.

If a gain is treated as a Revenue, a loss is—what do you think?

It would be treated as an Expense account.

Gains are Revenues; losses are Expenses.

Now that we kind-of have this under our belt, remember: the gains and losses only come about when you sell assets other than inventory.

Let's take a look at the next slide.

Slide 9

<i>Chapter 3 Module 5: Example #5</i>					
June 19:					
Accounts Receivable		15,000		
Land		12,000		
Gain on Sale of Land		3,000		
Accounts Receivable		=		Asset	
Land		=		Asset	
Gain on Sale of Land		=		Revenue	
Rev	-	Exp	=	NI	
↑3,000		NE		↑3,000	
			=		
			↑3,000		
				=	
				L	+
				NE	E
					↑3,000

And, let's take a look at the June 19th transaction.

We sold a small portion of our land that we had purchased on June 5th to XYZ Company for \$15,000. XYZ made no down payment. But, they agreed they would pay the full amount—in full—within the next two months.

It was determined—we were able to do some figuring out—and it was determined that the land that was sold had a cost of \$12,000.

To make this Entry: you debit Accounts Receivable to represent amounts owed to the company. What is owed to us is: \$15,000.

You credit Land. We do not own the land anymore. But you need to credit it. You need to reduce the land at its cost. It is recorded at cost. So when you sell it, you need to take it off of the Balance Sheet at cost.

The cost was \$12,000.

Since we sold it for more than its cost, we have a gain—in this case, a \$3,000 Gain on the Sale of Land.

We know that Accounts Receivable is an Asset. Land is also an Asset. And, a Gain is treated as a Revenue account.

So, in analyzing the effects:

A \$3,000 increase to Revenues for the gain causes a \$3,000 increase to Net Income. When Revenues go up, so does Net Income. But: when Net Income goes up, so does Equity. So, you would move it over to Retained Earnings.

Finally, our Assets have gone up \$3,000: a \$15,000 increase to Accounts Receivable but a \$12,000 decrease to Land. We do not have it anymore.

This gives us an overall \$3,000 increase.