


Chapter 3, Module 6

Slide 1

Chapter 3 Module 6

AMIS 211
Introduction to Financial Accounting

Professor Marc Smith



The slide content is enclosed in a black rectangular border. At the top, there is a dark grey horizontal bar containing the text "Chapter 3 Module 6" in a white, italicized serif font. Below this bar, the text "AMIS 211" and "Introduction to Financial Accounting" is centered in a bold, black serif font. Underneath, the name "Professor Marc Smith" is centered in a smaller, black serif font. The logo for Ohio State University Fisher College of Business is centered below the name. The logo consists of a square with "OHIO STATE UNIVERSITY" inside and "FISHER COLLEGE OF BUSINESS" to its right. At the bottom of the slide content area, there is a light grey horizontal bar above a dark grey horizontal bar.

Hi everyone. Welcome back.

Let's go ahead and finish up this Example #5.

And, let's jump right into it.

Let's go to the first slide.

Slide 2

<i>Chapter 3 Module 6: 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, once again, there are the Debit and Credit Rules.

So, if you need them, there they are (on Slide 2). Refer to them.

So, let's go ahead.

And, before we can jump into the next transaction, we need to take a couple of minutes and talk about a new account.

Go to the next slide with me.

Slide 3

Chapter 3 Module 6: Dividends

New Account = DIVIDENDS

Dividends represent payments made to owners

QUESTION: What type of account is dividends?

ANSWER: It is NOT an EXPENSE

Dividends have NO EFFECT on the company's income statement

And this new account that we want to talk about is: Dividends.

Dividends simply represent payments that are made to the Stockholders or Owners of the company.

The question is this: What type of account is Dividends?

If you remember back to a previous discussion on this, we said that “Hey, look, what type of account is Dividends NOT classified as?”

We know that Dividends is NOT classified as an Expense.

Dividends are not an Expense of the company. Hence, Dividends have absolutely NO EFFECT (NE) on the company's Net Income.

So, they are not an Expense.

What kind of account are they?

Go to the next slide with me.

Slide 4

Chapter 3 Module 6: Dividends

Dividends is classified as a *contra equity* account since it reduces equity

Which equity account does it reduce?
retained earnings

Remember:

	Beginning retained earnings
+	Net income
-	<u>Dividends</u>
	Ending retained earnings

Dividends are classified—and this is something new for us—as a *Contra-Equity* account.

The reason it is considered a *Contra-Equity* is it causes a reduction in Equity.

The word contra means to reduce. We are going to see a lot of these *contra* accounts as we move throughout the course. This is the first one.

Dividends reduce equity; hence, it is classified as a *Contra-Equity* account.

The question is: if it reduces Equity, which Equity account does it reduce?

It reduces Retained Earnings, right?

Dividends reduce Retained Earnings. And because it is treated as a reduction of Equity--NOT an Expense—it is classified as a *Contra-Equity* account.

Dividends reduce Retained Earnings because remember that little equation that we talked about earlier and said, “This is one that everybody seems to forget”:

Beginning Retained Earnings plus (+) Net Income, minus (-) Dividends, equals (=) the Ending Retained Earnings.

Dividends reduce Equity.

That said; let’s go to the next slide.

Slide 5

Chapter 3 Module 6: Example #5

June 21:

Dividends	12,000	
Cash		12,000

Dividends	=	Contra-Equity
Cash	=	Asset

<u>Rev</u>	-	<u>Exp</u>	=	<u>NI</u>		<u>A</u>	=	<u>L</u>	+	<u>E</u>
NE		NE		NE		↓12,000		NE		↓12,000

And, let’s go back to Example #5.

June 21st:

June 21st says that: We paid dividends amounting to \$12,000.

To record that, we will debit the Dividends account—we will debit the Contra-Equity.

Contra-Equity means opposite of Equity.

So, Equity has a Normal Balance on the credit side. Contra-Equities, such as Dividends, follow the opposite set of rules. They would have Normal Balance on the debit side. Contra means opposite.

So, we will debit the Contra-Equity: Dividends. We will credit: Cash for what was spent.

We know Dividends is a Contra-Equity account. Cash is an Asset.

When we analyze the effects of this transaction:

For Revenues, Expenses, and Net Income: there is No Effect (NE).
Dividends do not affect the Income Statement. They are not an Expense.

What is happening here:

Our Assets have decreased by the amount of cash spent. And, our Equity has decreased, specifically Retained Earnings, because Dividends reduce Retained Earnings.

And we still balance. Both sides of the Balance Sheet are decreasing by \$12,000.

Let's go to the next slide.

Slide 6

Chapter 3 Module 6: Example #5**June 22:**

Accounts Payable 5,000
Cash 5,000

Accounts Payable = Liability
Cash = Asset

Rev	-	Exp	=	NI		A	=	L	+	E
NE		NE		NE		↓5,000		↓5,000		NE

June 22nd:

Here is what it says:

We paid \$5,000 of the \$20,000 owed for the building purchased on June 17th.

What Entry are we going to make to record this?

We are going to credit: Cash, right? Cash is going out so we reduce it with a credit.

The debit—as you can see right here (on Slide 6) is to Accounts Payable. We are reducing a Liability. We are paying off an amount we owed.

So, we debit: Accounts Payable; credit: Cash.

Accounts Payable is classified as a Liability; Cash is classified as an Asset.

As you can see here (on Slide 6), the effects of the transaction:

There is No Effect (NE) on the Income Statement.

You reduce your Assets and reduce your Liabilities.

Again, it makes it so much easier, I think; if you identify the types of accounts you are dealing with before you do the effects.

Let's go to the next slide together.

Slide 7

<i>Chapter 3 Module 6: Example #5</i>						
June 23:						
Cash		7,000				
	Accounts Receivable		7,000			
Cash		=		Asset		
Accounts Receivable		=		Asset		
Rev	-	Exp	=	NI	A	=
NE		NE		NE	NE	=
					L	+
					NE	
						E
						NE

June 23rd:

We receive \$7,000 cash as partial settlement of the Account Receivable from XYZ Company.

What is going on here: we got cash, so we will debit: Cash.

And, we got paid from an Account Receivable. Our Account Receivable goes down. The Customer does not owe that to us anymore. So, we have to reduce what was owed to us because it has been paid.

Cash is an Asset; Accounts Receivable is also an Asset.

This one causes people some problems.

In this case, there is No Effect (NE) on any of the Accounting elements.

There is no Revenue here. Just because you got cash does not mean you earned Revenue. Right? That is the Realization Principle.

What you have going on is: one Asset: Cash going up and another Asset: Accounts Receivable going down.

Overall there is no change in any of the Accounting elements.

That is a tough one.

You want to make sure you are comfortable with the collection of an account.

Let's go to the last one.

Slide 8

Chapter 3 Module 6: Example #5**June 26:**

Advertising Expense 3,000
Accounts Payable 3,000

Advertising Expense = Expense
Accounts Payable = Liability

Rev	-	Exp	=	NI	A	=	L	+	E
NE		↑3,000		↓3,000	NE		↑3,000		↓3,000

June 26th:

We received a bill for Advertising: it is for \$3,000 payable in 30 days.

We are going to record this with a debit to Advertising Expense and a credit to Accounts Payable because we have not paid it yet.

Advertising Expense is an Expense; Accounts Payable is a Liability.

Doing the effects:

We increase our Expenses. We now have an Expense. But, increasing Expenses reduces Net Income. And, when we reduce Net Income, we reduce Equity.

At the same time, we increase our Liabilities because we now owe \$3,000 for this Advertising bill.

And, the last question I want to ask you is this:

Do we still balance?

The answer is yes, right?

On the Asset side, there is no change—No Effect (NE). Liabilities plus (+) Equity—one is going up and one is going down. They also net to No Effect (NE).

You will want to be comfortable with this.

You will want to be able to do these effects. It will be a big part of Exam 1.

The best way to deal with it is to make sure that you get some practice.