

## Chapter 3

### Topic 3 - Recording Owner's Equity Changes in T-Accounts

What is Owner's Equity???

- the claim of the owner against the total assets as shown in the accounting equation and as reported by the balance sheet.

What type of business transactions would cause a change in Owner's Equity?

Can you name four?

1. Additional investment by the owner of the business (Capital) ↑
2. Revenue ↑
3. Expense ↓
4. A withdrawal of assets for the owner's personal use (Drawings) ↓

Does an account called Owner's Equity exist? *Nope*

Owner's Equity (OE)

$$A = L + C + R - E - D$$

## 4 Separate Sections Under Owner's Equity

|              |   |  |
|--------------|---|--|
| Capital (C)  | + | The owner's investment (Credit)  |
| Revenue (R)  | + | The inflow of cash and accounts receivable resulting from sales (Credit)   |
| Expenses (E) | - | The operating costs incurred in bringing revenue into the business (Debit) |
| Drawings (D) | - | The withdrawal of assets for the owner's personal use. (Debit)             |

## Applying Debit and Credit Rules to Record Changes to Owner's Equity

Rules for Recording an Increase to Owner's Equity *Capital / Revenue*  
 - recorded in the account that causes the increase to OE in the accounting equation, on the side on which OE is placed in the accounting equation - the credit side.

Rules for Recording a Decrease to Owner's Equity *Expenses / Drawing*  
 - recorded in the account that decreases OE, and on the side opposite to the one on which OE appears in the accounting equation - the debit side.

### Debit or Credit

|              |   |
|--------------|---|
| Capital (C)  | + |
| Revenue (R)  | + |
| Expenses (E) | - |
| Drawings (D) | - |

Often the first transaction in a business is initial investment of the owner in his or her business. Jane Emery opened a business and invested \$60 000

| <u>What happens?</u>       | <u>Accounting Rule</u>               | <u>Accounting Entry</u>              |
|----------------------------|--------------------------------------|--------------------------------------|
| Cash increases by \$60 000 | Increase an asset, debit the account | Debit: Cash \$60000                  |
| OE increases by \$60 000   | Increase in OE credit the account    | Credit:<br>J. Emery, Capital \$60000 |

Oct. 16 Jane Emery decides to increase her investment in the business by taking \$3000 from her personal savings account and depositing the cash into the business's chequing account.

What happens?

Accounting Rule

Accounting Entry

Cash ↑

Increase an Asset

Debit Cash

Capital ↑

Increase OE

Credit Capital

| CASH          |            |
|---------------|------------|
| 2010          | 2010       |
| Sept 30 60000 | Oct 1 1000 |
|               | 5 5000     |
| Oct 16 3000   | 15 4000    |

| J. Emery, Capital |  |
|-------------------|--|
| 2010              |  |
| Sept 30 60000     |  |
| Oct 16 3000       |  |

Oct. 30 Jane Emery withdraws \$2000 from her business account and deposits it into her personal bank account.

What happens?

Cash ↓  
OE ↓

Accounting Rule

Decreasing an Asset  
Decreasing OE

Accounting Entry

Credit Cash  
Debit Drawing

| CASH          |            |
|---------------|------------|
| 2010          | 2010       |
| Sept 30 60000 | Oct 1 1000 |
| Oct 16 3000   | 5 5000     |
|               | 15 4000    |
|               | 30 2000    |

| J. Emery, Drawings |  |
|--------------------|--|
| 2010               |  |
| Oct 30 2000        |  |

## RECORDING REVENUE TRANSACTIONS

- revenue is an inflow of cash and accounts receivable that results from the sale of goods or service.

It causes a(n) INCREASE in owner's equity in the accounting equation. To record this increase in a ledger, a revenue account must be CREDITED.



Oct. 31 Jane Emery Real Estate has received \$26800 for buying and selling homes, land, and other forms of real estate for a variety of clients.

What happens?

Cash ↑  
OE ↑

Accounting Rule

Increase an Asset  
Increase OE

Accounting Entry

Debit Cash  
Credit Revenue

| CASH    |       | Commissions Earned |        |
|---------|-------|--------------------|--------|
| 2010    |       | 2010               |        |
| Sept 30 | 60000 | Oct 1              | 1000   |
| Oct 16  | 3000  | 5                  | 5000   |
|         |       | 15                 | 4000   |
|         |       | 30                 | 2000   |
| 31      | 26800 |                    |        |
|         |       |                    | 2010   |
|         |       |                    | Oct 31 |
|         |       |                    | 26800  |

name of revenue account depends on the nature of the business's operation

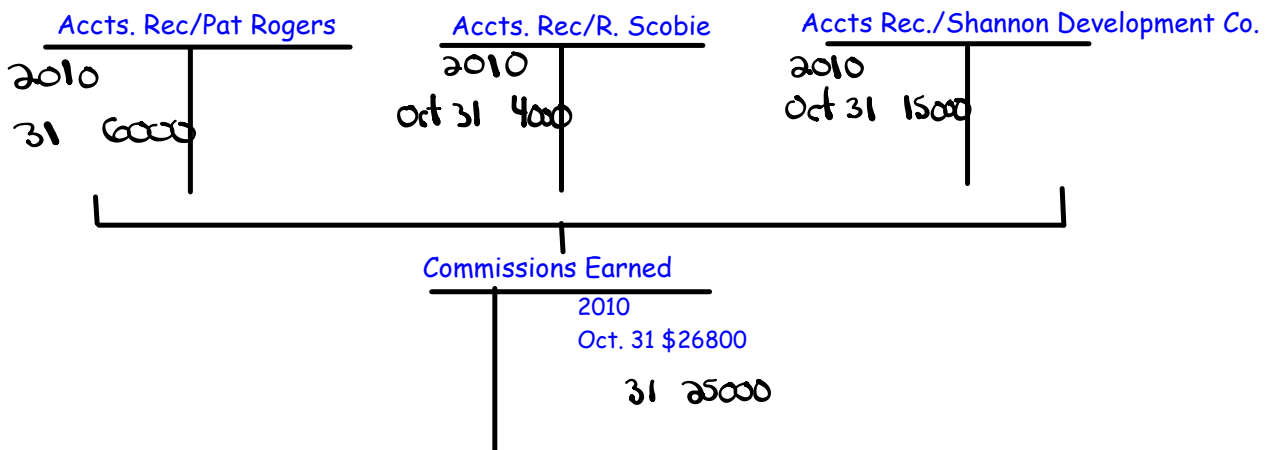
Oct. 31 J. Emery Real Estate earned commissions on credit by providing real estate services as follows: \$6000 for selling a building for Pat Rogers; \$4000 for selling a residence for R. Scobie; \$15000 for buying properties for Shannon Development Co/ All clients were given 30 days in which to pay.

What happens?

Accounting Rule

Accounting Entry

AIR ↑      Increase an Asset      Debit AIR  
OE ↑      Increase an OE      Credit Revenue



Oct. 31 J. Emery Real Estate pays \$6735 cash for the following expenses:  
 Rent \$1600; Salaries \$4500; Utilities \$595; Telephone \$40

What happens?

Accounting Rule

Accounting Entry

Cash ↓

Decrease an Asset

Credit Cash

OE ↓

Decrease OE

Debit Expenses

| Rent   |      | Salaries |      | Utilities |     | Telephone |    |
|--------|------|----------|------|-----------|-----|-----------|----|
| 2010   |      | 2010     |      | 2010      |     | 2010      |    |
| Oct 31 | 1600 | Oct 31   | 4500 | Oct 31    | 595 | Oct 31    | 40 |

| Cash    |       |       |      |
|---------|-------|-------|------|
| 2010    | 2010  |       |      |
| Sept 30 | 60000 | Oct 1 | 1000 |
| Oct 16  | 3000  | 5     | 5000 |
| 31      | 26800 | 15    | 4000 |
|         |       | 30    | 2000 |
|         |       | 31    | 6735 |

Oct. 31 J. Emery Real Estate receives a bill for \$2000 from The City Record, a local newspaper, for running of three advertisements at different times during October. The bill allows the business a period of 30 days in which to pay.

*Expense*

What happens?

Accounting Rule

Accounting Entry

A/P ↑

Increase a Liability

Credit A/P

OE ↓

Decrease OE

Debit Expenses

| Adverstising Expense |      |
|----------------------|------|
| 2010                 |      |
| Oct 31               | 2000 |

| Accts. Pay./The City Record |             |
|-----------------------------|-------------|
|                             | 2010        |
|                             | Oct 31 2000 |

Why is it important to record this transaction in October even though no cash will be paid out until November?

**MATCHING PRINCIPLE**

P3-7 Page 103 on TBook, Page 87 in Workbook. Record the transaction from P2-5 Page 44

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P 3-8 Page 103, refers to P 2-9 Page 54-55

P 3-9 Page 103

