



DEBITS AND CREDITS: ANALYZING AND RECORDING BUSINESS TRANSACTIONS

Chapter 2

Learning Objectives

1. Setting up and organizing a chart of accounts.
2. Recording transactions in T accounts according to the rules of debit and credit.
3. Preparing a trial balance.
4. Preparing financial statements from a trial balance.

Learning Objective 1

Setting up and organizing a chart of accounts.

Standard Account

- A business transaction is recorded in the accounting equation under a specific account
- Different accounts are used for each subdivisions of the accounting equation:
 - ▣ Assets
 - ▣ Liabilities
 - ▣ Equity
 - ▣ Expenses
 - ▣ Revenues



Standard Account

□ Needed

- A way to record the increases and decreases
- In specific account categories
- Keeping them together in one place

□ Standard account

- Formal account that includes columns for:
 - Date
 - Item
 - Posting reference
 - Debits
 - Credits

Standard Account

- Accounts have a separate form
- Each form contains all transactions affecting it
- All forms kept together in a ledger (book-like)
- Each page contains one account

Account Title				Account Title				Account No.			
Date	Item	PR	Debit	Date	Item	PR	Credit				
Left Side				Right Side							

Standard Account

Account Title				Account Title				Account No.								
Date		Item		PR		Debit		Date		Item		PR		Credit		
Debit				Credit												

- All T accounts have this structure
- Left side is called debit side
- Right side is called credit side
- Debit and Credit indicates position only

Balancing an Account

- The procedure used to balance an account is the same for all accounts

	Dr.	Cr.	
	4/2 5,000	4/3 400	
	4/20 600	4/25 500	
FOOTING	5,600	900	FOOTING
Bal	4,700		

- Add the items listed on the left side and foot (subtotal)
- Add the items listed on the right side and foot (subtotal)
- Subtract the smaller number from the larger number
- The result is the account balance, listed on the side with the larger amount ($5,600 - 900 = 4,700$)

Learning Objective 2

Recording transactions in T accounts according to the rules of debit and credit.

Recording Business Transactions: Debits and Credits

- Learn the rules

TABLE 2.1 Rules of Debit and Credit

Account Category	Increase (Normal Balance)	Decrease
Assets	Debit	Credit
Liabilities	Credit	Debit
Owner's Equity		
Capital	Credit	Debit
Withdrawals	Debit	Credit
Revenue	Credit	Debit
Expenses	Debit	Credit

- Normal balance of an account is the side that increases

Recording Business Transactions: Debits and Credits

□ The rules

Assets		=	Liabilities		+	Owner's Equity										
Dr.	Cr.		Dr.	Cr.	+	Capital		-	Withdrawals		+	Revenue		-	Expenses	
+	-		-	+		Dr.	Cr.		Dr.	Cr.		Dr.	Cr.		Dr.	Cr.
						-	+		+	-		-	+		+	-

□ Rules for withdrawals and expenses are the opposite of those for capital and revenue

Assets		+	Withdrawals		+	Expenses		=	Liabilities		+	Capital		+	Revenue	
Dr.	Cr.		Dr.	Cr.		Dr.	Cr.		Dr.	Cr.		Dr.	Cr.		Dr.	Cr.
+	-		+	-		+	-		-	+		-	+		-	+

Balancing the Equation

- Amount(s) entered on the debit side of one account(s) must be on the credit side of another account(s)
- This ensures the accounting equation is in balance
 - ▣ You can have multiple debits with one credit
 - ▣ You can have multiple credits with one debit
 - ▣ You can have multiple debits with multiple credits
- Debit totals must equal credit totals

Chart of Accounts

- A numbered list of all of the business' accounts

TABLE 2.2 Chart of Accounts for Mia Wong, Attorney-at-Law

Balance Sheet Accounts

Assets

111 Cash

112 Accounts Receivable

121 Office Equipment

Liabilities

211 Accounts Payable

Owner's Equity

311 Mia Wong, Capital

312 Mia Wong, Withdrawals

Income Statement Accounts

Revenue

411 Legal Fees

Expenses

511 Salaries Expense

512 Rent Expense

513 Advertising Expense

The Transaction Analysis

□ The five steps to analyzing each transaction

Step 1 - Determine which accounts are affected. Example: Cash, Accounts Payable, Rent Expense. A transaction always affects at least two accounts.

Step 2 - Determine which categories the accounts belong to: assets, liabilities, capital, withdrawals, revenue, or expenses.

Step 3 - Determine whether the accounts increase or decrease. Example: If you receive cash, that account increases.

Step 4 - What do the rules of debit and credit say?

Step 5 - What does the T account look like?

Place amounts into accounts either on the left or right side depending on the rules.

The Transaction Analysis

- The five-step analysis from another perspective

1	2	3	4	5
Accounts Affected	Category	↓ ↑ (decrease) (increase)	Rules of Dr. and Cr.	Appearance of T Accounts

- Do not try to debit or credit an account until you go through the first three steps of the transaction analysis

Applying the Transaction Analysis

- A - August 28: Mia Wong invests \$6,000 cash and \$200 of office equipment in the business.

1 Accounts Affected	2 Category	3 ↓ ↑	4 Rules of Dr. and Cr.	5 Appearance of T Accounts				
Cash	Asset	↑	Dr.	<table border="1"> <tr><td colspan="2">Cash 111</td></tr> <tr><td>(A) 6,000</td><td></td></tr> </table>	Cash 111		(A) 6,000	
Cash 111								
(A) 6,000								
Office Equipment	Asset	↑	Dr.	<table border="1"> <tr><td colspan="2">Office Equipment 121</td></tr> <tr><td>(A) 200</td><td></td></tr> </table>	Office Equipment 121		(A) 200	
Office Equipment 121								
(A) 200								
Mia Wong, Capital	Capital	↑	Cr.	<table border="1"> <tr><td colspan="2">Mia Wong, Capital 311</td></tr> <tr><td></td><td>6,200 (A)</td></tr> </table>	Mia Wong, Capital 311			6,200 (A)
Mia Wong, Capital 311								
	6,200 (A)							

Compound Entries

- A transaction that involves more than one debit or more than one credit
- Example
 - ▣ A debit of \$6,000 to Cash and a debit of \$200 to Office Equipment for a credit of \$6,200 to Mia Wong, Capital
- The name for this is double-entry bookkeeping.

Applying the Transaction Analysis

- B - Aug. 29: Law practice bought office equipment for cash, \$500.

1 Accounts Affected	2 Category	3 ↓ ↑	4 Rules of Dr. and Cr.	5 T Account Update						
Office Equipment	Asset	↑	Dr.	<table border="1"> <tr> <td colspan="2" style="text-align: center;">Office Equipment 121</td> </tr> <tr> <td>(A) 200</td> <td></td> </tr> <tr> <td>(B) 500</td> <td></td> </tr> </table>	Office Equipment 121		(A) 200		(B) 500	
Office Equipment 121										
(A) 200										
(B) 500										
Cash	Asset	↓	Cr.	<table border="1"> <tr> <td colspan="2" style="text-align: center;">Cash 111</td> </tr> <tr> <td>(A) 6,000</td> <td>500 (B)</td> </tr> </table>	Cash 111		(A) 6,000	500 (B)		
Cash 111										
(A) 6,000	500 (B)									

Applying the Transaction Analysis

- C - Aug. 30: Bought more office equipment on account, \$300.

1 Accounts Affected	2 Category	3 ↓ ↑	4 Rules of Dr. and Cr.	5 T Account Update								
Office Equipment	Asset	↑	Dr.	<table border="1"> <tr> <td colspan="2">Office Equipment 121</td> </tr> <tr> <td>(A)</td> <td>200</td> </tr> <tr> <td>(B)</td> <td>500</td> </tr> <tr> <td>(C)</td> <td>300</td> </tr> </table>	Office Equipment 121		(A)	200	(B)	500	(C)	300
Office Equipment 121												
(A)	200											
(B)	500											
(C)	300											
Accounts Payable	Liability	↑	Cr.	<table border="1"> <tr> <td colspan="2">Accounts Payable 211</td> </tr> <tr> <td></td> <td>300 (C)</td> </tr> </table>	Accounts Payable 211			300 (C)				
Accounts Payable 211												
	300 (C)											

Applying the Transaction Analysis

- D - Sept. 1–30: Provided legal services for cash, \$2,000.

1 Accounts Affected	2 Category	3 ↓ ↑	4 Rules of Dr. and Cr.	5 T Account Update						
Cash	Asset	↑	Dr.	<table border="1"> <tr> <td colspan="2">Cash 111</td> </tr> <tr> <td>(A) 6,000</td> <td>500 (B)</td> </tr> <tr> <td>(D) 2,000</td> <td></td> </tr> </table>	Cash 111		(A) 6,000	500 (B)	(D) 2,000	
Cash 111										
(A) 6,000	500 (B)									
(D) 2,000										
Legal Fees	Revenue	↑	Cr.	<table border="1"> <tr> <td colspan="2">Legal Fees 411</td> </tr> <tr> <td></td> <td>2,000 (D)</td> </tr> </table>	Legal Fees 411			2,000 (D)		
Legal Fees 411										
	2,000 (D)									

Applying the Transaction Analysis

- E - Sept. 1–30: Provided legal services on account, \$3,000.

1 Accounts Affected	2 Category	3 ↓ ↑	4 Rules of Dr. and Cr.	5 T Account Update						
Accounts Receivable	Asset	↑	Dr.	<table border="1"> <tr> <td colspan="2">Accounts Receivable 112</td> </tr> <tr> <td>(E) 3,000</td> <td></td> </tr> </table>	Accounts Receivable 112		(E) 3,000			
Accounts Receivable 112										
(E) 3,000										
Legal Fees	Revenue	↑	Cr.	<table border="1"> <tr> <td colspan="2">Legal Fees 411</td> </tr> <tr> <td></td> <td>2,000 (D)</td> </tr> <tr> <td>3,000 (E)</td> <td></td> </tr> </table>	Legal Fees 411			2,000 (D)	3,000 (E)	
Legal Fees 411										
	2,000 (D)									
3,000 (E)										

Applying the Transaction Analysis

- F - Sept. 1–30: Received \$900 cash from clients for services rendered previously on account.

1 Accounts Affected	2 Category	3 ↓ ↑	4 Rules of Dr. and Cr.	5 T Account Update								
Cash	Asset	↑	Dr.	<table border="1"> <tr> <td colspan="2" style="text-align: right;">Cash 111</td> </tr> <tr> <td>(A) 6,000</td> <td style="border-left: 1px solid black;">500 (B)</td> </tr> <tr> <td>(D) 2,000</td> <td style="border-left: 1px solid black;"></td> </tr> <tr> <td>(F) 900</td> <td style="border-left: 1px solid black;"></td> </tr> </table>	Cash 111		(A) 6,000	500 (B)	(D) 2,000		(F) 900	
Cash 111												
(A) 6,000	500 (B)											
(D) 2,000												
(F) 900												
Accounts Receivable	Asset	↓	Cr.	<table border="1"> <tr> <td colspan="2" style="text-align: right;">Accounts Receivable 112</td> </tr> <tr> <td>(E) 3,000</td> <td style="border-left: 1px solid black;">900 (F)</td> </tr> </table>	Accounts Receivable 112		(E) 3,000	900 (F)				
Accounts Receivable 112												
(E) 3,000	900 (F)											

Applying the Transaction Analysis

- **G** - Sept. 1–30: Paid salaries expense, \$700.

1 Accounts Affected	2 Category	3 ↓ ↑	4 Rules of Dr. and Cr.	5 T Account Update																
Salaries Expense	Expense	↑	Dr.	<table border="1"> <tr> <td colspan="4">Salaries Expense 511</td> </tr> <tr> <td>(G)</td> <td>700</td> <td></td> <td></td> </tr> </table>	Salaries Expense 511				(G)	700										
Salaries Expense 511																				
(G)	700																			
Cash	Asset	↓	Cr.	<table border="1"> <tr> <td colspan="4">Cash 111</td> </tr> <tr> <td>(A)</td> <td>6,000</td> <td>500</td> <td>(B)</td> </tr> <tr> <td>(D)</td> <td>2,000</td> <td>700</td> <td>(G)</td> </tr> <tr> <td>(F)</td> <td>900</td> <td></td> <td></td> </tr> </table>	Cash 111				(A)	6,000	500	(B)	(D)	2,000	700	(G)	(F)	900		
Cash 111																				
(A)	6,000	500	(B)																	
(D)	2,000	700	(G)																	
(F)	900																			

Applying the Transaction Analysis

- H - Sept. 1–30: Paid rent expense, \$400.

1 Accounts Affected	2 Category	3 ↓ ↑	4 Rules of Dr. and Cr.	5 T Account Update														
Rent Expense	Expense	↑	Dr.	<table border="1"> <tr> <td colspan="2">Rent Expense 512</td> </tr> <tr> <td>(H)</td> <td>400</td> </tr> </table>	Rent Expense 512		(H)	400										
Rent Expense 512																		
(H)	400																	
Cash	Asset	↓	Cr.	<table border="1"> <tr> <td colspan="2">Cash 111</td> </tr> <tr> <td>(A)</td> <td>6,000</td> <td>500</td> <td>(B)</td> </tr> <tr> <td>(D)</td> <td>2,000</td> <td>700</td> <td>(G)</td> </tr> <tr> <td>(F)</td> <td>900</td> <td>400</td> <td>(H)</td> </tr> </table>	Cash 111		(A)	6,000	500	(B)	(D)	2,000	700	(G)	(F)	900	400	(H)
Cash 111																		
(A)	6,000	500	(B)															
(D)	2,000	700	(G)															
(F)	900	400	(H)															

Applying the Transaction Analysis

- I - Sept. 1–30: Received a bill for Advertising Expense (to be paid next month), \$200.

1 Accounts Affected	2 Category	3 ↓ ↑	4 Rules of Dr. and Cr.	5 T Account Update
Advertising Expense	Expense	↑	Dr.	Advertising Expense 513 <hr/> (I) 200
Accounts Payable	Liability	↑	Cr.	Accounts Payable 211 <hr/> 300 (C) 200 (I)

Applying the Transaction Analysis

- J - Sept. 1–30: Wong withdrew cash for personal use, \$100.

1 Accounts Affected	2 Category	3 ↓ ↑	4 Rules of Dr. and Cr.	5 T Account Update
Mia Wong, Withdrawals	Withdrawals	↑	Dr.	Mia Wong, Withdrawals, 312
Cash	Asset	↓	Cr.	
				(J) 100
				Cash 111
				(A) 6,000 500 (B)
				(D) 2,000 700 (G)
				(F) 900 400 (H)
				100 (J)

Summary of Transactions

Assets		=	Liabilities	+	Owner's Equity						
Cash 111		=	Accounts Payable 211	+	Capital	-	Withdrawals	+	Revenue	-	Expenses
(A) 6,000	500 (B)	=		+	Mia Wong,		Mia Wong,		Legal		Salaries
(D) 2,000	700 (G)	=	300 (C)	+	Capital 311	-	Withdrawals 312	+	Fees 411	-	Expense 511
(F) 900	400 (H)		200 (I)		6,200 (A)		(J) 100		2,000 (D)		(G) 700
	100 (J)								3,000 (E)		
Accounts Receivable 112											Rent Expense 512
(E) 3,000	900 (F)										(H) 400
Office Equipment 121											Advertising Expense 513
(A) 200											(I) 200
(B) 500											
(C) 300											

Learning Objective 3

Preparing a trial balance.

Trial Balance

- List of the ending balances of all the accounts in a ledger
- Total debits should equal total credits
- List in same order as they appear in chart of accounts

Trial Balance

**MIA WONG, ATTORNEY-AT-LAW
TRIAL BALANCE
SEPTEMBER 30, 200X**

	Dr.	Cr.
Cash	7 2 0 0 0 0	
Accounts Receivable	2 1 0 0 0 0	
Office Equipment	1 0 0 0 0 0	
Accounts Payable		5 0 0 0 0 0
Mia Wong, Capital		6 2 0 0 0 0
Mia Wong, Withdrawals	1 0 0 0 0 0	
Legal Fees		5 0 0 0 0 0
Salaries Expense	7 0 0 0 0 0	
Rent Expense	4 0 0 0 0 0	
Advertising Expense	2 0 0 0 0 0	
Totals	11 7 0 0 0 0	11 7 0 0 0 0

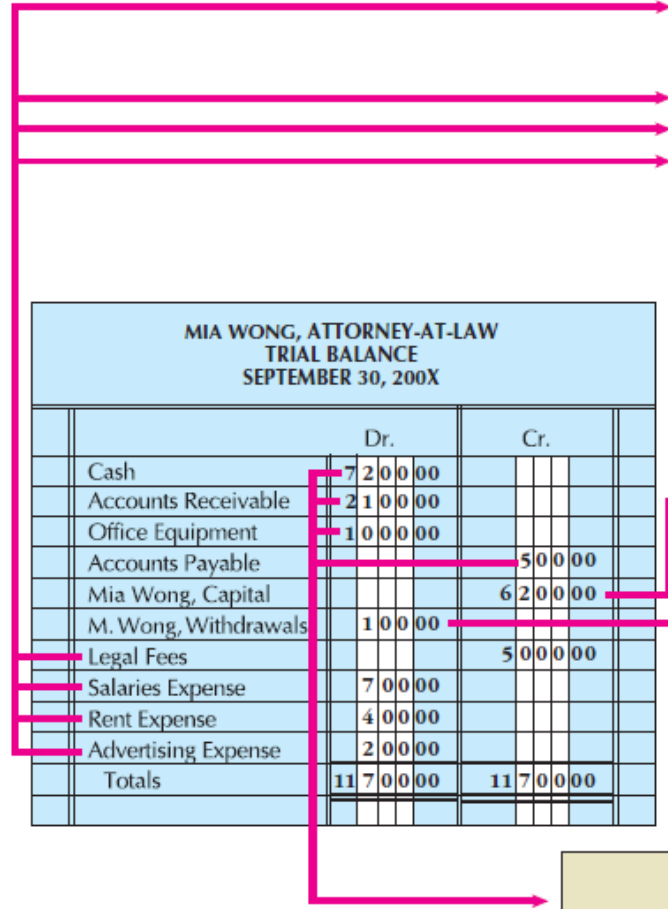
Learning Objective 4

Preparing financial statements
from a trial balance.

Steps in Preparing Financial Statements from a Trial Balance

- When a trial balance is complete, the total of all the debits must equal the total of all the credits.
- **Income Statement:** Once the trial balance is complete, the first report to make is the income statement, which is made up of only revenue and expense.
- **Statement of Owner's Equity:** The second report to prepare is the statement of owner's equity, which shows how to calculate a new figure for capital.
- **Balance Sheet:** The third report is the balance sheet, which lists out each asset, liability, and the new figure for capital.

Steps in Preparing Financial Statements from a Trial Balance



MIA WONG, ATTORNEY-AT-LAW INCOME STATEMENT FOR MONTH ENDED SEPTEMBER 30, 200X				
Revenue:				
Legal Fees			\$ 5 000 00	
Operating Expenses:				
Salaries Expense	\$ 7 000 00			
Rent Expense	4 000 00			
Advertising Expense	2 000 00			
Total Operating Expenses			1 300 00	
Net Income			\$ 3 700 00	

MIA WONG, ATTORNEY-AT-LAW TRIAL BALANCE SEPTEMBER 30, 200X				
	Dr.	Cr.		
Cash	7 200 00			
Accounts Receivable	2 100 00			
Office Equipment	1 000 00			
Accounts Payable		5 000 00		
Mia Wong, Capital		6 200 00		
M. Wong, Withdrawals	1 000 00			
Legal Fees		5 000 00		
Salaries Expense	7 000 00			
Rent Expense	4 000 00			
Advertising Expense	2 000 00			
Totals	11 700 00	11 700 00		

MIA WONG, ATTORNEY-AT-LAW STATEMENT OF OWNER'S EQUITY FOR MONTH ENDED SEPTEMBER 30, 200X				
Mia Wong, Capital				
September 1, 200X			\$ 6 200 00	
Net Income for September	\$ 3 700 00			
Less Withdrawals for September	1 000 00			
Increase in Capital			3 600 00	
Mia Wong, Capital				
September 30, 200X			\$ 9 800 00	

MIA WONG, ATTORNEY-AT-LAW BALANCE SHEET SEPTEMBER 30, 200X				
Assets		Liabilities and Owner's Equity		
Cash	\$ 7 200 00	Liabilities		
Accts. Receivable	2 100 00	Accounts Payable	\$ 5 000 00	
Office Equipm.	1 000 00	Owner's Equity		
		M. Wong, Capital	9 800 00	
		Total Liab. and		
Total Assets	\$ 10 300 00	Owner's Eq.	\$ 10 300 00	

Summary of the chapter

- The chart of accounts aids in locating and identifying accounts quickly.
- Remember that the rules of debit and credit only tell us on which side to place information. Whether the debit or credit represents increases or decreases depends on the account category: assets, liabilities, capital, and so on. Think of a business transaction as an exchange: You get something and you give or part with something.
- A transaction that involves more than one debit or more than one credit is called a **compound entry**.

Summary of the chapter

- You will notice that assets, withdrawals, and expenses increase when you put amounts on the left, or debit, side of these accounts. The accounting system balances because liabilities, capital, and revenue increase when you put amounts on the right, or credit, side of these accounts. The increase side of any account will represent its normal balance.

Summary of the chapter

- *Footings* are used to obtain the totals of each side of every T account that has more than one entry. The footings are used to find the ending balance. The ending balances are used to prepare a **trial balance**. The trial balance is not a financial statement, although it is used to prepare financial statements. The trial balance lists all the accounts with their balances in the same order as they appear in the chart of accounts.

Summary of the chapter

- The trial balance is a list of ending balances of ledger accounts. These balances are used to prepare the three financial reports. Financial reports have no debits or credits. The inside columns are used to subtotal numbers. Revenue and expenses go on the income statement. Withdrawals and either net income or net loss go on the statement of owner's equity to calculate a new figure for capital. The balance sheet is a list of assets, liabilities, and the new amount for ending capital. Remember that the trial balance has debit or credits, not the financial reports.

Summary of the chapter

- Once the trial balance is complete, the first statement to make is the income statement, which is made up of only revenue and expenses. Remember that there are no debits or credits on financial statements. All we are taking are the ending balances of each title from the trial balance. For the income statement, we list fees as the revenue and then list the expense titles in the inside column. Total operating expenses are then subtracted from the fees to arrive at a net income or a net loss.

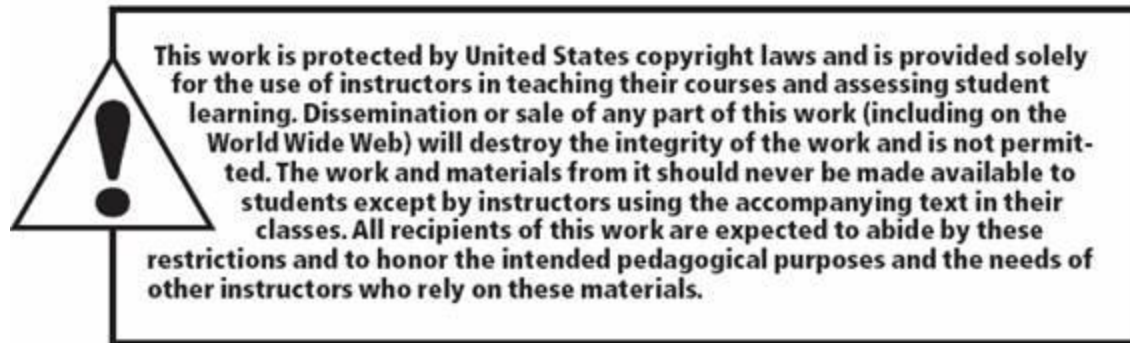
Summary of the chapter

- The second statement to prepare is the statement of owner's equity, which shows how to calculate a new figure for capital.
- The third report is the balance sheet, which lists out each asset, liability, and the new figure for capital.

Questions



Copyright



All rights reserved. No part of this publication may be reproduced, stored in a retrieval system, or transmitted, in any form or by any means, electronic, mechanical, photocopying, recording, or otherwise, without the prior written permission of the publisher. Printed in the United States of America.