

Chapter 3
USING ACCOUNTS

In Chapter 1 and 2 we looked at several business transactions

Ex. 1 When a customer paid cash to repay a debt to a business

Asset-Cash ↑
Asset-Accounts Receivable ↓

both on the left side of the accounting equation

Ex. 2 When a business paid cash for a debt - eliminating the claim of a creditor

Asset-Cash ↓ on the left side of the accounting equation
Liability-Accounts Payable ↓ on the right side of the accounting equation

In a normal business day a business may be involved in hundreds or even thousands of transactions involving cash.

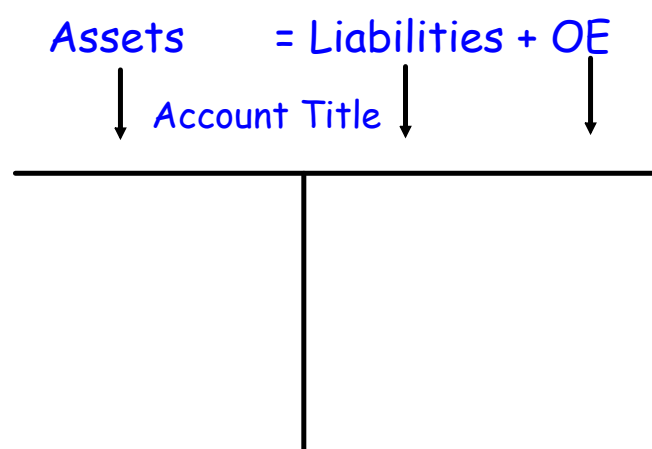
To find the balance of cash at the end of the day would you:

- 1.) record the increase and decreases in cash directly in one equation
- 2.) prepare hundreds or even thousands of separate accounting equations
- 3.) prepare a new balance sheet after each change in cash?

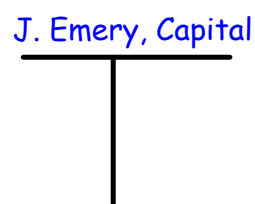
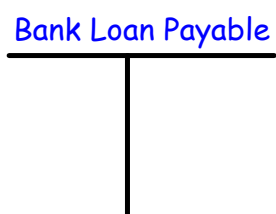
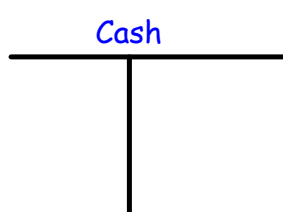
All of these methods are inefficient. A new device is needed to record changes to the items in the accounting equation.

Account - a device used for recording the effects of transactions under one title.

Topic 1 - Establishing Accounts

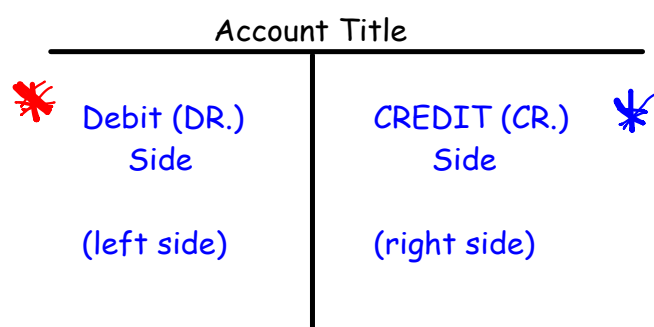


T Accounts



you would use a separate account for each asset and liability, and for each part of owner's equity.

In the language of accounting, the left side of every account is known as the **debit (DR.)** side and the right side is known as the **credit (CR.)** side



Opening Accounts

Do you see any relationship between the position of each element in the accounting equation and the position of the dollar amount the T-account? *Left* *Right*

Assets				=	Liabilities		+ Owner's Equity
Cash	Automobile	Furniture	Office Equipment	=	Bank Loan Payable	Accounts Payable	J. Emery, Capital
\$60 000	\$15 000	\$8 000	\$7 000	=	\$20 000	\$10 000	\$60 000
Cash	Automobile	Furniture	Office Equipment		Bank Loan Payable	Accounts Payable	J. Emery, Capital
60 000	15 000	8 000	7 000		20 000	10 000	60 000

Assets on Debit (left)

Liabilities & OE on Credit (Right)

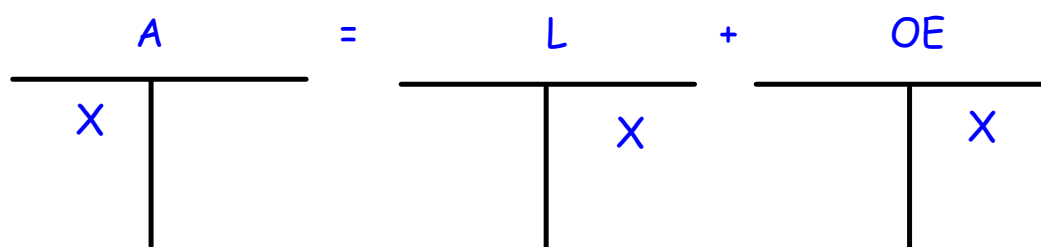
These entries are called opening balances

Assets are on the left side of the accounting equation

-all assets will show their beginning balances on the left side (Dr)

Where would you locate the opening balances for liabilities and owner's equity, subelement Capital? right side (Cr)

Positions of Opening Balances



Rule for Opening Balances

An account is opened by placing its beginning amount, called an opening balance, on the same side that the account appears in the accounting equation

Opening Accounts for a Business

J. Emery Real Estate
Balance Sheet
as at September 30, 19 —

ASSETS

Cash	\$60 000.00
Automobile	15 000.00
Furniture	8 000.00
Office Equipment	7 000.00

LIABILITIES

Bank Loan Payable	\$20 000.00
Accounts Payable:	
Bell Furniture Co. ...	\$3 000.00
Ryan Equipment Co. ...	2 000.00
Westtown Motors Ltd. ...	<u>5 000.00</u>
Total Liabilities	<u>10 000.00</u>
Total Liabilities	\$30 000.00

OWNER'S EQUITY

	J. Emery, Capital	<u>60 000.00</u>
Total Assets	Total Liabilities and Owner's Equity	<u>\$90 000.00</u>

Cash	
19—	
Sept. 30	60 000

Bank Loan Payable	
19—	
Sept. 30	20 000

Automobile	
19—	
Sept. 30	15 000

Accts. Pay./Bell Furniture Co.	
19—	
Sept. 30	3 000

Short for Accounts Payable

notice a separate account is opened for each creditor

Furniture	
19—	
Sept. 30	8 000

Accts. Pay./Ryan Equipment Co.	
19—	
Sept. 30	2 000

Office Equipment	
19—	
Sept. 30	7 000

Accts. Pay./Westtown Motors Ltd.	
19—	
Sept. 30	5 000

When the business has customers, a separate account is opened for each one. The short form of Accounts Receivable is Accts. Rec.

Why is there no account called Owner's Equity ?

Dollar signs are not required - T Accounts are not formal reports

ASSETS \$90 000 = LIABILITIES \$30 000 + OWNER'S EQUITY \$60 000

Assets	Left	DR
Liabilities	Right	CR

OPENING LEDGER

- when accounts have been opened for all assets, liabilities and the owner's equity, the entire group of accounts forms the ledger.

LEDGER: a file or group of accounts

There are many different types and forms of ledgers but for now we will think of a ledger as "a group of T - accounts."

The equation in the ledger will always show that the total debits are equal to the total credits.

See Summary of Ledger Account Balances - Page 78

Bryan's Bakery

Cash 40000
 Land 10000
 Building 55000
 Van 5000
 Bank Loan 20000
 Accounts Payable:
 Walmart 10000
 Sobeys 15000
 B. Carter Capital 65000

Set up T-Accounts

Cash	
2016 Oct 20	40000

Bank Loan	
2016 Oct 20	20000

Land	
2016 Oct 20	10000

Accts. Pay Walmart	
2016 Oct 20	10000

Building	
2016 Oct 20	55000

A/P Sobeys	
2016 Oct 20	15000

Van	
2016 Oct 20	5000

B. Carter Capital	
2016 Oct 20	65000

Finish P 3-3

	Assets				=	Liabilities			+	OE
	Cash	Computer Equipment	Computer Software	Total Assets		Bank Loan Payable	Accts. Pay/ Larry's Comp. Store	Accts. Pay/ Manley's Ltd.		
1	15000			15000				0	15000	
2		+8000		+8000		+8000		8000		
3	-4300		+4300	0						
4		-500		-500		-500		-500		
5	+6000			+6000	+6000			+6000		
6	-1460	+7300		+5840			+5840	+5840		
Totals	15240	14800	4300	<u>34340</u>	6000	7500	5840	<u>19340</u>	<u>15000</u>	

$$A = L + OE$$

$$34340 = 19340 + 15000$$

P 3-3c

Peter's Programming Service
 Opening Balance Sheet
 as at April 12, 19--

ASSETS		LIABILITIES	
Cash	\$15 240	Bank Loan Payable	\$6 000
Computer Equipment	14 800	Accounts Payable:	
Computer Software	4 300	Larry's Computer Store	\$ 7 500
		Manley's Ltd.	<u>5 840</u>
			<u>13 340</u>
		Total Liabilities	\$19 340
		OWNER'S EQUITY	
		P. Ramlagen, Capital	<u>\$15 000</u>
Total Assets	<u>\$34 340</u>	Total Liabilities and Owner's Equity	<u>\$34 340</u>

P 3-3d

Cash	Computer Equipment	Computer Software
19-- Apr. 12 15 240	19-- Apr. 12 14 800	19-- Apr. 12 4 300
Bank Loan Payable	Accounts Payable/ Larry's Computer Store	Accounts Payable/ Manley's Ltd.
19-- Apr. 12 6 000	19-- Apr. 12 7 500	19-- Apr. 12 5 840
P. Ramlagen, Capital		
19-- Apr. 12 15 000		

P 3-3e

Peter's Programming Service
Summary of Ledger Account Balances
as at April 12, 19--

TOTAL DEBIT (LEFT) BALANCES		TOTAL CREDIT (RIGHT) BALANCES	
Cash	\$15 240	Bank Loan Payable	\$ 6 000
Computer Equipment	14 800	Accts. Pay./Larry's Computer Store	7 500
Computer Software	4 300	Accts. Pay./Manley's Ltd.	5 840
	_____	P. Ramlagen, Capital	15 000
Total Debits	<u>\$34 340</u>	Total Credits	<u>\$34 340</u>
Total Assets	<u>\$34 340</u>	= Total Liabilities + Owner's Equity	<u>\$34 340</u>

The totals prove that the total of the debit balances equals the total of the credit balances. In other words, the accounting equation within the ledger balances.

KEY FOR TOPIC 1 MINI-CASES

MC 3-1a

No. Julian understands that the term debit means left and that the term credit means right. But, he is applying the terminology incorrectly. Using the rule that he has stated, Julian will not be successful in recording business transactions at least half of the time.

MC 3-1b

The term debit in accounting means left or an entry placed on the left side of an account. The term credit in accounting means right or an entry placed on the right side of an account.

MC 3-1c

A transaction that will work for Julian would be as follows: The firm bought office supplies on account. The entry for this transaction would be debit Office Supplies and credit Accounts Payable.

MC 3-1d

A transaction that will not work for Julian would be as follows: Suppose the firm paid an outstanding liability in full by cheque. The entry for this transaction would be debit Accounts Payable and credit Cash.

MC 3-2a

This is a good start since Wolf has identified two of the three elements of the accounting equation in his records. Unfortunately, Wolf has not identified his personal investment into the business. In terms of the accounting equation $A = L + OE$, Wolf will not be able to balance the equation because of the missing component.

MC 3-2b

Wolf has not included his personal investment into the business. The accounting element that is missing is owner's equity and the specific account is Capital.

MC 3-2c

	A			L		OE
	Cash		=	Bank Loan		W. Moritz,
	(a) \$500	Tools		Payable		Capital
	(b) \$300	(a) \$1 500	=	(b) \$300		(a) \$2 000
			=			

It is important that Wolf understand that the dollar amount of each transaction be identified and recorded. What Wolf failed to identify was the second half of his personal investment into the business. By referring to the labelled T-accounts, you could show Wolf the resulting entries from the two transactions that occurred as he began his business. Transaction (a) involved three accounts. These included an increase in the asset Cash, an increase in the asset Tools, and finally an increase in his owner's equity Capital account. Transaction (b) involved two accounts, both of which he identified. These included an increase to the asset Cash, and an increase to the liability Bank Loan Payable. Wolf is on the right track, but he is not illustrating an understanding of the double-entry system.

MC 3-3a

No. Margaret is not correct. Eight accounts are enough to make up a ledger.

MC 3-3b

A ledger is the collection and the classification of all of the accounts of a business. The ledger could be as simple as a loose leaf book in a manual system, or as sophisticated as the computer disk resulting from the use of a computer accounting program.