

CHAPTER 2: INVESTING AND FINANCING DECISIONS AND THE STATEMENT OF FINANCIAL POSITION

Double-Entry System

The double-entry system is based on the principle of duality, which means that every economic event has two aspects—effort and reward, sacrifice and benefit, source and use—that offset, or balance, each other. In the double-entry system, each transaction must be recorded with at least one debit and one credit, and the total amount of the debits must equal the total amount of the credits.

The T Account

The T account is a good place to begin the study of the double-entry system. Such an account has three parts: a title, which identifies the asset, liability, or owner's equity account; a left side, which is called the **debit** side; and a right side, which is called the **credit** side. The T account, so called because it resembles the letter T, is used to analyze transactions and is **not** part of the accounting records.

Any entry made on the left side of the account is a debit, and any entry made on the right side is a credit. The terms debit and credit are simply the accountant's words for "left" and "right" (not for "increase" or "decrease").

CHAPTER 2 - EXERCISE

On June 1, 2013, Peter Jackson and his friends started a business called World Wide Webster Inc. The following events occurred during its first month.

- a. On June 1, Peter and his friends invested \$10,000 into the business.
- b. On June 2, the company borrowed \$15,000, using a note payable to the bank.
- c. On June 3, the company acquired a \$15,000 truck and \$5,000 worth of equipment, all paid in cash.
- d. On June 4, the company purchased \$300 worth of supplies on credit. "On credit" means that you receive the supplies now, and pay cash for them later.
- e. On June 5, the company signed contract for first website design for \$10,000.
- f. On June 15, the company paid off \$300 accounts payable using cash.
- g. On June 16, the company paid cash for and receives \$600 worth of supplies.
- h. On June 17, the company acquired and received \$1,000 worth of equipment, paid in cash.
- i. On June 18, the company ordered a \$900 snow blower, to be delivered next month.

Step 1: Analyze the transactions to determine the accounts (at least two) that are affected.

Step 2: Journalize (record) the transactions.

The Accounting Equation

$$A = L + E$$

Assets		=	Liabilities		+	Stockholders' Equity	
Debit (+)	Credit (-)		Debit (-)	Credit (+)		Debit (-)	Credit (+)
Accounts have debit balances				Accounts have credit balances			Accounts have credit balances

- a. On June 1, Peter and his friends invested \$10,000 into the business.

Left Side	Right Side

(1) Does the total of debits equal the total of credits? (2) Is the accounting equation in balance? Then prepare the journal entry.

GENERAL JOURNAL			
Date	Account Titles and Explanation	Debit	Credit

- b. On June 2, the company borrowed \$15,000, using a note payable to the bank.

Left Side	Right Side

(1) Does the total of debits equal the total of credits? (2) Is the accounting equation in balance? Then prepare the journal entry.

GENERAL JOURNAL			
Date	Account Titles and Explanation	Debit	Credit

- c. On June 3, the company acquired a \$15,000 truck and \$5,000 worth of equipment, all paid in cash.

Left Side	Right Side

(1) Does the total of debits equal the total of credits? (2) Is the accounting equation in balance?
Then prepare the journal entry.

GENERAL JOURNAL				
Date		Account Titles and Explanation	Debit	Credit

- d. On June 4, the company purchased \$300 worth of supplies on credit. "On credit" means that you receive the supplies now, and pay cash for them later.

Left Side	Right Side

(1) Does the total of debits equal the total of credits? (2) Is the accounting equation in balance?
Then prepare the journal entry.

GENERAL JOURNAL				
Date		Account Titles and Explanation	Debit	Credit

- e. On June 5, the company signed contract for first website design for \$10,000.

Left Side	Right Side

(1) Does the total of debits equal the total of credits? (2) Is the accounting equation in balance?
Then prepare the journal entry.

GENERAL JOURNAL				
Date		Account Titles and Explanation	Debit	Credit

- f. On June 15, the company paid off \$300 accounts payable using cash.

Left Side	Right Side

(1) Does the total of debits equal the total of credits? (2) Is the accounting equation in balance?
Then prepare the journal entry.

GENERAL JOURNAL			
Date	Account Titles and Explanation	Debit	Credit

- g. On June 16, the company paid cash for and receives \$600 worth of supplies.

Left Side	Right Side

(1) Does the total of debits equal the total of credits? (2) Is the accounting equation in balance?
Then prepare the journal entry.

GENERAL JOURNAL			
Date	Account Titles and Explanation	Debit	Credit

- h. On June 17, the company acquired and received \$1,000 worth of equipment, paid in cash.

Left Side	Right Side

(1) Does the total of debits equal the total of credits? (2) Is the accounting equation in balance?
Then prepare the journal entry.

GENERAL JOURNAL			
Date	Account Titles and Explanation	Debit	Credit

- i. On June 18, the company ordered a \$900 snow blower, to be delivered next month.

Left Side	Right Side

(1) Does the total of debits equal the total of credits? (2) Is the accounting equation in balance?
Then prepare the journal entry.

GENERAL JOURNAL			
Date	Account Titles and Explanation	Debit	Credit

Step 3: Post the transactions to T accounts to determine the ending balances of each of the accounts.

Assets		=	Liabilities		+	Stockholders' Equity	
Debit (+)	Credit (-)		Debit (-)	Credit (+)		Debit (-)	Credit (+)
Accounts have debit balances				Accounts have credit balances			Accounts have credit balances

Assets				Liabilities				Stockholders' Equity			
+ Cash -				- Accounts Payable +				- Contributed Capital +			
BegBal	0					0	BegBal			0	BegBal
Jun 1	10,000									10,000	Jun 1
+ Supplies -				- Notes Payable +				- Retained Earnings +			
BegBal	0					0	BegBal			0	BegBal
+ Equipment -											
BegBal	0										

Normal Balance of an Account

The normal balance of an account is its usual balance and is the side (debit or credit) of the account for recording increases in the account. For example, since asset accounts are increased with debits, asset accounts normally have debit balances. Likewise, liability accounts normally have credit balances. – Asset accounts have normal debit balances. Liability and equity accounts have normal credit balances.

Step 4: Prepare a statement of financial position for World Wide Webster Inc. as of June 30, 2013.

WORLD WIDE WEBSTER INC.
Statement of Financial Position
As of June 30, 2013

Assets

Current assets	
Cash	_____
Supplies	_____
Total current assets	_____
Non-current assets	
Property, plant & equipment	_____
Total assets	_____

Liabilities & Stockholders' Equity

Current liabilities	
Accounts payable	_____
Notes payable	_____
Total liabilities	_____
Stockholders' Equity	
Contributed capital	_____
Retained earnings	_____
Total stockholders' equity	_____
Total liabilities & stockholders' equity	_____