

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.

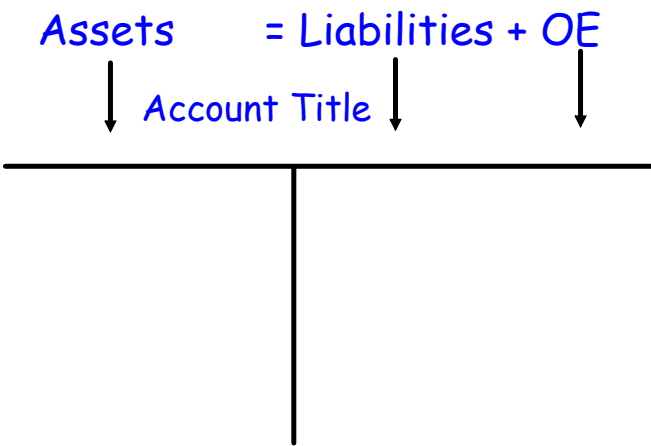
To find the balance of cash at the end of the day would you:

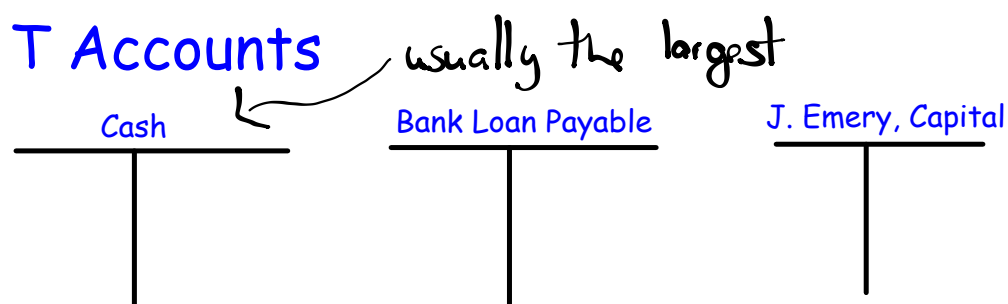
- 1.) record the increase and decreases in cash directly in one equation
- 2.) prepare hundreds or even thousands of separate accounting equations
- 3.) prepare a new balance sheet after each change in cash?

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





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

Account Title	
Debit (DR.) Side (left side)	CREDIT (CR.) Side (right 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?

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

Assets carry a debit balance

Liabilities
carry a credit
balance

OE
carry a
credit
balance

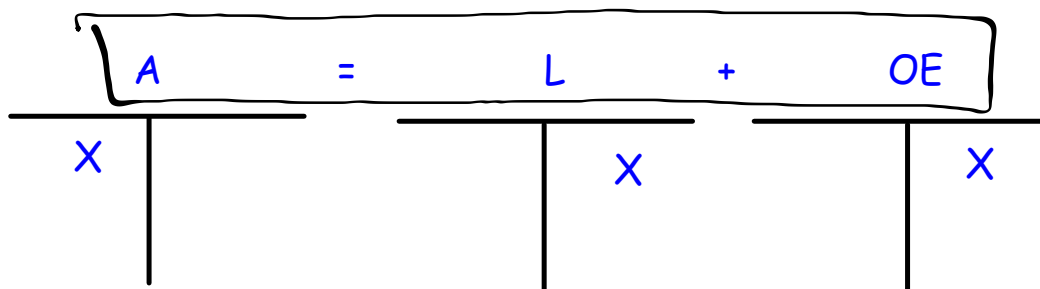
These entries are called opening balances

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

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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>\$30 000.00</u>

OWNER'S EQUITY

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

Total Assets \$90 000.00

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.

J. Emery, Capital
19— Sept. 30 60 000

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

Set up T-Accounts

Bryan's Bakery

$$A = L + OE$$

Cash 40000

Land 10000

Building 55000

Van 5000

Assets (4 accounts)

Bank Loan 20000

Accounts Payable:

Walmart 10000

Sobeys 15000

Liabilities (3 accounts)

B. Carter Capital 65000 → OE (1 account)

CASH	
DATE	40 000

BANK LOAN	
20000	DATE

LAND	
10 000	

A/P WALMART	
10 000	

BUILDING	
55 000	

A/P SOBEYS	
15 000	

VAN	
5000	

CAPITAL	
65000	

TOTAL DEBITS = TOTAL CREDITS
 \$ 110 000 = \$ 110 000

Questions from homework

3-1

a) Saskatchewan Garden Maintenance Company

P 3-1a

Cash <hr/> 19-- Today's Date 1 000	Land <hr/> 19-- Today's Date 52 000	Building <hr/> 19-- Today's Date 124 000
Maintenance Equipment <hr/> 19-- Today's Date 9 500	Truck <hr/> 19-- Today's Date 8 000	Office Equipment <hr/> 19-- Today's Date 900
Bank Loan Payable <hr/> 19-- Today's Date 8 500	Accounts Payable/ Guthrie Home Hardware Ltd. <hr/> 19-- Today's Date 1 000	Accounts Payable/ P & P Equipment Supplies, Inc. <hr/> 19-- Today's Date 2 000
Mortgage Payable <hr/> 19-- Today's Date 130 000	N. Liebensson, Capital <hr/> 19-- Today's Date 53 900	

P 3-1b

Saskatchewan Garden Maintenance Company
Summary of Ledger Account Balances
as at Today's Date, 19--

TOTAL DEBIT (LEFT) BALANCES		TOTAL CREDIT (RIGHT) BALANCES	
Cash	\$ 1 000	Bank Loan Payable	\$ 8 500
Land	52 000	Accts. Pay./Guthrie Home Hardware Ltd.	1 000
Building	124 000	Accts. Pay./P & P Equip. Supplies, Inc. .	2 000
Maintenance Equipment	9 500	Mortgage Payable	130 000
Truck	8 000	N. Liebensson, Capital	53 900
Office Equipment	900		
Total Debits	\$195 400	Total Credits	\$195 400
Total Assets	\$195 400	Total Liabilities + Owner's Equity	\$195 400

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Finish problem 3-3

3-3 a)

	Assets Change				=	Liabilities Change			+	OE
	Cash	Computer Equipment	Computer Software	Total Assets		Bank Loan Payable	Accts. Pay/ Larry's Comp. Store	Accts. Pay/ Manley's Ltd.	Total Liabilities	Peter Ramlagen, Capital
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	34340	6000	7500	5840	19340	15000	

b)

$$A = L + OE$$

$$34340 = 19340 + 15000$$

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.	5 840
			<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--		19--		19--	
Apr. 12	15 240	Apr. 12	14 800	Apr. 12	4 300
Bank Loan Payable		Accounts Payable/ Larry's Computer Store		Accounts Payable/ Manley's Ltd.	
19--		19--		19--	
Apr. 12	6 000	Apr. 12	7 500	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,
				Payable		Capital
		(a) \$500	=			(a) \$2 000
		(b) \$300	=	(b) \$300		
		Tools				
		(a) \$1 500				

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.