

# Financial Accounting

## Module 3: Recording Business Transactions



# Module Learning Outcomes

Understand double-entry accounting

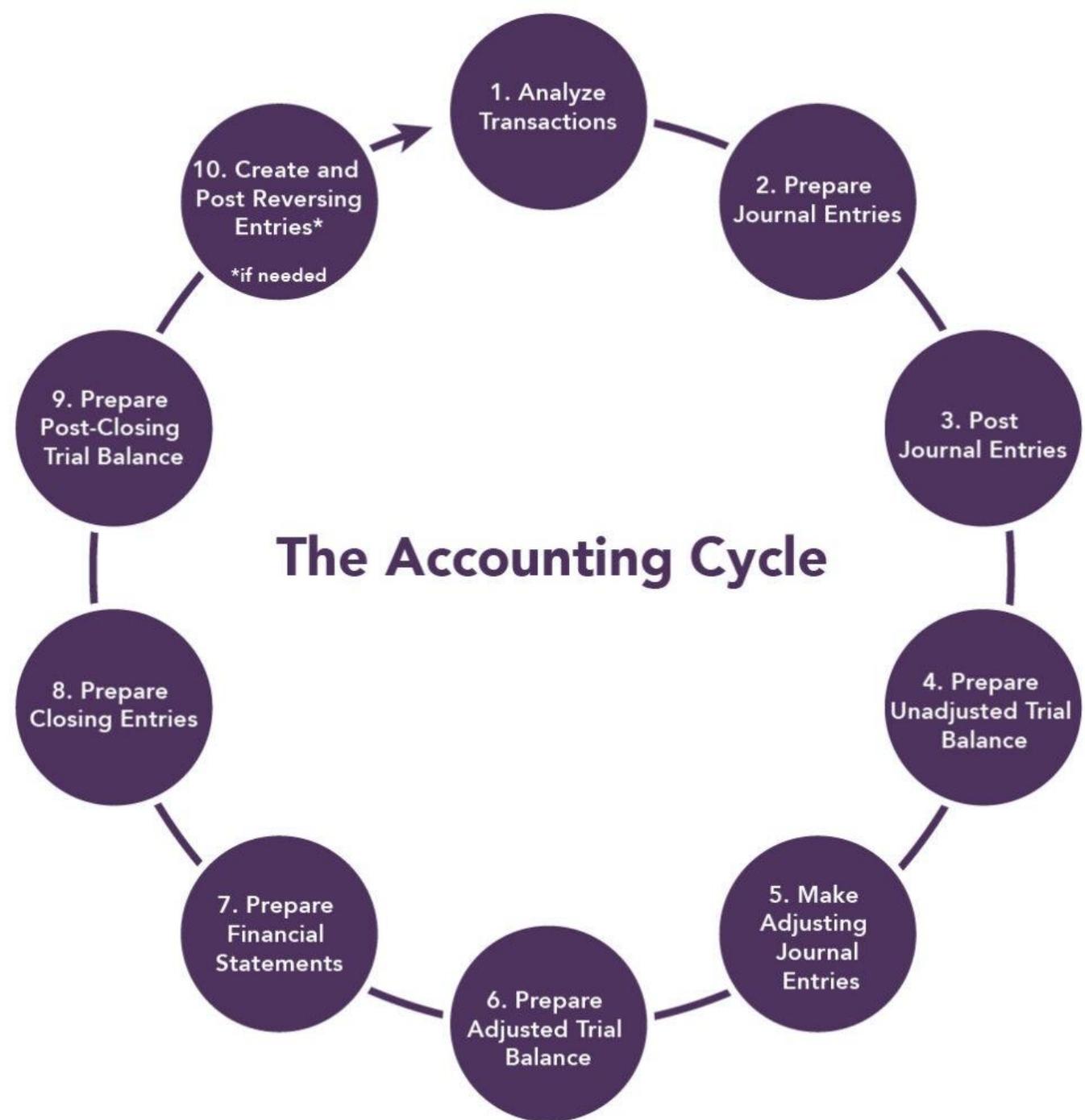
3.1: Identify the basic reporting structure of accounting information

3.2: Identify the accounting books of record

3.3: Account for business transactions using double-entry bookkeeping

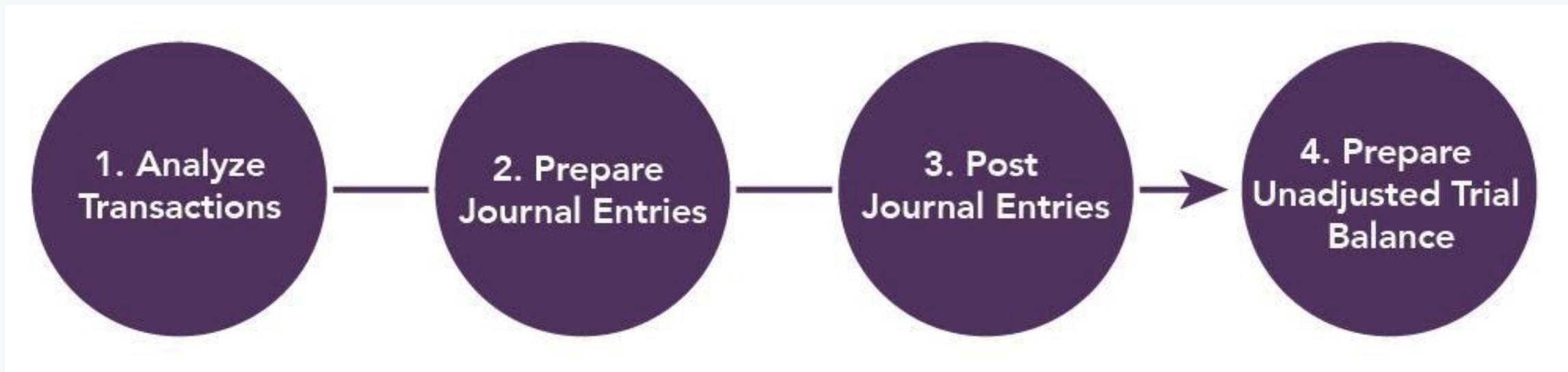
# The Accounting Cycle

- Double-entry bookkeeping allows all stakeholders to get an accurate picture of operations
- Accountants follow a strict, well-defined process to provide this information



# The Accounting Cycle (cont.)

In this module, we'll cover the first four steps:



# Double Entry Bookkeeping

# Learning Outcomes: Double Entry Bookkeeping

- 3.1: Identify the basic reporting structure of accounting information
  - 3.1.1: Define accounts as they are used in bookkeeping
  - 3.1.2: Explain the role of accounts
  - 3.1.3: List the general rules for debits and credits

# Accounts

- An account is a part of the accounting system used to classify and summarize a specific set of a business's transactions.
- Firms set up accounts for each different business element, such as cash, accounts receivable, and accounts payable.
- Accounts are categorized by type listed in this order:
  - Assets
  - Liabilities
  - Equity, which is broken down into:
    - Capital
    - Withdrawals
    - Revenue
    - Expenses

# The Role of Accounts

- We use accounts to track things that are important to us (using the monetary principle) and we try not to have more accounts than we need.
- Each account then will have a running total, called a “balance” that we, as bookkeepers, keep up to date and accurate.



# Rules of Debits and Credits

- Double-entry bookkeeping is the foundation of accounting.
- In the double-entry system, every transaction affects at least two accounts, and sometimes more.
- Instead of using negative and positive numbers, we record our transactions in terms of debit and credit.
- Debits are on the left and credits are on the right.

# Debits and Credits Example

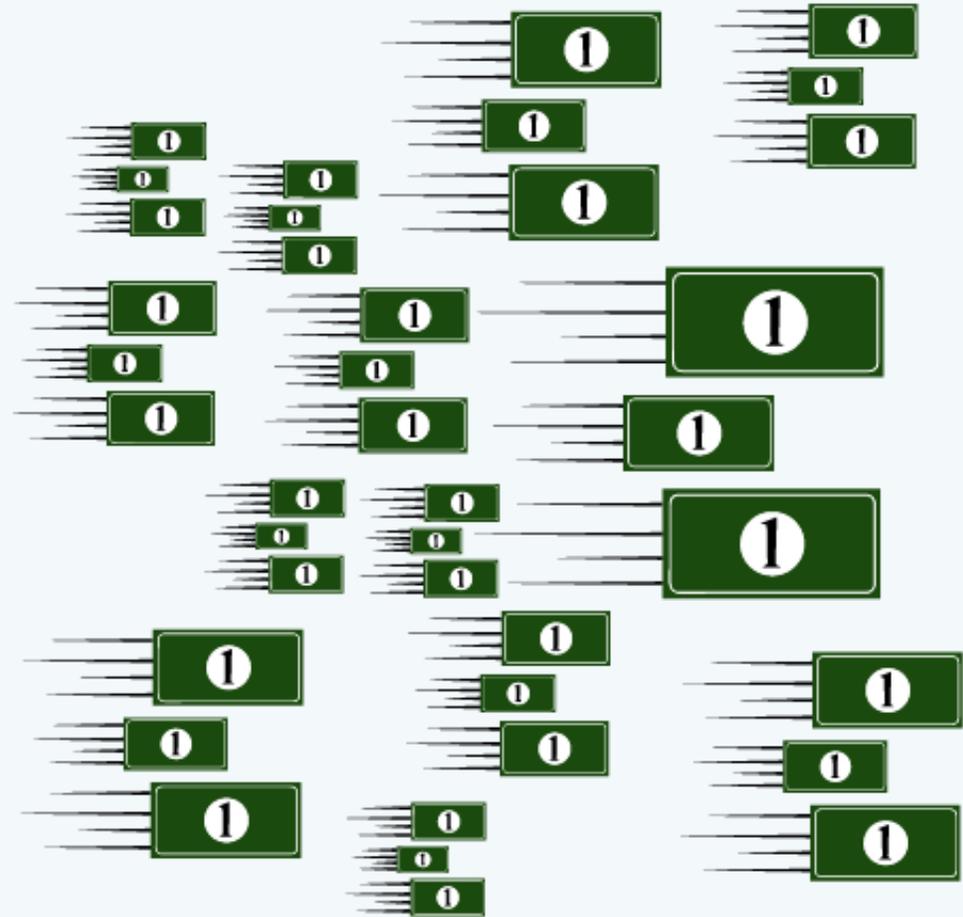
On April 1, Cheyenne Houghton opened a bank account in the name of her business, Cheyenne Creates, using \$10,000 of her own money from her personal account.

Checking Account, Cheyenne Creates	
Debit	Credit
\$10,000	

Cheyenne Houghton, Capital	
Debit	Credit
	\$10,000

# Debits and Credits and the Accounting Equation

- On the left side of the accounting equation:
  - Assets are increased by a debit, decreased by a credit
- On the right side of the accounting equation:
  - Liabilities are increased by a credit, decreased by a debit
  - Equity is increased by a credit, decreased by a debit



# Practice Question 1

The Lazy Z company received an additional \$20,000 in revenue in the last quarter from their sales of sleepwear. Being their accountant, you would record the increase in company revenue as a debit in \_\_\_\_\_ and a credit to \_\_\_\_\_ accounts.

- A. checking : revenue
- B. sales : cash
- C. revenue : inventory
- D. capital : accounts receivable

# Journals and Ledgers

# Learning Outcomes: Journals and Ledgers

## 3.2: Identify the accounting books of record

3.2.1: Identify a journal

3.2.2: Identify a ledger

3.2.3: Describe how a ledger is related to a T account

# Journals

A shorthand chronological list of transactions

JOURNAL				Page 1
DATE	DESCRIPTION	POST. REF.	DEBIT	CREDIT
20XX				
Apr. 1	Checking		10,000.00	
	Cheyenne Houghton, Capital			10,000.00
	To record initial investment by owner and deposit to bank account			
Apr. 4	Materials Expenses		3,000.00	
	Checking			3,000.00
	To purchase materials to create pottery			

# Ledgers

- A ledger is another book, similar to the journal, but organized by account. A general ledger is the complete collection of all the accounts and transactions of a company.
- This is a German ledger from 1828.



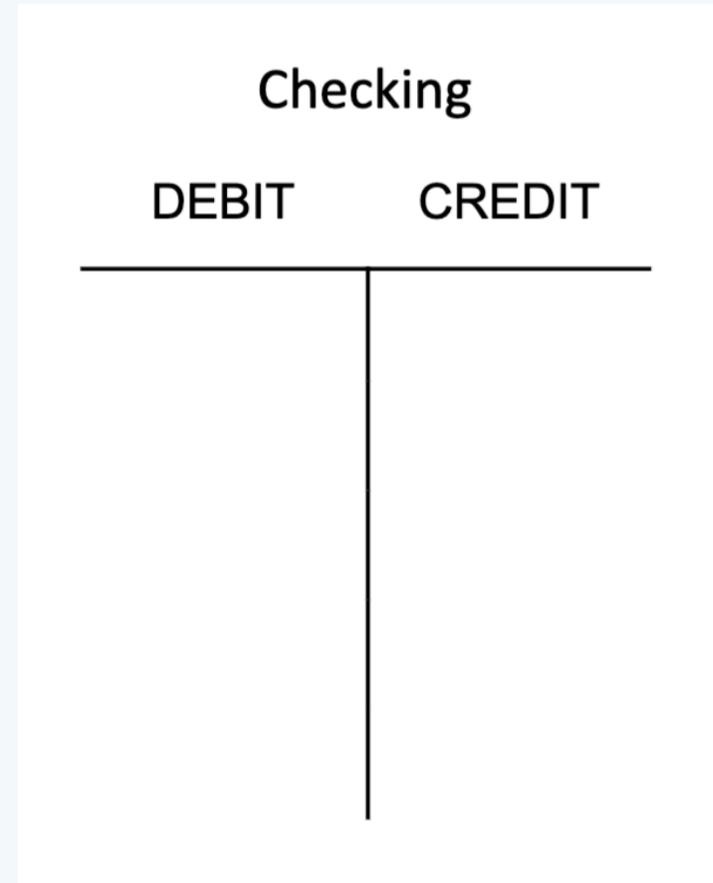
# Ledgers (cont.)

- This is a modern ledger

GENERAL LEDGER						
Account: Checking				Account No. 1100		
DATE	ITEM	POST. REF.	DEBIT	CREDIT	BALANCE	
					DEBIT	CREDIT
20-						
<b>Oct.</b>	<b>1</b>	<i>Balance</i>	a			199,846.33
Oct	9		J41	12,315.64		187,530.69
Oct	20		J41	474.55		187,056.14
Oct	23		J41	12,376.89		174,679.25
<b>Nov</b>	<b>4</b>		J42	484.42		174,194.83
Nov	6		J42	32.00		174,162.83
Nov	6		J43	12,180.03		161,982.80
Nov	13		J43	1,494.06		160,488.74
Nov	16		J44	6,529.02		153,959.72
Nov	16		J44	1,212.21		152,747.51
Nov	16		J44	537.00		152,210.51
Nov	20		J44	9,425.15		142,785.36
<b>Dec</b>	<b>3</b>		J45	427.43		142,357.93
Dec	4		J45	10,970.92		131,387.01
Dec	9		J46	32.00		131,355.01
Dec	14		J46	2,194.72		129,160.29
Dec	15		J46	6,651.26		122,509.03
Dec	15		J46	1,219.11		121,289.92
Dec	18		J46	482.76		120,807.16
Dec	18		J46	14.70		120,792.46
Dec	18		J46	52,905.17		67,887.29

# T Accounts

- A T account is just a simpler way to present a ledger
- You remove everything but the debit and credit columns



# Recording Process

# Learning Outcomes: Recording Process

## 3.3: Account for business transactions using double-entry bookkeeping

3.3.1: Analyze transactions and create journal entries

3.3.2: Post journal entries to a general ledger

3.3.3: Calculate the account balance

3.3.4: Prepare a trial balance

# Create Journal Entries

Let's take a look at a two transactions:

- On October 1, Nick opened a bank account in the name of NeatNiks using \$20,000 of his own money from his personal account.
- October 4, Nick rented a truck for \$12,000 cash for October thru March (6 months).

Now, let's journalize these transactions

# Create Journal Entries (cont.)

<b>JOURNAL</b>				<b>Page 1</b>	
<b>Date</b>	<b>Description</b>	<b>Post. Ref.</b>	<b>Debit</b>	<b>Credit</b>	
20–					
Oct. 1	Checking		20,000.00		
Oct. 1	Nick Frank, Capital			20,000.00	
Oct. 1	To record initial investment by owner and deposit to bank account				
Oct. 4	Prepaid Rent		12,000.00		
Oct. 4	Checking			12,000.00	
Oct. 4	To record prepayment of rent on vehicle				

# Post to the Ledger

- This process is largely automated in computerized accounting systems.
- Each account needs its own ledger—all of these ledgers will come together to form the general ledger.
- Take a look at this transaction again:
  - On October 1, Nick opened a bank account in the name of NeatNiks using \$20,000 of his own money from his personal account.
- When we post from the journal to the ledger, we do exactly as the journal tells us. If we think it's wrong, we go back to whoever analyzed the transaction.
- When we post, we note the page of the journal so we can go back later and find our source if we need to.
- We note the account number in the POST. REF. column of the journal.

# Post to the Ledger (cont.)

GENERAL LEDGER							
Account: Checking				Account No. 1100			
DATE	ITEM	POST. REF.	DEBIT	CREDIT	BALANCE		
					DEBIT	CREDIT	
20--							
Oct	1	<i>Balance</i>	a			0.00	
Oct	1		GJ1	20,000.00		20,000.00	

GENERAL LEDGER							
Account: Nick Frank, Capital				Account No. 310			
DATE	ITEM	POST. REF.	DEBIT	CREDIT	BALANCE		
					DEBIT	CREDIT	
20--							
Oct	1	<i>Balance</i>	a			0.00	
Oct	1		GJ1		20,000.00	20,000.00	

# Calculate Account Balances

- Ledgers include columns for account balances
- You calculate these balances by combining the credit and debit entries within the ledger

GENERAL LEDGER							
DATE		ITEM	POST. REF.	DEBIT	CREDIT	BALANCE	
						DEBIT	CREDIT
20–							
<b>Oct</b>	<b>1</b>	<b>Balance</b>	a			0.00	
Oct	20		GJ1	7,250.00		7,250.00	
Oct	30		GJ2		1,600.00	5,650.00	

# Calculate Account Balances (cont.)

- The balance on October 31 is a debit of \$5,650.00, calculated as follows:

<b>Beginning balance</b>	\$-
debit entry	7,250.00
credit entry	(1,600.00)
<b>Ending balance</b>	<u>\$5,650.00</u>

# Prepare a Trial Balance

- To prepare a trial balance, you'll take all of the balances from your general ledgers and compile them into one table.
- Put all the debit balances in one column, and all the credit balances in another, and compare the totals.

NeatNiks Trial Balance (unadjusted) For the month ended October 31, 20XX			
Ref No.	Accounts	Debits	Credits
110	Checking	3,500.00	
120	Accounts Receivable	5,650.00	
125	Supplies	2,600.00	
130	Prepaid Rent	12,000.00	
210	Account Payable		1,600.00
220	Contractor Payable		–
310	Nick Frank, Capital Contributions		20,000.00
330	Nick Frank, Withdrawals	4,000.00	
410	Service Revenue		8,750.00
510	Insurance Revenue	1,500.00	
520	Rent Expense	–	
530	Supplies Expense	–	
540	Contractor Expense	1,100.00	
	Totals	30,350.00	30,350.00

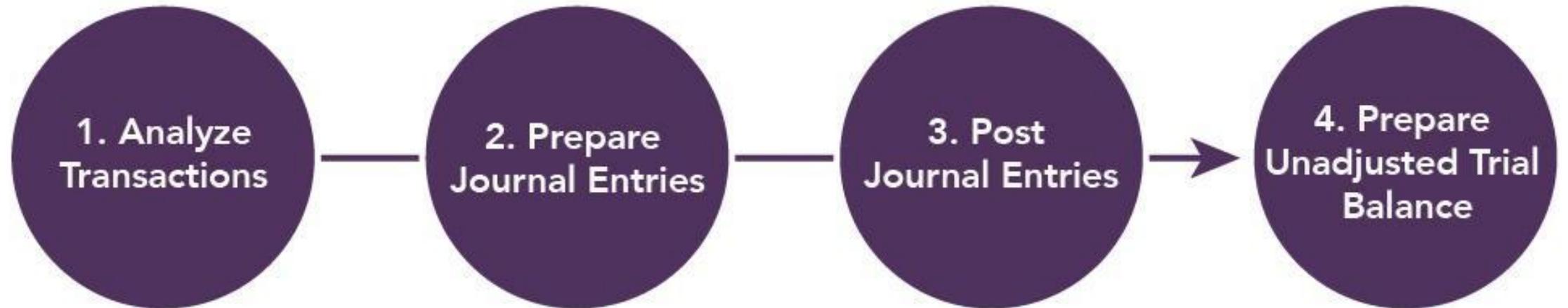
# Practice Question 2

A trial balance is:

- A. A ledger where actions and events are placed in chronological order.
- B. Where the debits and credits are in one column and calculated together.
- C. Also known as a general journal where each type of account has its own section.
- D. Where all of the balances are taken from the general ledgers and compiled into one table.

# Quick Review

- We went over the first four steps of the accounting cycle:



# Quick Review

- What are the definitions of accounts as they are used in bookkeeping?
- Describe the role of accounts in financial accounting.
- How would you list the general rules for debits and credits?
- What is a journal?
- What is a ledger?
- How is a ledger related to a T account?
- How do you analyze transactions and create journal entries?
- What is the process of posting journal entries to a general ledger?
- How do you calculate the account balance?
- How do you prepare a trial balance?