NEAR EAST UNIVERSITY

CB

ACC 202

SINGLE AND DOUBLE ENTRY BOOK KEEPING SYSTEMS AND BALANCE SHEETS FINANCE

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Double entry accounting:

The rules of debit and credit are designed so that equal amounts of debit and credit entries are needed to record every business transaction. Assume, for example, that a company purchased land for $50,000. If the land were purchased for cash, the land account would be debited for $50,000, and the cash account would be credited for the same amount. If the land were purchased by issuing a note payable, the land account would be debited and the liability account , Notes Payable, would be credit. If the land were purchased by paying $10,000 cash and issuing a note payable for the remaining $40,000, the transaction would be recorded as follows: debit Land, $50,000; credit Notes payable, $40,000. Notice that in each case, equal dollar amounts of debit and credit entries are needed to record the transaction.

The need for equal amounts of debit and credit entries to record every business transaction is called the double entry system of accounting. The double entry system is used by virtually every business organization, regardless of whether the company's accounting records are maintained manually or by computer.

Since every transaction is recorded by equal amounts of debits and credits, it follows that the total of all debit entries in the ledger is equal to the total of all credit entries.

Recording transactions in ledger accounts

The procedure for recording transactions in ledger accounts will be illustrated by using the September transactions of Roberts Real Estate Company. Each transaction will first be analyzed in terms of increases and decreases in assets, liabilities, and owner's equity. Then we shall follow the rules of debit and credit in entering these increases and decreases in T accounts. asset accounts will be shown on the left hand side of the page; liability and owner's equity will be shown on the right side. For convenience in following the transactions into the ledger accounts, the letter used to identify a given transaction will also appear opposite the debit and credit entries for that transaction. This use of identifying letters is for illustrative purposes only and is not used in actual accounting practice.

-Transaction (a) Roberts invested $180,000 cash in the business on September .

Analyses	RULE	ENTRY
The asset Cash was increased	Increases in assets are recorded by depts.	DEBIT :Cash,$180,000
The owner's equity was increased	Increases in owners equity are recorded by credits	CREDIT : James Robertz, CREDIT ,$180,000

CASH	
9/1 (A)180,000	

JAMES ROBERS,CAPITAL	
	9/1 (A)180,000

Transaction (b):

On September 3, Roberts Real Estate Company purchased land for cash in the amount of $141,000

ANALYSES	RULE	ENTRY
The asset Land was increased	Increases in assets are recorded by debits	DEBIT: land, $141,000
The asset Cash was decreased	Decreases in assets are recorded by credits	CREDIT: Cash, $141,000

CASH

9/1 180,000	9/3 (b) 141,000

LAND

9/3 (b) 141,000	

Transaction (credit)

On September 5, Roberts Real Estate Company purchased a building from Kent Company at a total of $36,000. The terms of the purchase required a cash payment of $15,000 with the remainder of $21,000 payable within 90 days.

ANALYSES	RULE	ENTRY
A new asset, Building, was acquired	Increases in assets are recorded by debits	DEBIT: Building, $36,000
The asset cash was decreased	Decreases in assets are recorded by credits	CREDIT: Cash, $15,000
A new liability, Accounts payable, was incurred	Increases in liabilities are recorded by credits	CREDIT: Accounts payable, $21,000

CASH	
9/1 180,000	9/3 141,000
	9/5 (C) 15,000

ACCOUNTS PAYABLE	
	9/5 (C)21,000

BUILDING	
9/5(c)36,000	

Transaction (d)

On September 10, Roberts Real Estate Company sold portion of its land to Carter's Drugstore for a price of $11,000. The land was sold at its cost, so there was no gain or loss on the transaction.

ANALYSES	RULE	ENTRY
A new asset, AccountsRecievable, was acquired	Increases in assets are recorded by debit	DEBIT:Acs Receivable, $11,000
The asset Land was decreased	Decreases in assets are recorded by credits	CREDIT: Land, $11,000

Accounts Receivable

9/10 (debit) 11,000	

LAND

9/3 141,000	9/10 (debit) 11,000

Transaction (e)

On September 14, Roberts Real Estate Company purchased office equipment on credit from General Equipment, Inc., in the amount of $5,400.

ANALYSES	RULE	ENTRY
A new asset, Office Equipment, was acquired.	Increases in assets are recorde by debits	DEBIT: Office Equipment, $5,400
A new liability, Accounts payable, was incurred	Increases in liabilities are recorded by credits	CREDIT: Accounts payable, $5,400

Office Equipment

9/14 (e) 5,400	

ACCOUNTS PAYABLE

	9/5 21,000
	9/14 (e) 5,400

Transaction (f)

On September 20, cash of $1,500 was received assets assets partial collection of the account receivable from Carter's Drugstore.

ANALYSES	RULE	ENTRY
The asset Cash was increased	Increases in assets are recorded by debits	DEBIT: Cash, $1,500
The assets Accounts Receivable was decreased	Decreases in assets are recorded by credits	CREDIT: Accounts Receivable, $1,500

CASH

9/1	180,000	9/3	141,000
9/20 (F)	1,500	9/5	15,000

ACCOUNTS RECEIVABLE

9/10	11,000	9/20 (F)	1,500

Transaction (g)

A cash payment of $3,000 was made on September 30 in settlement of the amount owing to General Equipment, Inc.

ANALYSES	RULE	ENTRY
The liability Accounts payable was decreased	Decreases in liabilities are recorded by debits	DEBIT: Accounts Payable, $3,000
The asset cash was decreased	Decreases in assets are recorded by credits	CREDIT: Cash, $3,000

CASH

9/1	180,000	9/3	141,000
9/2	1,500	9/5	15,000
		9/30	3,000

ACCOUNTS PAYABLE

9/30 (g)	3,000	9/5	21,000
		9/14	5,400

Running balance form of ledger account

The T form of account used thus far is very convenient for illustrative purposes. Details are avoided and we can concentrate on basic ideas. T accounts are also often used in advanced accounting courses and by professional accountants for preliminary analyses of transaction. In other words, the simplicity of the T account provides a concise conceptual picture of the elements of business transactions.In normal accounting records, however, more information is needed, and the T account is replaced in many manual systems by a ledger a with special rulings, such assets the following systems by a ledger account with special rulings, such assets the following illustration of the Cash account for Roberts Real Estate Company:

CASH Account No./

Date		Explanation	Ref	DEBIT	CREDIT	Balance

The "normal "Balance" of an account

The running balance form of ledger account does no indicate specifically whether the balance of the account is a debit or credit balance. However, this causes no difficulty because we know that asset accounts normally have debit balances and that accounts for liabilities and owner's equity normally have credit balances.

The balance of any account normally results from recording more increases than decreases. In asset accounts, increases are recorded assets debits, so assets accounts normally have debit balances. In liability and owner's equity accounts, increases are recorded assets credits, so these accounts normally have credit balances.

Occasionally an assets account may temporarily acquire a credit balance, either assets the result of an accounting error or because of an unusual transaction. For example, an account receivable may acquire a credit balance because of overpayment by a customer. However, a credit balance in the Building account could be credit only by an accounting error.

Sequence and numbering of ledger accounts

Accounts are usually arranged in the ledger in financial statement order, that is, assets first, followed by liabilities , owner's equity , revenue, and expenses. The number of accounts needed by a business will depend upon its size, the nature of its operations, and the extent to which management and regulatory agencies want detailed classification of information. An identification number is assigned to each account . A chart of accounts is listed of the account titles and account numbers being used by given business.

In the following list of accounts, certain numbers have not been assigned; these numbers are held in reserve so that additional accounts can be inserted in the ledger in proper sequence whenever such accounts become necessary. In this illustration, the numbers from 1 to 29 are used exclusively for asset accounts; numbers from 30 to 49 are reserved for liabilities ;numbers in the 50s signify owner's equity accounts; numbers in the 60s represent revenue accounts and numbers from 70 to 99 designate expense accounts. The balance sheet accounts with which we are concerned here are numbered assets shown in the following brief chart of accounts:

Account Title	Account NO:
Assets :	
Cash	1
Accounts Receivable	4

Land	20	
Building	22	
Office equipment		25
Liabilities:		
Accounts payable		32
Owner's equity :		
James Roberts,Capital		50

In large business with hundreds or thousands of accounts, a more elaborate numbering system is used. Some companies use an eight or ten digit number for each ledger account; each of the digits carries special significance assets to the classification of the account.

Sequence of assets

At this point we need to give further attention to the sequence of accounts within the asset group. Assets shown in all the balance sheets in illustrated thus far, cash the is always listed first. It is followed by notes receivable, accounts receivable, and supplies. Next come the relatively permanent assets used in the business (often called planned a). Of this group, land is listed first and followed by buildings. After these two items, any order is acceptable for other assets used in the business, such assets automobiles, furniture and fixtures, computers, lighting equipment, store equipment etc..

The Balance Sheet

The purpose of a balance sheet is to show the financial position of a business at a particular date. Every business prepares a balance sheet at the end of the year, and most companies prepare at the end of each month. A balance sheet consist of a listing of the assets and liabilities of a business and owner's equity. The following balance sheet portraits the financial position of Vagabound Travel Agency at December 31.

VAGABOND TRAVEL AGENCY

BALANCE SHEET

DECEMBER 31,19-

ASSETS		LIABILITIES AND OWNERS EQUITY	
Cash	$7,500	liabilities :	
Notes receivable	8,000	Notes payable	$52,000
Accounts receivable	57,000	Accounts payable	15,000
Supplies	1,500	Salaries payable	3,000
Land	40,000	Total liabilities	70,000
Building	44,000	Owner's equity :	
Office Equipment	12,000	Terry Crane,capital	100,000
Total	$170,000	Total	$170,000

Note that the balance sheet sets forth in its heading three items: (1) The name of the business, (2) the name of the financial statement "Balance sheet", and (3) the date of the balance sheet. Below the heading is the body of the balance sheet, which consists of three distinct sections: assets, liabilities , and owner's equity.

Another point to note about the form of a balance sheet is that cash is always the first asset listed; it is followed by the notes receivable, accounts receivable, supplies and any other assets that will soon be converted into cash or consumed in operations. Following these items are the more permanent assets, such assets land, buildings, and equipment.

The liabilities of a business are always listed before the owner' equity. Each liability (such assets notes payable, accounts payable and salaries payable) should be listed separately, followed by a total figure for liabilities.

The concept of business entity

Generally accepted accounting principles require that a set of financial statements describe the affairs of a specific business entity. This concept is often called the entity principle

A business entity is an economic unit that engages in identifiable business activities. The business entity is regarded assets being separate from the personal affairs of its owner. For example, Vagabon is an economic unit operating assets a Travel Agency. Its owner, Terry Crane, may have a personal account a home, a car, and even other business, such as cattle ranch. These items are not involved in the trowel agency business, and should not appear in Vagabond's financial statements.

If the owner were to intermingle his or her personal affairs with the transactions of a business, the resulting financial statements would be misleading and would fail to describe clearly the activities of the business entity.

Assets

Assets are economic resources which are owned by a business and are expected to benefit future operations. assets may have definite physical form such assets buildings, machinery, or merchandise. On the other hand, assets exists not in physical or tangible form, but in the form of valuable legal claims or rights; examples are amounts due from customers, investments in Government bonds, and patent rights.

One of the most basic and at the same time most controversial problems in accounting is determining the dollar values for the various assets of a business. At present, generally accepted accounting principles call for the valuation of assets in a balance sheet at cost, rather than at appraised market values. The specific accounting principles supporting cost assets the bases for asset valuation are discussed below.

Effect of business transactions upon the balance sheet. Assume that James Roberts, a licensed real state broker, decided to start a real state business of his own, to be known as Roberts Real Estate Company. The planned operations of the new business call for obtaining listings of houses being offered for sale by owners. Advertising these houses, and showing them to prospective buyers. The listing agreement signed with each owner provides that Roberts Real Estate Company shall receive at the time of sale a commission equal to 6% of the sales price of the property.

The new business was begun on September 1, when Roberts deposited $180,000 in a bank account in the name of the business, Roberts Real Estate Company. The Initial balance sheet of the new business then appeared assets follows:

Roberts Real Estate Company

Balance sheet

September 1, 19-

ASSETS		Owners EQUITY	
Cash	$180,000	James Roberts, capital	$180,00

Observe that the equity of the owner in the assets is designated on the balance sheet by the caption, James Roberts, capital. The word capital is the traditional accounting term used in describing the equity of the proprietor in the assets of the business.

Purchase of an asset for cash

The next transaction entered into by Roberts Real Estate Company was the purchase of land suitable assets a site for an office. The price for the land was $141,000 and payment was made in cash on September 3. The effect of this transaction on the balance sheet was twofold: First, cash was decreased by the amount paid out;and second, a new asset land, was acquired. After these exchange of cash for land, the balance sheet appeared assets follows:

Roberts Real Estate Company

BALANCE sheet

September, 19_

Assets		OWNER's EQUITY	
Cash	$39,000	James Roberts,capital	$180,000
Land	141,000		
Total	$180,000	Total owner's equity	180,000

Purchase of an asset and incurring of a liabilities

On September 5 an opportunity arose to buy from Kent Company a complete office building which had to be moved to permit the construction of a free way. A price of $36,000 was agreed upon, which included the cost of moving the building and installing it upon the Roberts companies lot. Assets the building was in excellent condition and would have cost approximately $80,000 to build, Roberts considered this a very fortunate purchase.

The terms provided for an immediate cash payment of $15,000 and payment of the balance of $21,000 within 90 days. Cash was decreased $15,000, but a new asset, building, was recorded at cost in the amountof $36,000. Total assets were thus increased by $21,000 but the total of liabilities and owner's equity was also increased as result of recording the $21,000 account payable as a liability. After these transaction had been recorded, the balance sheet appeared as shown below. Remember that cash is always the first asset listed in a balance sheet.

Roberts Real Estate Company

BALANCE SHEET

September 5, 19_

ASSETS		LIABILITIES &OWNER'S EQUITY	
Cash	$24,000	LIABILITIES :	
Land	141,000	Accounts payable	$21,000
Building	36,000	OWNER's equity :	

		James Roberts, capital	180,000
Total	$201,000	Total	$201,000

Note that building appears in the balance sheet at $36,000, its cost to Roberts Real Estate Company. The estimate of $80,000 as the probable cost to construct such a building is irrelevant. Even if someone should offer to buy the building from the Roberts Company for $80,000 or more, this offer, if refused, would have no bearing on the balance sheet. Accounting records are intended to provide a historical record of costs actually incurred; therefore, $36,000 price at which the building was purchased is the amount to be recorded.

Sale of an asset

After the office building had been moved to the Roberts companies lot, Roberts decided that the lot was much larger than needed. The adjoining business, Carter's Drag Store, wanted, more room for a parking area so, on September 10, Roberts Company sold the unused part of the lot to Carters Drag Store, for a price of $11,000. Since the sales price was computed at the same amount per foot as Roberts Company had paid for the land, there was neither a profit nor a loss on the sale. No down payment was required but it was agreed that the full price would be paid within three months. By this transaction of new asset, Accounts receivable, was acquired, but the asset land was decreased by the same amount; consequently there was no change in the amount of total assets. After this transaction, the balance sheet appeared as follows:

Roberts Real Estate Company

Balance Sheet

September 10, 19_

ASSETS		LIABILITIES & OWNER'S EQUITY	
Cash	$24,000	Liabilities:	
Accounts receivable	11,000	Accounts payable	$21,000
Land	130,000	Owners equity :	
Building	36,000	James Roberts, capital	180,000
Total	$201,000	Total	$201,000

In the illustration thus far, Roberts Real Estate Company has an account receivable from only one debtor, and an account payable to only one creditor. As the business grows, the number of deptors and creditors will increase, but the accounts receivable and accounts payable designations will continue to be used. The additional records necessary to show the amount receivable from each individual debtor and amount owing to each individual creditor will be explained later.

Purchase of an asset on credit.

A complete set of office furniture and equipment was purchased on credit from General Equipment, Inc.,on September14 for $5,400. as the result of this transaction the business owned a new asset, Office equipment, but it had also incurred a new liability in the form of accounts payable. The increase in total assets was exactly offset by the increase in liabilities. After this transaction the balance sheet appeared as follows:

Roberts Real Estate Company

Balance Sheet

September 14, 19_

ASSETS		LIABILITIES & OWNER'S EQUITY	
Cash	$24,000	Liabilities:	
Accounts receivable	11,000	Accounts payable	$26,400
Land	130,000	Owners equity :	
Office equipment	5,400	James Roberts,capital	180,000
Building	36,000	Total	$206,400
Total	$206,400		

Collection of an account receivable

On September 20 cash in amount of $1,500 was received as partial settlement of the account receivable from Carters Drag Store. This transaction caused cash to increase in the accounts receivable to decrease by an equal amount. In essence, this transaction was merely the exchange of one asset for another of equal value. Consequently, there was no change in the amount of total assets. After this transaction, the balance sheet appeared as follows:

Roberts Real Estate Company

Balance Sheet

September 20, 19_

ASSETS		LIABILITIES & OWNER'S EQUITY	
Cash	$25,500	Liabilities:	
Accounts receivable	9,500	Accounts payable	$26,400
Land	130,000	Owners equity :	
Building	36,000	James Roberts,capital	180,000
Office equipment	5,400	Total	$206,400
Total	$206,400		

Payment of liability

On September 30, Roberts Real Estate Company paid $3,000 in cash to General Equipment Inc., this payment caused a decrease in cash and equal decrease in liabilities. Therefore the balance sheet totals were still in balance. After this transaction, the balance sheet appeared as follows:

Roberts Real Estate Company

Balance Sheet

September 30, 19_

ASSETS		LIABILITIES & OWNER'S EQUITY	
Cash	$22,500	Liabilities:	
Accounts receivable	9,500	Accounts payable	$23,400
Land	130,000	Owners equity :	
Office equipment	5,400	James Roberts,capital	180,000
Building	36,000	Total	$203,400
Total	$203,400		

The transactions which have been illustrated for the month of September were merely preliminary to be formal opening for business of Roberts Real Estate Company on October 1. Since we have assumed that the business earned no commissions and incurred no expenses during September, the owner's equity at September 30 is shown in the above balance sheet at $180,000,unchanged from the original investment Roberts on September 1 . September was a month devoted exclusively to organizing the business and not to regular operations.

Effect of business transactions upon the account equation.

A balance sheet is merely a detailed expression of the accounting equation, Assets = LIABILITIES + OWNER's EQUITY .

To emphasize the relationship between the accounting equation and the balance sheet, let us now repeat the September transactions of Roberts Real Estate Company to show the effect of each transaction upon the accounting equation. Briefly restated, the seven transactions were as follows:

September

1-Begun the business by depositing $180,000 in a company bank account.

3-Purchased land for $141,000cash.

5-Purchased a building for $36,000, paying $15,0000 cash and incurring a liability of $21,000.

10-Sold part of the land at a price equal to cost of $11,000, collectable within three months.

14-Purchased office equipment on credit for $5,400.

20-Received $1,500 cash as partial collection of the $11,000 account receivable.

30-Paid $3,000 on accounts payable.

The table below shows the effects of each of the September transactions on the accounting equation. The final line in the table corresponds to the amounts in the balance sheet at the and of September. Note that the equality of the two sides of the equation was maintained throughout the recording of the transactions.

	ASSETS					=Liabi lities	+OWNER EQUITY
	cash +	acc.recei vable	+land	+building	+off.equi pment.	+acc.paya ble	+J.Robert s capital
Sept 1	+$180,000	0	0	0	0	0	+$180,000
3	-141,000	0	+$141,000	0	0	0	
balances	$39,000	0	141,000	0	0	0	180,000
Sept.5	-15,000	0		+$36,000	0	+$21,000	
balnces	$24,000	0	141,000	36,000	0	21,000	180,000
sept.10		+$11,000	-11,000		0		
balances	$24,000	11,000	130,000	36,000	0	21,000	180,000
sept.14					+$5,400	+ 5,400	
balances	$24,000	$11,000	130,000	36,000	5,400	26,400	180,000
sept.20	+ 1,500	-1,500					
balances	$25,500	$9,500	130,000	36,000	5,400	26,400	180,000
sept 30	-3,000					-3,000	
balances	$22,500	+ $9,500	+ 130,000	+$36,000	+ $5,400	= $23,400+	180,000

BALANCE Sheets for the three types of organizations.

assets and liabilities are presented in the same manner in the balance sheets of each type of business organizations. Some differences arise, however, in the presentation of owner s equity.

Roberts Real Estate Company was a single proprietorship, owned by one person. Therefore, the owner's equity section of the balance sheet included only one item: the equity of the proprietor, James Roberts. If the business were a partnership of two or more persons, we would use the caption Partners equity instead of owner's equity and would list under that caption the amount of each partners equity.If the business were organized as a corporation, thecaption used in the balance sheet would be stockholder equity.It is not customary in a corporations balance sheet to show separately the equity of each stockholder . The equity of all the stockholders as a group is shown, and this ownership equity is divided into two amounts: (1) Capital Stock, the amount of the owner's original investment and, (2) retained earnings, the amount of profits (or losses) accumulated since the formation of the business.

These three methods of showing ownership equity in the balance sheet are illustrated as follows.

FOR A SINGLE PROPRIETORSHIP

Owner's equity :		
Dale Nelson,capital	$50,000	

FOR A PARTNERSHIP

Partners' equity :		
Pamela Barnes,capital	$40,000	
Scott Davis, capital	35,000	
Total capital		$75,000

FOR A CORPORATION

Stockholders' EQUITY :		
Capital Stock	$1,000,000	
Retained earnings	278,000	
Total capital		$1,278,000

The preceding illustration of the ownership equity of a corporation shows that $1,000,000 of capital was invested in the corporation by stockholders, and that through profitable operation of the business an additional $278,000 of earned capital has been accumulated. The corporation has chosen to retain this $278,000 in the business rather than to distribute these earnings to the stockholders as dividends. The total earnings of the corporation may have been considerably more than $278,000 , because any earnings which were paid to the stockholders as dividends would not appear on the balance sheet. The term retained earnings describes only the earnings which were not paid out in the form of dividends. Although stockholders naturally like to receive dividends, retaining earnings in the business may enable the corporation to acquire additional operating properties, to expand the scope of operations, and thereby to enjoy larger future earnings.

Generally accepted accounting principles apply to all three forms of business organization.

The balance sheet

Preparing a balance sheet for Roberts Real Estate Company at October 31 we can obtain the balances of the asset, liability, and owner's equity accounts from the adjusted trial balance illustrated earlier.

The following balance sheet is shown in report form, that is, with the liabilities and owner's equity sections listed below rather than to the right of the asset section. Both the account form and the report form are widely used.

Roberts Real Estate Company

Balance Sheet

October 31, 19_

ASSETS

Cash		$15,490	
Accounts receivable		17,890	
Land		130,000	
Building	$36,000		
Less:Accumulated depreciation	150	35,850	
Office equipment	$5,400		
Less: Accumulated depreciation	45		5,355
Total assets			$204,585

liabilities & owner'S equity

LIABILITIES		
Accounts payable		$23,814
Owner's EQUITY :		
James Roberts,capital Oct.1	$180,000	
Net income for Oct	2,571	
Subtotal	$182,571	
Less: Withdrawals	1,800	
James Roberts,capital,Oct 31		180,771
Total liabilities and owner's equity		$204,585