

# **TOPIC 2**

## **[week 2]**

# **INTRODUCTION TO DOUBLE-ENTRY BOOK-KEEPING**

The logo for Stanford Online, featuring a stylized orange 'S' and the text 'Stanford Online' in orange, with the tagline 'EDUCATION BEYOND BORDERS' in smaller grey text below it.

# LEARNING OUTCOMES

Upon completion of the lecture, the students should be able to:

- Know that the two sides of the accounting equation are represented by the two parts of balance sheet.
- Understand how the double-entry system works in accounts.
- Explain the accounting equation.
- Prepare the simple ledger accounts.
- Balance the accounts and extract the trial balance at the end of the accounting period.

# The Accounting Equation

$$\text{ASSETS} = \text{LIABILITIES} + \text{OWNER'S EQUITIES}$$

- **Assets**

Future economic benefits [or service potential] controlled by a business as a result of past transactions or events

- **Liabilities**

Future sacrifices of economic benefits that a business is presently obliged to make to other entities as a result of past transactions or events.

- **Owner's Equities**

Future sacrifices of economic benefits that a business is presently obliged to make to the owners of the business as a result of past transactions or events.

# Typical Account Titles

- **Assets**

**Cash at bank:** Money on hand or in the bank

**Accounts receivable or trade debtors:** Claim on open account against the cash of a client or a customer.

**Bill receivable:** Claim against the cash of another party, supported by a formal document, a bill of exchange, signed by the other party.

**Inventory or stock:** Inventory or stock that an entity sells in the normal course of the business.

**Office Supplies:** Stationery, stamps, paper clips, staples and so forth.

**Office furniture:** Desks, chairs, filing cabinets, and so forth.

**Office equipment:** Computers, calculators, and other equipments used in a business.

**Building:** Building used in a business

**Land:** Land on which a business building stands.

- **Liabilities**

**Accounts payable or trade creditors:** Liability to pay cash to another party on open account.

**Bill payable:** Liability to pay cash to another party, supported by a signed document such as a bill of exchange or a commercial bill.

**Salary or wage payable:** Liability to pay an employee for work

- **Owner's Equities**

**Capital:** The interest of the owner of the business in its assets. [This account title bears the name of the owner]

**Drawings:** The owner's drawings of assets from the business for personal use. [This account title bears the name of the owner]



# Rules of Debit and Credit


- **Assets**

[dr.]	Accounts Title	[cr.]
Increase		Decrease
<b>Normal</b>		
<b>Balance</b>		

- **Liabilities**

[dr.]	<b>Accounts Title</b>	[cr.]
Decrease		Increase
		<b>Normal</b>
		<b>Balance</b>

- **Owner's Equities**

[dr.]	<b>Accounts Title</b>	[cr.]
Decrease		Increase
		<b>Normal</b>
		<b>Balance</b>

# Worked Example

On 1 August 19x5, Susan Jones opens a business that she names Jones's Consulting. She will be the sole owner of the business, so it will be a proprietorship. During the entity's first ten days of operations, the following transactions take place:

- a) To begin operations, Jones deposits \$70 000 of personal funds in a bank account entitled Jones' Consulting.
- b) Jones pays \$50 000 cash for a piece of land for future office site.
- c) Jones purchases \$1 000 in office supplies on credit.
- d) Jones pays cash of \$5 000 for office furniture.
- e) Jones pays \$500 on the account payable she created in transaction [c].
- f) Jones withdraws \$1 000 cash for personal use.

**Transaction:** Invested \$70 000 into the business

- **Analysis:** The investment in the business increased its asset cash, and also the owner's equity of the entity.

<b>Cash at Bank</b>	
<b>[a]</b>	<b>70 000</b>
<b>Jones, Capital</b>	
	<b>[a] 70 000</b>

**Transaction:** Paid \$50 000 cash for a piece of land to be used as an office.

- **Analysis:** The purchase increased the entity's asset land, and decreased cash.

	<b>Cash at Bank</b>	
<b>[a]</b>	<b>70 000</b>	<b>[b] 50 000</b>
	<b>Land</b>	
<b>[b]</b>	<b>50 000</b>	

**Transaction:** Purchased \$1 000 of office supplies on account payable.

- **Analysis:** The purchase increased the entity's asset office furniture, and decreased the liability accounts payable.

	<b>Office Supplies</b>	
<b>[c]</b>	<b>1 000</b>	
	<b>Accounts Payable</b>	
	<b>[c]</b>	<b>1 000</b>

**Transaction:** Paid \$5 000 cash for office furniture.

- **Analysis:** The purchase increased the entity's asset office furniture, and decreased cash.

<b>Cash at Bank</b>	
[a]	70 000
[b]	50 000
[d]	5 000
<b>Office Furniture</b>	
[d]	5 000

**Transaction:** Paid \$500 on the account payable created in transaction [c].

- **Analysis:** The payment decreased cash, and also the liability accounts payable.

<b>Cash at Bank</b>	
[a]	70 000
[b]	50 000
[d]	5 000
[e]	<b>500</b>
<b>Accounts Payable</b>	
[e]	<b>500</b>
[c]	1 000

**Transaction:** Withdrew \$1 000 for personal living expenses.

- **Analysis:** The drawings decreased cash, and also the owner's equity of the entity.

<b>Cash at Bank</b>	
[a]	70 000
[b]	50 000
[d]	5 000
[e]	500
[f]	<b>1 000</b>
<b>Jones, Drawings</b>	
[f]	<b>1 000</b>

# Balancing The Accounts

	<b>Cash at Bank</b>				<b>Land</b>		
[a]	70 000	[b]	50 000	[b]	50 000		
		[d]	5 000	[B]	<b>50 000</b>		
		[e]	500				
		[f]	1 000		<b>Accounts Payable</b>		
[B]	<b>13 500</b>			[e]	500	[c]	1 000
						[B]	<b>500</b>
	<b>Office Supplies</b>						
[c]	1 000				<b>Jones, Capital</b>		
[B]	<b>1 000</b>					[a]	70 000
				[B]	<b>70 000</b>		
	<b>Office Furniture</b>						
[d]	5 000				<b>Jones, Drawings</b>		
[B]	<b>5 000</b>			[f]	1 000		
				[B]	<b>1 000</b>		

**Jones Consulting  
Trial Balance  
as at 10 August 19x5**

	<b>Debit</b>	<b>Credit</b>
<b>Account Title</b>	<b>[\$]</b>	<b>[\$]</b>
Cash at Bank	13 500	
Office Supplies	1 000	
Office Furniture	5 000	
Land	50 000	
Accounts Payable		500
Jones, Capital		70 000
Jones, Drawings	1 000	
	<b>70 500</b>	<b>70 500</b>

# Trial Balance

- Is a list of all accounts with their balances.
- It provides a check on accuracy by showing whether the total debits equal the total credits.
- It may be taken at any time the postings are up to date.

