



BACHELOR of ECONOMICS



**Thammasat University
Faculty of Economics
Bachelor of Economics (International Program)**

AC 201

Fundamental Accounting

Semester 2/2015

Course Materials

Topics:

Chapter 2 Investing and Financing Decisions
and the Accounting System

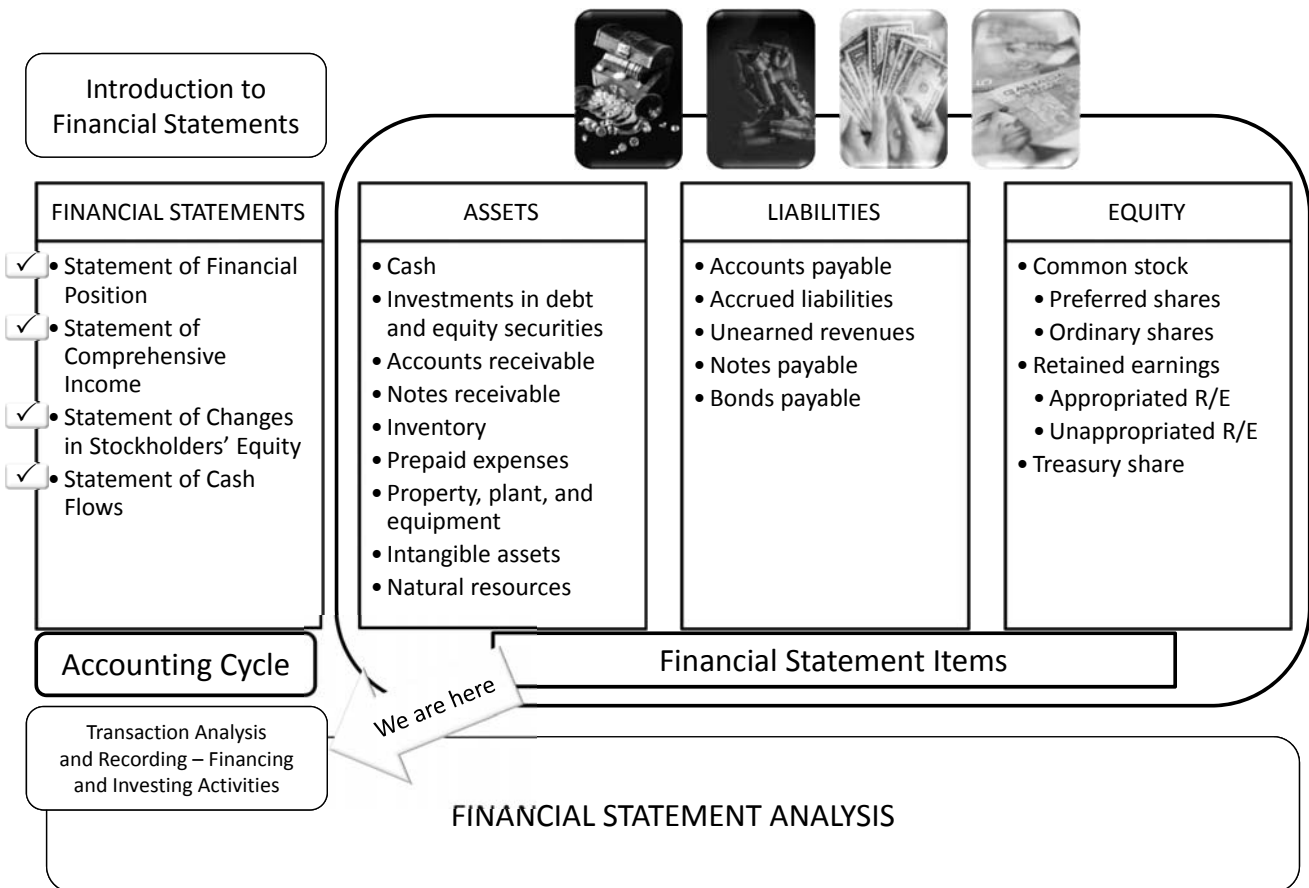
Session:

Session #2

Instructor:

Ajarn Santana Singhasaneh





AC201 Fundamental Accounting



BACHELOR
of ECONOMICS



CHAPTER 2: INVESTING AND FINANCING DECISIONS AND THE ACCOUNTING SYSTEM

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Overview of Accounting Concepts



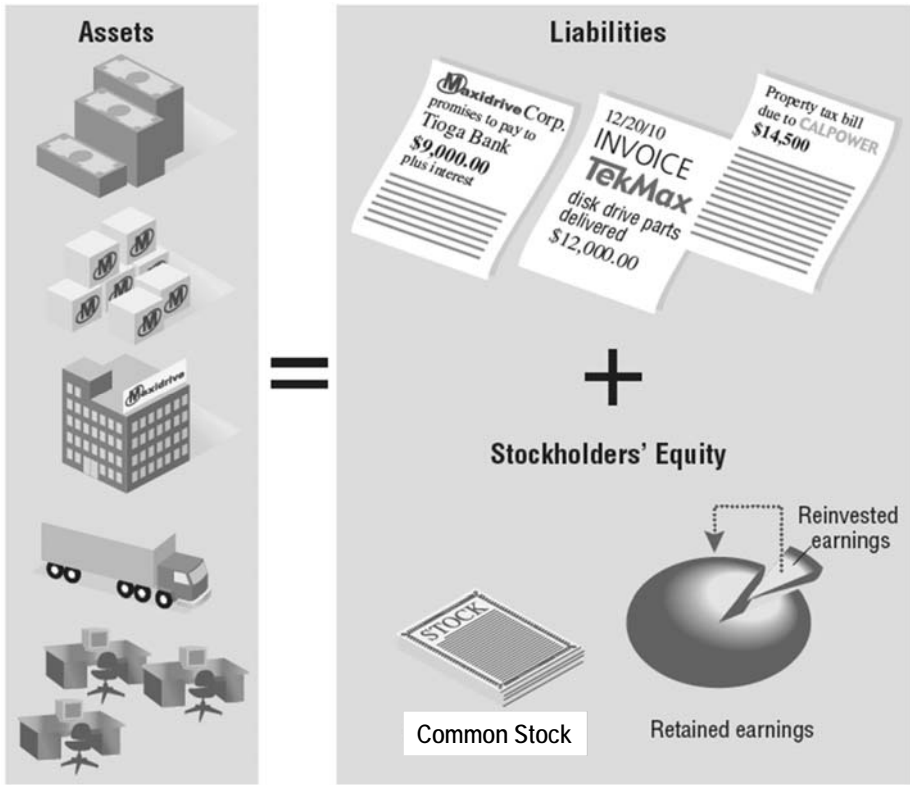
Accounting Assumptions & Principle

Four accounting assumptions & principle underlie reporting on the statement of financial position:

- a) **Separate-entity assumption** – transactions of the business are accounted for separately from transactions of the owner.
- b) **Unit-of-measure assumption** – financial information is reported in the national monetary unit.
- c) **Continuity (going-concern) assumption** – a business is expected to continue to operate into the foreseeable future.
- d) **Historical cost principle** – financial statements elements should be recorded at the cash-equivalent cost on the date of the transaction.



The Accounting Equation



Elements of Statement of Financial Position

$$A = L + SE$$

Economic resources with probable future benefits owned or controlled by the entity. Measured by the historical cost principle.

Probable debts or obligations (claims to a company's resources) that result from a company's past transactions and will be paid with assets or services. Entities that a company owes money to are called creditors.

The financing provided by the owners and by business operations. Often referred to as common stock and retained earnings.

Assets = **Liabilities** + **Owners' Equity**
 [Resources] [A method of financing resources that requires repayment]* [A method of financing resources that does not require repayment and represents ownership interests in the business]



Papa John's Statement of Financial Position

Papa John's Statement of Financial Position as at **December 31, 2008**

PAPA JOHN'S INTERNATIONAL, INC.		
Consolidated Balance Sheet		
December 31, 2008		
(dollars in thousands)		
ASSETS		
Current Assets		
Current assets	Cash	\$ 11,000
	Accounts receivable	24,000
	Supplies	17,000
	Prepaid expenses	10,000
	Other current assets	13,000
Total current assets		75,000
Noncurrent Assets		
Noncurrent assets	Investments	1,000
	Property and equipment (net)	190,000
	Notes receivable	8,000
	Intangibles	77,000
	Other assets	36,000
Total assets		\$387,000

High Liquidity
 ↓
Low Liquidity

point in time the balance sheet is prepared (at year-end in this case)
payments due from franchisees and others on account food, beverages, and paper supplies on hand rent, advertising, and/or insurance paid in advance a summary of several current assets with smaller balances
another company's stocks and bonds purchased with excess cash the remaining cost of long-lived assets to be used in future operations (original cost \$388,000 minus \$198,000, the estimated portion of cost already used in the past) long-term amounts due from franchisees patents, trademarks, and goodwill a summary of several long-term assets with smaller balances

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Papa John's Statement of Financial Position

Papa John's Statement of Financial Position as at **December 31, 2008**
(cont'd)

LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities		
Current liabilities	Accounts payable	\$ 29,000
	Accrued expenses payable	71,000
Total current liabilities		100,000
Noncurrent liabilities		
Noncurrent liabilities	Unearned franchise fees	6,000
	Notes payable	124,000
	Other long-term liabilities	27,000
Total liabilities		257,000
Stockholders' Equity*		
Current liabilities	Common Stock	7,000
	Retained earnings	123,000
Total stockholders' equity		130,000
Total liabilities and stockholders' equity		\$387,000

Shortest Maturity
 ↓
Longest Maturity

payments due to suppliers a summary of payroll, rent, and other obligations
amounts paid by franchisees for services they will receive loans from creditors
amounts received from contributors (investors) cumulative profits not distributed to investors

Investment Reinvestment

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What Business Activities Cause Changes in Financial Statement Amounts ?

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Transactions

Transactions are events that have an economic impact on the entity.

Transactions include 2 types of events:

- **External event** - an exchange between a business and one or more external parties to a business
- **Internal event** - a measurable internal event, such as adjustments for the use of assets in operations.

Nature of Business Transactions:
Most transactions with external parties involve an exchange where the business entity gives up something and promise to repay or receives something in return.



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Accounts

An account is a standardized format that organizations use to accumulate the dollar effects of transactions related to each financial statement item.



Accounts

EXHIBIT 3.6 Chart of Accounts for a Typical Company

Assets (100–199)

Current Assets (100–150):

- 101 Cash
- 103 Notes Receivable
- 105 Accounts Receivable
- 107 Inventory
- 108 Supplies

Long-Term Assets (151–199):

- 151 Land
- 152 Buildings
- 154 Office Furniture or Equipment

Liabilities (200–299)

Current Liabilities (200–219):

- 201 Notes Payable
- 202 Accounts Payable
- 203 Salaries Payable
- 204 Interest Payable
- 206 Income Taxes Payable

Long-Term Liabilities (220–239):

- 222 Mortgage Payable

Owners' Equity (300–399)

- 301 Capital Stock
- 330 Retained Earnings

Sales (400–499)

- 400 Sales Revenue

Expenses (500–599)

- 500 Cost of Goods Sold
- 501 Sales Salaries and Commissions
- 523 Rent Expense
- 525 Travel Expense
- 528 Advertising Expense
- 551 Officers' Salaries
- 553 Administrative Salaries
- 570 Payroll Taxes
- 571 Office Supplies Expense
- 573 Utilities Expense
- 578 Office Equipment Rent Expense
- 579 Accounting and Legal Fees



Statement of Financial Position Accounts

Typical Statement of Financial Position Account Titles

Assets

Cash
Short-Term Investment
Accounts Receivable
Notes Receivable
Inventory (to be sold)
Supplies
Prepaid Expenses
Long-Term Investments
Equipment
Buildings
Land
Intangibles

Liabilities

Accounts Payable
Accrued Expenses
Notes Payable
Taxes Payable
Unearned Revenue
Bonds Payable

Stockholders' Equity

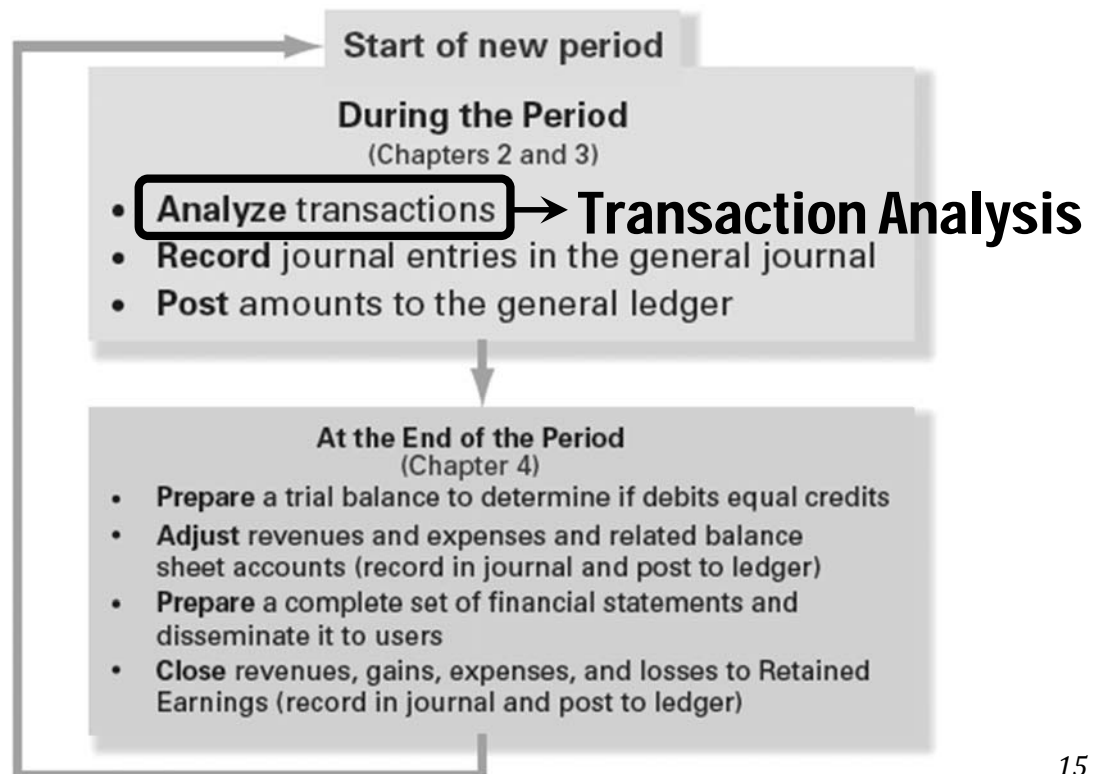
Common stock
Retained Earnings



How do Transactions Affect Accounts ?



The Accounting Cycle



Principles of Transaction Analysis

1. Dual Effects

Every transaction affects **at least two accounts**.

2. Balancing the Accounting Equation

The accounting equation must remain **in balance** after each transaction.

$$A = L + SE$$



Steps of Transaction Analysis

Step 1: Identify and classify accounts and effects

- **Identify the accounts (by title) affected** and make sure at least two accounts change.
- **Classify them by type of account.**
Was each account an asset (A), a liability (L), or a stockholders' equity (SE)?
- **Determine the direction of the effects.**
Did the account increase [+] or decrease [-]?

Step 2: Verify account equation is in balance

- **Verify that the accounting equation (A = L + SE) remains in balance.**

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Using Accounts to Categorize Transactions

- An account is a specific accounting record that provides an efficient way to categorize similar transactions.
- An individual account is a summary of every transaction affecting a certain item (like cash).

Assets				=	Liabilities		+	Stockholders' Equity	
Cash	Investments	Equip.	Notes Receivable		Dividends Payable	Notes Payable		Common Stock	Retained Earnings
(a)									
(b)									
(c)									
(d)									
(e)									
(f)									
Effect				=					

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Transaction Analysis: Example Part I

Papa John's Statement of Financial Position as at December 31, 2008

PAPA JOHN'S INTERNATIONAL, INC. Consolidated Balance Sheet December 31, 2008 (dollars in thousands)		<i>point in time the balance sheet is prepared (at year-end in this case)</i>	
ASSETS			
Current Assets			
Current assets	Cash	\$ 11,000	
	Accounts receivable	24,000	<i>payments due from franchisees and others on account</i>
	Supplies	17,000	<i>food, beverages, and paper supplies on hand</i>
	Prepaid expenses	10,000	<i>rent, advertising, and/or insurance paid in advance</i>
	Other current assets	13,000	<i>a summary of several current assets with smaller balances</i>
Total current assets	75,000		
Noncurrent Assets			
Noncurrent assets	Investments	1,000	<i>another company's stocks and bonds purchased with excess cash</i>
	Property and equipment (net)	190,000	<i>the remaining cost of long-lived assets to be used in future operations (original cost \$388,000 minus \$198,000, the estimated portion of cost already used in the past)</i>
	Notes receivable	8,000	<i>long-term amounts due from franchisees</i>
	Intangibles	77,000	<i>patents, trademarks, and goodwill</i>
	Other assets	36,000	<i>a summary of several long-term assets with smaller balances</i>
Total assets	\$387,000		

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Transaction Analysis: Example Part I

Papa John's Statement of Financial Position as at December 31, 2008 (cont'd)

LIABILITIES AND STOCKHOLDERS' EQUITY			
Current Liabilities			
Current liabilities	Accounts payable	\$ 29,000	<i>payments due to suppliers</i>
	Accrued expenses payable	71,000	<i>a summary of payroll, rent, and other obligations</i>
	Total current liabilities	100,000	
Noncurrent Liabilities			
Noncurrent liabilities	Unearned franchise fees	6,000	<i>amounts paid by franchisees for services they will receive</i>
	Notes payable	124,000	<i>loans from creditors</i>
	Other long-term liabilities	27,000	
Total liabilities	257,000		
Stockholders' Equity*			
	Common Stock	7,000	<i>amounts received from contributors (investors)</i>
	Retained earnings	123,000	<i>cumulative profits not distributed to investors</i>
Total stockholders' equity	130,000		
Total liabilities and stockholders' equity	\$387,000		

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Transaction Analysis: Example Part I

Followings were transactions incurred during the month of **January 2009** for Papa John's International Inc.:

- Papa John's issues \$2,000 of additional common stock to new investors for cash.
- Papa John's borrows \$6,000 from the bank signing a three-year note.
- Papa John's purchases new ovens, counters, refrigerators, and other equipment costing \$10,000, paying \$2,000 in cash and signing a two-year note for the balance.
- Papa John's lends \$3,000 cash to new franchisees who sign notes to be repaid in five years.
- Papa John's purchases the stock of another company as a long-term investment, paying \$1,000 in cash.
- The board of directors declares that Papa John's will pay \$3,000 in cash dividends to shareholder next month.

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Analyzing Transactions (1)

- Papa John's issues \$2,000 of additional common stock to new investors for cash.

Step 1: Identify and classify accounts and effects

- Cash (+A) \$2,000.
- Common stock (+SE) \$2,000.

Step 2: Is the accounting equation in balance?

	Assets				=	Liabilities		+	Stockholders' Equity	
	Cash	Investments	Equip.	Notes Receivable		Dividends Payable	Notes Payable		Common Stock	Retained Earnings
(a)	2,000								2,000	
(b)										
(c)										
(d)										
(e)										
(f)										
Effect	2,000				=	2,000				

$$A = L + SE$$

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Analyzing Transactions (2)

(b) Papa John's borrows \$6,000 from the bank signing a three-year note.

Step 1: Identify and classify accounts and effects

1. Cash (+A) \$6,000.
2. Notes Payable (+L) \$6,000.

Step 2: Is the accounting equation in balance?

	Assets				=	Liabilities		+	Stockholders' Equity	
	Cash	Investments	Equip.	Notes Receivable		Dividends Payable	Notes Payable		Common Stock	Retained Earnings
(a)	2,000							2,000		
(b)	6,000					6,000				
(c)										
(d)										
(e)										
(f)										
Effect	8,000				=	8,000				

$$A = L + SE$$

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Analyzing Transactions (3)

(c) Papa John's purchases new ovens, counters, refrigerators, and other equipment costing \$10,000, paying \$2,000 in cash and signing a two-year note for the balance.

Step 1: Identify and classify accounts and effects

1. Equipment (+A) \$10,000.
2. Cash (-A) \$2,000
- Notes Payable (+L) \$8,000.

Step 2: Is the accounting equation in balance?

	Assets				=	Liabilities		+	Stockholders' Equity	
	Cash	Investments	Equip.	Notes Receivable		Dividends Payable	Notes Payable		Common Stock	Retained Earnings
(a)	2,000							2,000		
(b)	6,000					6,000				
(c)	(2,000)		10,000			8,000				
(d)										
(e)										
(f)										
Effect	16,000				=	16,000				

$$A = L + SE$$

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Analyzing Transactions (4)

- (d) Papa John's lends \$3,000 cash to new franchisees who sign notes to be repaid in five years.

Step 1: Identify and classify accounts and effects

1. Notes Receivable (+A) \$3,000. 2. Cash (-A) \$3,000.

Step 2: Is the accounting equation in balance?

	Assets				=	Liabilities		+	Stockholders' Equity	
	Cash	Investments	Equip.	Notes Receivable		Dividends Payable	Notes Payable		Contributed Capital	Retained Earnings
(a)	2,000							2,000		
(b)	6,000					6,000				
(c)	(2,000)		10,000			8,000				
(d)	(3,000)			3,000						
(e)										
(f)										
Effect	16,000				=	16,000				

$$A = L + SE$$

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Analyzing Transactions (5)

- (e) Papa John's purchases the stock of another company as a long-term investment, paying \$1,000 in cash.

Step 1: Identify and classify accounts and effects

1. Investment (+A) \$1,000. 2. Cash (-A) \$1,000.

Step 2: Is the accounting equation in balance?

	Assets				=	Liabilities		+	Stockholders' Equity	
	Cash	Investments	Equip.	Notes Receivable		Dividends Payable	Notes Payable		Common Stock	Retained Earnings
(a)	2,000							2,000		
(b)	6,000					6,000				
(c)	(2,000)		10,000			8,000				
(d)	(3,000)			3,000						
(e)	(1,000)	1,000								
(f)										
Effect	16,000				=	16,000				

$$A = L + SE$$

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Analyzing Transactions (6)

- (f) The board of directors declares that Papa John's will pay \$3,000 in cash dividends to shareholder next month.

Step 1: Identify and classify accounts and effects

1. Retained Earnings (-SE) \$3,000. 2. Dividends Payable (+L) \$3,000.

Step 2: Is the accounting equation in balance?

	Assets				=	Liabilities		+	Stockholders' Equity	
	Cash	Investments	Equip.	Notes Receivable		Dividends Payable	Notes Payable		Common Stock	Retained Earnings
(a)	2,000								2,000	
(b)	6,000						6,000			
(c)	(2,000)		10,000				8,000			
(d)	(3,000)			3,000						
(e)	(1,000)	1,000								
(f)						3,000				(3,000)
Effect	16,000				=	16,000				

$$A = L + SE$$

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How do Companies Keep Track of Account Balances ?

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How Do Companies Keep Track of Account Balances ?

- There are difficulties of tracking multiple accounts, involving hundreds of transactions, using the spreadsheet method below while doing all the computations by hand.

	Assets				=	Liabilities		+	Stockholders' Equity	
	Cash	Investments	Equip.	Notes Receivable		Dividends Payable	Notes Payable		Common Stock	Retained Earnings
(a)	2,000								2,000	
(b)	6,000						6,000			
(c)	(2,000)		10,000				8,000			
(d)	(3,000)			3,000						
(e)	(1,000)	1,000								
(f)						3,000				(3,000)
Effect	16,000				=	16,000				



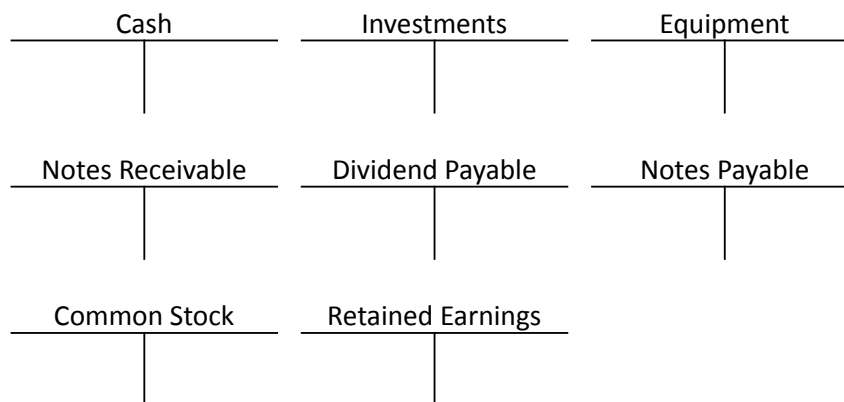
How Do Companies Keep Track of Account Balances ?

- The problem can be solved by separating the “+” and the “-” for each account into separate columns, totaling each column, and then computing the difference between the columns to arrive at an ending balance.
- The simplest, most fundamental format is the configuration of the letter T. This is called a **T-account**.
- A T-account is an abbreviated representation of an actual account (illustrated later) and is used as a teaching and learning tool.



How Do Companies Keep Track of Account Balances ?

- The followings are examples of T-accounts, representing the transactions described previously.
- The account title (Cash, for example) appears at the top of the T-account. Transaction amounts may be recorded on both the left side and the right side of the T-account.



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How Do Companies Keep Track of Account Balances ?

- Instead of using the terms left and right to indicate which side of a T-account is affected, terms unique to accounting were developed.
- **Debit** (abbreviated Dr) is used to indicate the left side of a T-account.
- **Credit** (abbreviated Cr) is used to indicate the right side of a T-account.
- **Debit means left, credit means right.**

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How Do Companies Keep Track of Account Balances ?

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

Asset accounts

are increased by *debits* and decreased by *credits*.

→ Assets accounts have **normal debit balances**.

Liability and owners' equity accounts

are decreased by *debits* and increased by *credits*.

→ Liability and owners' equity accounts have **normal credit balances**.

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How Do Companies Keep Track of Account Balances ?

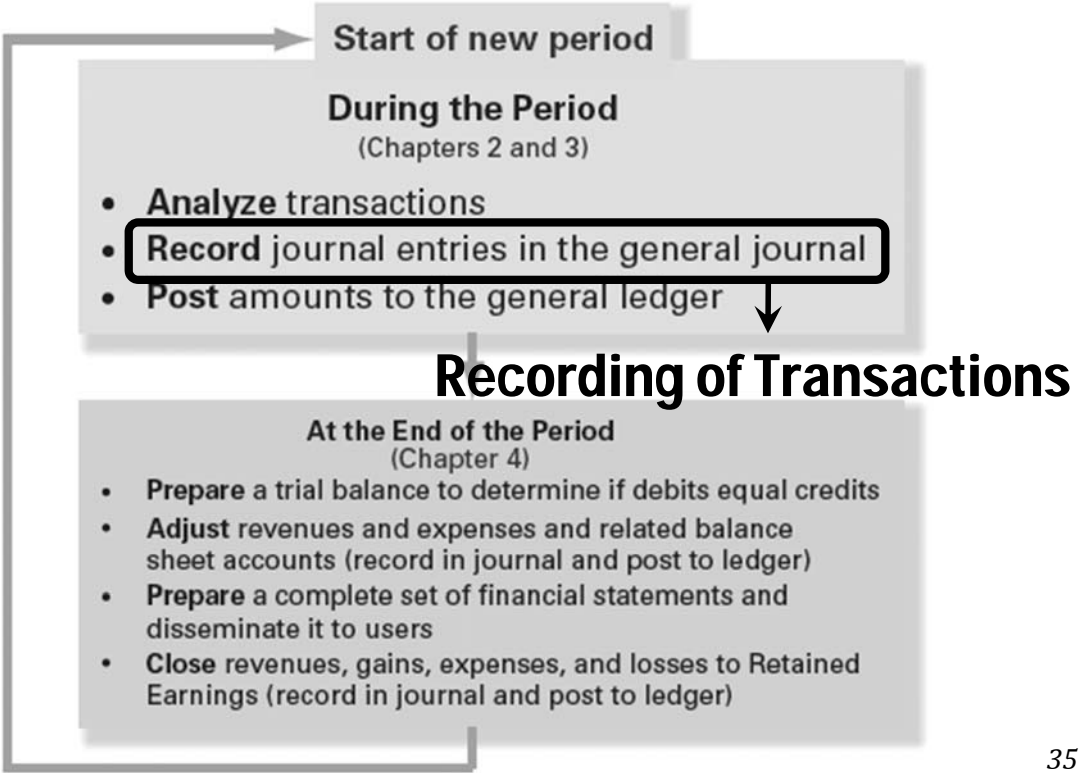
Basic facts regarding **double-entry accounting**:

1. Debits are always entered on the left side of an account and credits on the right side.
2. For every transaction, there must be at least one debit and one credit.
3. Debits must always equal credits for each transaction.

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The Accounting Cycle



Recording of Transactions (1)

Two important tools used by accountants:

- Journal Entries** – After analyzing a transaction, the effects of the transaction is recorded in a debits-equal-credits format.
The accounts and amounts to be debited are listed first. Then the accounts and amounts to be credited are listed below the debits and indented, resulting in debits on the left and credits on the right.

General Journal Entry Format

Date	Debit Entry	XX	
	Credit Entry		XX
	Explanation.		



Recording of Transactions (2)

A journal entry might look like this:

		Debit	Credit
(c)	Property and Equipment (+A)	10,000	
	Cash (-A)		2,000
	Notes Payable (+L)		8,000

Reference:
Letter,
number, or
date.

Account Titles:
Debited accounts on top.
Credited accounts on bottom
usually indented.

Amounts:
Debited amounts on left.
Credited amounts on right.

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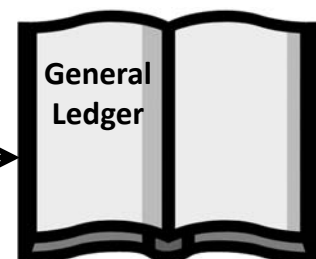


Posting the Transactions (1)

After journal entries are prepared, the accountant **posts** (transfers) the dollar amounts to each account affected by the transaction to the **General Ledger**

		Debit	Credit
(c)	Property and Equipment (+A)	10,000	
	Cash (-A)		2,000
	Notes Payable (+L)		8,000

Post →



Journal entries
do NOT provide
the account balances

Posting to general ledgers
help determining
the account balances

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Posting the Transactions (2)

2. T-Account

- a simplified representation of a ledger account
- a useful tool for summarizing the transactions effects and determining the balances for each account.

101 - Cash	
12/31/08 Bal.	11,000
1/2/09	2,000
1/6/09	6,000
	<u>19,000</u>

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Analyzing the Transaction - Transaction (a)

- (a) Papa John's issues \$2,000 of additional common stock to new investors for cash.

Step 1: Identify and classify accounts and effects

1. Cash (+A) \$2,000. 2. Common stock (+SE) \$2,000.

Step 2: Is the accounting equation in balance?

	Assets				=	Liabilities		+	Stockholders' Equity	
	Cash	Investments	Equip.	Notes Receivable		Dividends Payable	Notes Payable		Common Stock	Retained Earnings
(a)	2,000								2,000	
(b)										
(c)										
(d)										
(e)										
(f)										
Effect	2,000				=	2,000				

$$A = L + SE$$

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Recording & Posting - Transaction (b)

(b) Papa John's borrows \$6,000 from the bank signing a three-year note.

General Journal				
Date	Account Titles and Explanation	Ref.	Debit	Credit
1/6/09	Cash	101	6,000	
	Notes Payable	204		6,000
	Borrowed from bank			

101 - Cash	
12/31/08 Bal.	11,000
1/2/09	2,000
1/6/09	6,000
	<u>19,000</u>

204 - Notes Payable	
12/31/08 Bal.	124,000
1/6/09	6,000
	<u>130,000</u>



Following are the T-accounts (in thousands of dollars) that **changed** during the period because of these transactions. The beginning balances are the amounts from the December 31, 2008, Papa John's balance sheet. The balances of all other accounts remained the same.

+ Cash (A) -		+ Investments (A) -		+ Property and Equipment, Net (A) -	
12/31/08 bal.	11,000	12/31/08 bal.	1,000	12/31/08 bal.	190,000
(a)	2,000	(e)	1,000	(c)	10,000
(b)	6,000	1/31/09 bal.	<u>2,000</u>	1/31/09 bal.	<u>200,000</u>
1/31/09 bal.	<u>13,000</u>				

+ Notes Receivable (A) -		- Notes Payable (L) +		- Dividends Payable (L) +	
12/31/08 bal.	8,000	12/31/08 bal.	124,000	12/31/08 bal.	0
(d)	3,000	(b)	6,000	(f)	3,000
1/31/09 bal.	<u>11,000</u>	(c)	8,000	1/31/09 bal.	<u>3,000</u>
		1/31/09 bal.	<u>138,000</u>		

- Common Stock (SE) +		- Retained Earnings (SE) +	
12/31/08 bal.	7,000	12/31/08 bal.	123,000
(a)	2,000	(f)	3,000
1/31/09 bal.	<u>9,000</u>	1/31/09 bal.	<u>120,000</u>



How is the Statement of Financial Position Prepared and Analyzed?

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How is the Statement of Financial Position Prepared and Analyzed?

- After analyzing a transaction, a **JOURNAL ENTRY** is posted.
- The transaction is then posted to the **GENERAL LEDGER**.
- **T-ACCOUNTS** are used to illustrate this process.
- The **STATEMENT OF FINANCIAL POSITION** is then prepared using the balances shown in the T-accounts.

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Papa John's Statement of Financial Position

Statements of Financial Position as at **January 31, 2009** and **December 31, 2008**

Most recent balance sheet amounts are usually listed on the left

PAPA JOHN'S INTERNATIONAL, INC.
Consolidated Balance Sheets
(dollars in thousands)

\$ are indicated at the top and bottom of the asset sections and of the liabilities & shareholders' equity section

	January 31, 2009	December 31, 2008
ASSETS		
Current Assets		
Cash	\$ 13,000	\$ 11,000
Accounts receivable	24,000	24,000
Supplies	17,000	17,000
Prepaid expenses	10,000	10,000
Other current assets	13,000	13,000
Total current assets	77,000	75,000
Investments	2,000	1,000
Property and equipment (net)	200,000	190,000
Notes receivable	11,000	8,000
Intangibles	77,000	77,000
Other assets	36,000	36,000
Total assets	\$403,000	\$387,000

Assets and liabilities are classified into two categories: current and noncurrent.

Current assets are those to be used or turned into cash within the upcoming year

Noncurrent assets are those that will last longer than one year

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Papa John's Statement of Financial Position

Statements of Financial Position as at **January 31, 2009** and **December 31, 2008**

\$ are indicated at the top and bottom of the asset sections and of the liabilities & shareholders' equity section

LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities		
Accounts payable	\$ 29,000	\$ 29,000
Dividends payable	3,000	0
Accrued expenses payable	71,000	71,000
Total current liabilities	103,000	100,000
Unearned franchise fees	6,000	6,000
Notes payable	138,000	124,000
Other long-term liabilities	27,000	27,000
Total liabilities	274,000	257,000
Stockholders' Equity		
Common Stock	9,000	7,000
Retained earnings	20,000	123,000
Total stockholders' equity	29,000	130,000
Total liabilities and stockholders' equity	\$403,000	\$387,000

Current liabilities are those obligations to be paid or settled within the next 12 months with current assets.

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Current Ratio

$$\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}}$$

Current ratio for Papa John's:

$$2006 = 0.83$$

$$2007 = 0.68$$

$$2008 = 0.75$$

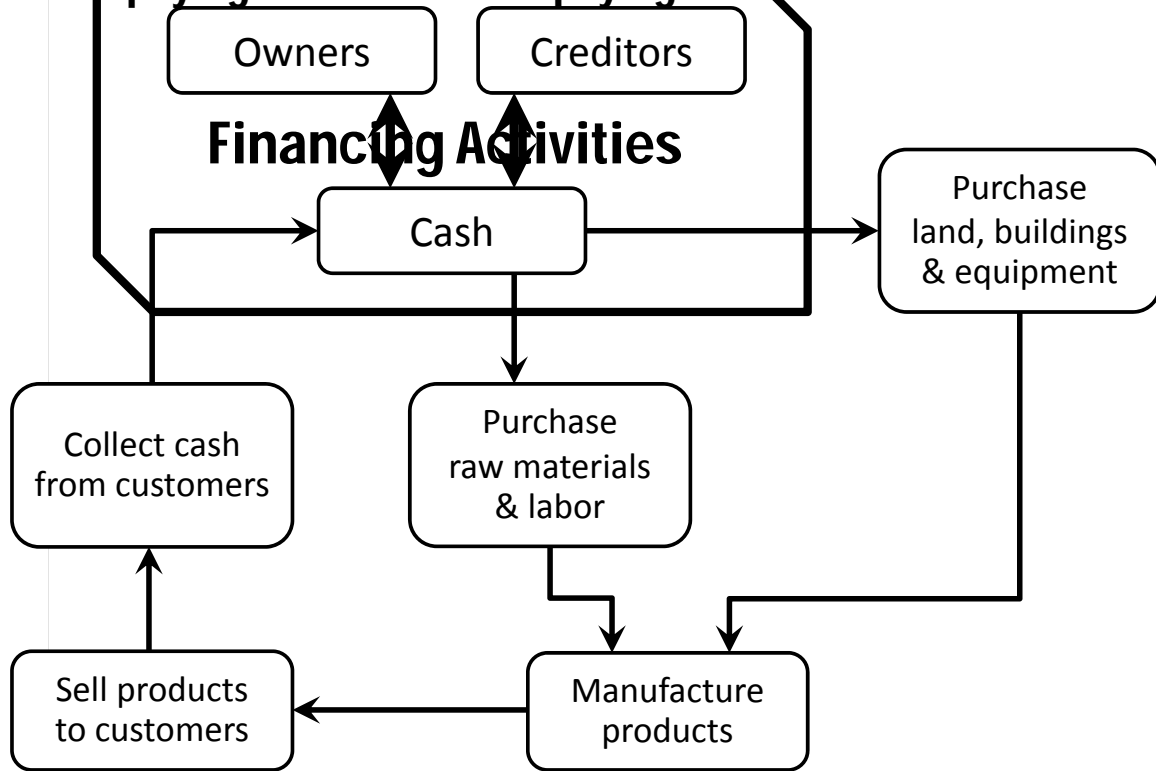
The current ratio for Papa John's shows a low level of liquidity, below 1.



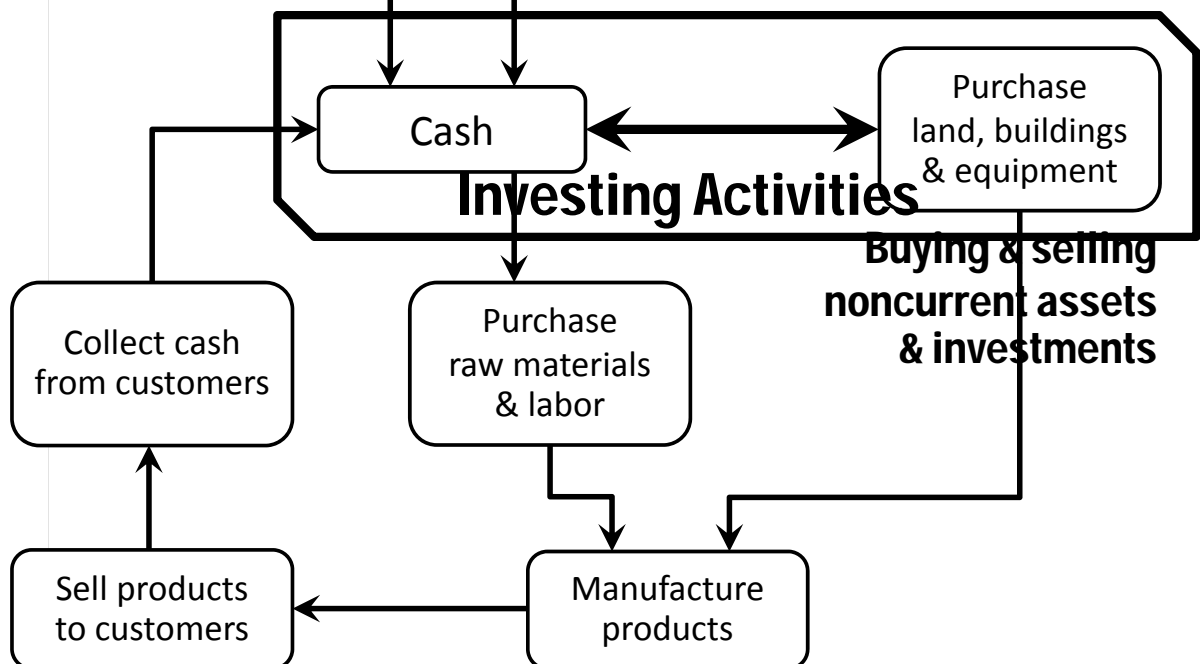
Focus on Cash Flows – Investing & Financing Activities



**Issuing & repurchasing
stocks & paying dividends** **Borrowing
& repaying debts**



Owners Creditors



**Buying & selling
noncurrent assets
& investments**



Statement of Cash Flows

Companies report cash inflows and outflows over a period in their statement of cash flows.

Operating activities	
(Covered in the next chapter.)	
Investing Activities	
Purchasing long-term assets and investments for cash	—
Selling long-term assets and investments for cash	+
Lending cash to others	—
Receiving principal payments on loans made to others	+
Financing Activities	
Borrowing cash from banks	+
Repaying the principal on borrowings from banks	—
Issuing stock for cash	+
Repurchasing stock with cash	—
Paying cash dividends	—

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Investing & Financing Activities

PAPA JOHN'S INTERNATIONAL, INC.
Consolidated Statement of Cash Flows
 For the month ended January 31, 2009
 (in thousands)

Operating activities	
(None in this chapter.)	
Investing activities	
Purchased property and equipment (c)	\$ (2,000)
Purchased investments (e)	(1,000)
Lent funds to franchisees (d)	(3,000)
Net cash used in investing activities	<u>(6,000)</u>
Financing activities	
Issued common stock (a)	2,000
Borrowed from banks (b)	6,000
Net cash provided by financing activities	<u>8,000</u>
Net increase in cash	2,000
Cash at beginning of month	<u>11,000</u>
Cash at end of month	<u>\$13,000</u>

Items are referenced to events (a) through (f) illustrated in this chapter.

Also called capital expenditures.

← Agrees with the amount on the balance sheet.

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

On June 1, 2015, 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 invest \$10,000 into the business in exchange for 10,000 shares of \$1 par value common stock.
- 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" (or "on account") 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 purchased \$1,000 worth of equipment, paid in cash.
- i. On June 18, the company ordered a \$900 snow blower, to be delivered next month.

The company uses the following general ledger accounts.

Cash
Supplies
Equipment
Accounts payable
Notes payable
Common stock
Retained earnings

Step I - Analyzing Transactions

Analyze each of the following transactions of World Wide Webster by performing each of the following steps. Then, use the chart on page 4 to keep track of the amount in each account:

- a. On June 1, Peter and his friends invest \$10,000 into the business in exchange for 10,000 shares of \$1 par value common stock.

1. Decide if a transaction took place.	Yes – received cash and gave stock.
2. Identify the accounts affected.	Cash, Common stock (from the above list)
3. Classify each account affected.	Cash is an Asset (A) Common stock is Stockholders' Equity (E)
4. Identify direction and amount.	Cash (A) + \$10,000 = Stockholders' Equity (E) + \$10,000.
5. Ensure the accounting equation is in balance.	Yes – see chart on page 4.

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

1. Decide if a transaction took place.	
2. Identify the accounts affected.	
3. Classify each account affected.	
4. Identify direction and amount.	
5. Ensure the accounting equation is in balance.	

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

1. Decide if a transaction took place.	
2. Identify the accounts affected.	
3. Classify each account affected.	
4. Identify direction and amount.	
5. Ensure the accounting equation is in balance.	

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

1. Decide if a transaction took place.	
2. Identify the accounts affected.	
3. Classify each account affected.	
4. Identify direction and amount.	
5. Ensure the accounting equation is in balance.	

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

1. Decide if a transaction took place.	
2. Identify the accounts affected.	
3. Classify each account affected.	
4. Identify direction and amount.	
5. Ensure the accounting equation is in balance.	

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

1. Decide if a transaction took place.	
2. Identify the accounts affected.	
3. Classify each account affected.	
4. Identify direction and amount.	
5. Ensure the accounting equation is in balance.	

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

1. Decide if a transaction took place.	
2. Identify the accounts affected.	
3. Classify each account affected.	
4. Identify direction and amount.	
5. Ensure the accounting equation is in balance.	

h. On June 17, the company purchased \$1,000 worth of equipment, paid in cash.

1. Decide if a transaction took place.	
2. Identify the accounts affected.	
3. Classify each account affected.	
4. Identify direction and amount.	
5. Ensure the accounting equation is in balance.	

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

1. Decide if a transaction took place.	
2. Identify the accounts affected.	
3. Classify each account affected.	
4. Identify direction and amount.	
5. Ensure the accounting equation is in balance.	

Chart

	Assets			=	Liabilities		+	Equity			
Ref.	Cash	+	Supplies	+	Equipment	=	Accounts Payable	+	Notes Payable	+	Common stock
(a)	+10,000										+10,000
(b)											
(c)											
(d)											
(e)											
(f)											
(g)											
(h)											
(i)											
Total											
						=			+		

The Debit/Credit Framework

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	

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.

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.

Step II – Journalizing the Transactions

Required: Analyze each of the following transactions of World Wide Webster and prepare the journal entry required to record the related transaction.

- On June 1, Peter and his friends invest \$10,000 into the business in exchange for 10,000 shares of \$1 par value common stock.

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.

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.

GENERAL JOURNAL			
Date	Account Titles and Explanation	Debit	Credit

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

GENERAL JOURNAL			
Date	Account Titles and Explanation	Debit	Credit

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

GENERAL JOURNAL			
Date	Account Titles and Explanation	Debit	Credit

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

GENERAL JOURNAL			
Date	Account Titles and Explanation	Debit	Credit

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

GENERAL JOURNAL				
Date		Account Titles and Explanation	Debit	Credit

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

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.

GENERAL JOURNAL				
Date		Account Titles and Explanation	Debit	Credit

Step III - Posting To T-Accounts

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").

Required: Post the journal entries in Step II into the following T-accounts. Then determine the ending balances of each of the T-accounts. Note that all "beginning balances" (BegBal) have zero balance. This is because June is the first month of its operations.

Assets				Liabilities				Stockholders' Equity			
+ Cash -				- Accounts Payable +				- Common Stock +			
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										

Step IV - Preparing a Trial Balance

Required: Use the ending balances from the T-accounts in Step III to prepare a trial balance for World Wide Webster as of June 30, 2015.

WORLD WIDE WEBSTER INC.

**Trial Balance
As of June 30, 2015**

Account Title	Debit	Credit
Cash		
Supplies		
Equipment		
Notes Payable		
Common Stock		
Totals		

Trial balance is prepared before preparing the financial statements. It is usually prepared in financial statement order, i.e. assets, liabilities, equity, revenue, and expenses.

Step V - Preparing a Statement of Financial Position

Required: Use the balances from the trial balance in Step IV to prepare a classified Statement of Financial Position for World Wide Webster as of June 30, 2015.

WORLD WIDE WEBSTER INC.
Statement of Financial Position
As of June 30, 2015

Assets

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

Liabilities & Stockholders' Equity

Current liabilities	
Notes payable	_____
Total liabilities	_____
Stockholders' Equity	
Common stock	_____
Retained earnings	_____
Total stockholders' equity	_____
Total liabilities & stockholders' equity	_____