

Accounting Transactions

- **accounting information system** - the system of collecting and processing transaction data and communicating financial information to decision makers
 - type of business and its transactions
 - size of the company
 - amount of data
- Accounting information systems begin with determining what relevant transaction data should be collected and processed
- events causing changes in assets, liabilities or shareholders' equity should be recorded
 - things affecting these accounts
- **accounting transaction** occurs when assets, liabilities or shareholders' equity items change as a result of some economic event

Analyzing Transactions

- assets should always equal to liabilities + shareholders equity
- **Transaction 1** - Investment by Shareholders
 - \$10 000 cash invested in Sierra Corp. in exchange for 10 000 common shares
 - RESULT
 - increase 10000 assets and shareholders' equity
- **Transaction 2** - Issue of Note Payable
 - Sierra borrowed 5000 from a bank by signing a note payable
 - the note was promised to be repaid in three months plus 6% interest
 - RESULT - increase in assets and liabilities
 - cash by 5000
 - liabilities - Note Payable by 5000
- **Transaction 3** - Purchase of Equipment
 - Sierra acquired equipment by paying \$5000 cash to Superior Equipment
 - RESULT - Cash would decrease 5000, equipment would increase 5000
- **Transaction 4** - Receipt of Cash in Advance from Customer
 - Sierra receives \$1200 cash advance from R. Knox for advertising services expected to be completed before November 15.

- RESULT - cash and unearned revenue increases by 12,000
 - unearned indicates that this is a liability account - rather than being a revenue account
- **Transaction 5 - Payment of Rent**
 - Sierra Corp. paid its office rent for the month of October in \$900 cash
 - RESULT - cash decreases 900, rent expense increases by 900
 - rent is an expense incurred by Sierra in their efforts to generate revenues
 - **retained earnings are increased by revenues and decreased by expenses and dividends**
- **Transaction 6 - Purchase of Insurance**
 - Sierra paid \$600 for a one year insurance policy expiring next year on Sept 30, effective October 30
 - RESULT - cash decreases by \$600 and prepaid insurance increases by \$600
 - payment of expenses benefiting more than one accounting period are identified as prepaid expenses or prepayments
- **Transaction 7 - Hiring of New Employees**
 - Sierra hired four new employees to begin work on Monday October 8th
 - Each employee will receive a weekly salary of \$500, first check October 19th
 - RESULT - No effects on the accounting equation
 - does not affect any accounts
- **Transaction 8 - Purchase of Supplies on Account**
 - Sierra purchased advertising materials on account from Aero Supply Corp, for \$2500
 - due in 30 days
 - RESULT - supplies increase, accounts payable increases
- **Transaction 9 - Services Performed on Account**
 - Sierra performed \$10 000 of advertising services for Copa Ltd.
 - Sierra sent Copa a bill for these services asking for payments before the end of the month
 - RESULT - Accounts Receivables increase and Revenues

increase

- **Transaction 10** - Payment of Salaries
 - Employees worked two weeks, earning \$4000 in salaries
 - (4 employees x 500/week x 2 weeks) = 4000
 - Employees were paid on October 19
 - salaries are an expense similar to rent because they are a cost of generating revenues
 - **RESULT** - cash and expenses decrease
- **Transaction 11** - Payment of Dividend
 - Sierra paid a \$500 cash dividend
 - Dividends are a distribution of retained earnings rather than an expense - not incurred to generate revenue
 - **RESULT** - decreases Cash and Dividends
 - **cash dividend transactions reduce cash and retained earnings**
- **Transaction 12** - Collection of Account
 - Copa paid Sierra the amount owing on its account
 - **RESULT** - Cash increases and Accounts Receivables decrease

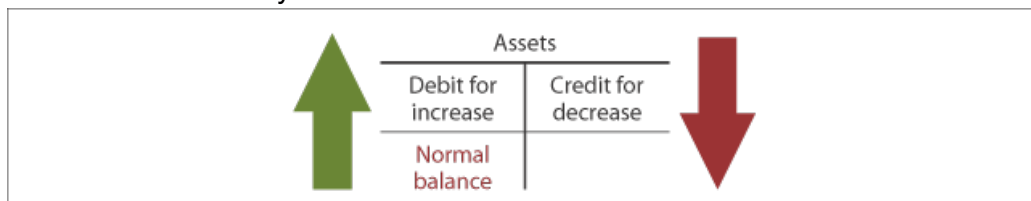
	Assets					=	Liabilities			+	Shareholders' Equity			
	Cash	A/R	Sup.	Pre. Ins.	Equipment	A/P	N/P	Unearned Revenue	Common Shares	Retained Earnings				
										Rev.	- Exp.	- Div.		
(1)	+\$10,000								+\$10,000					
(2)	+5,000						+\$5,000							
(3)	-5,000				+\$5,000									
(4)	+1,200							+\$1,200						
(5)	-900											-\$900		
(6)	-600			+\$600										
(8)			+\$2,500			+\$2,500								
(9)		+\$10,000								+\$10,000				
(10)	-4,000											-4,000		
(11)	-500												-\$500	
(12)	+10,000	-10,000												
	\$15,200	\$0	\$2,500	\$600	\$5,000	\$2,500	\$5,000	\$1,200	\$10,000	\$10,000	-\$4,900	-\$500	\$500	
	\$23,300						\$23,300							

The Account

- **account** is an individual accounting record of increases and decreases in a specific asset, liability or shareholders' equity item
- accounts consist of three parts
 - title of the account
 - a left or debit side
 - a right or credit side
- This makes up a **T- Account**

Debits and Credits

- **debit** means left
 - recording amounts on the left side of the account is referred to as debiting
- **credit** means right
 - recording amounts on the right side of the account is referred to as crediting
- Totalling accounts
 - an account will have a debit balance if the sum of all debits exceeds the sum of all credits in the account
 - an account will have a credit balance if the sum of all credits exceeds the sum of all debits in the account
- debit movement in accounts must equal credit movement in the accounts
 - **double entry accounting system** is the equality of debts and credits in which the dual effect of each transaction is recorded in appropriate accounts
- ASSETS
 - Debits - increase
 - Credits - decrease
 - normally show debit balances



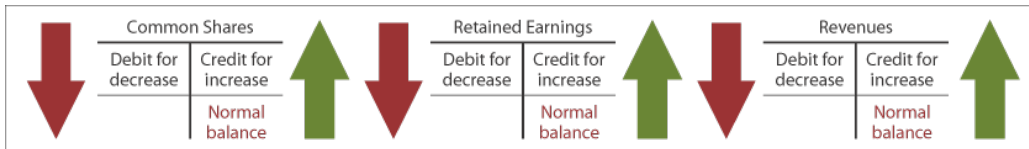
- LIABILITIES AND SHAREHOLDERS' EQUITY
 - Debits - decrease
 - Credits - increase
 - normally show credit balances



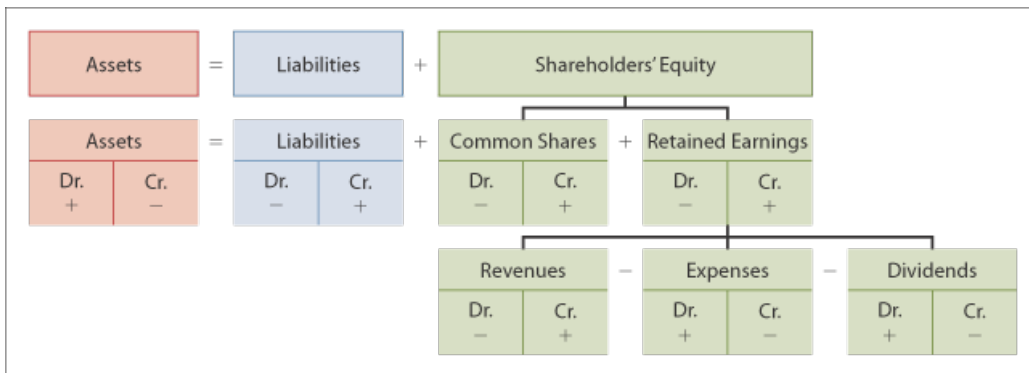
- Increases in Shareholders' Equity
 - Common shares and retained earnings both increase

shareholder's equity

- Common shares are issued in exchange for the shareholders' investments
- Retained earnings are what has been accumulated through the profitable operation of the company
- revenues increase retained earnings -> increasing shareholders' equity**
- normal balance shown as credit**



- Decreases in Shareholders' Equity
 - Dividends and expenses decrease retained earnings - > decreasing shareholders' equity
 - normal balance shows as debit



Steps in the Recording Process

- accounting cycle** consists of nine steps in total
 - first three steps are called the recording process
- STEP 1 Each transaction is analyzed to determine if it has an effect on the accounts

- **source document** where evidence of the transaction comes from
 - sales slip
 - cheque
 - bill
 - receipt
- STEP 2 Transaction information is recorded as a journal entry in the general journal
- STEP 3 information is transferred from the general journal to the appropriate accounts in the general ledger

The Journal

- transactions are recorded in chronological order in a journal -> then transferred to accounts
- journal -> book of original entry
- journal shows the debit and credit effects on specific accounts
- the most basic form of a journal -> **general journal**
- The General Journal
 - discloses the complete effect of a transaction in one place -> includes an explanation and identification of source document
 - provides a chronological record of transactions
 - helps prevent and locate errors
- **journalizing** - entering transaction data in the general journal
- Features of a journal entry
 - date of the transaction entered in Date column
 - account to be debited is entered first
 - account to be credited is entered second and is indented
 - indenting differentiates credits and debits
 - debits are recorded in the first column and credits in the second column
 - brief explanation
- **simple journal entry** when an journal entry affects only two accounts - debit and credit
- **compound entry** when three or more accounts are required in one journal entry
- total debits and credits should amount to the same number

GENERAL JOURNAL			
Date	Account Titles and Explanation	Debit	Credit
2012			
Oct. 1	Cash	10,000	
	Common Shares		10,000
	(Issued common shares)		

The Ledger

- the entire group of accounts maintained by a company - > referred to as the ledger
- keeps all the information about changes in specific account balances in one place
- **general ledgers** contain all the assets, liabilities and shareholders' equity, revenue and expense accounts.
 - Each account has a number -> easy identification
- often arranged in the order in which accounts are presented in the financial statements
- **chart of accounts** is the framework for the accounting databases

SIERRA CORPORATION—CHART OF ACCOUNTS									
Assets		Liabilities		Shareholders' Equity		Revenues		Expenses	
1000	Cash	3000	Accounts Payable	4000	Common Shares	5000	Service Revenue	7000	Salaries Expense
1100	Accounts Receivable	3100	Salaries Payable	4500	Retained Earnings			7100	Supplies Expense
1500	Supplies	3200	Interest Payable	4600	Dividends			7500	Rent Expense
1550	Prepaid Insurance	3300	Unearned Revenue					7600	Depreciation Expense
2000	Equipment	3400	Notes Payable					8200	Insurance Expense
2010	Accumulated Depreciation—Equipment							8400	Interest Expense
								9000	Income Tax Expense

Posting

- **posting** is the procedure of transferring journal entries from the general journal to the general ledger accounts
- should be done in chronological order
- should be done on a timely basis
 - ensures that the general ledger is up to date

SIERRA CORPORATION

General Journal

Date	Account Titles and Explanation	Debit	Credit
2012			
Oct. 1	Cash	10,000	
	Common Shares		10,000
	(Issued common shares)		
1	Cash	5,000	
	Notes Payable		5,000
	(Issued three-month, 6% note payable for cash)		
1	Equipment	5,000	
	Cash		5,000
	(Purchased equipment for cash)		
2	Cash	1,200	
	Unearned Revenue		1,200
	(Received advance from R. Knox for future service)		
2	Rent Expense	900	
	Cash		900
	(Paid cash for October office rent)		
3	Prepaid Insurance	600	
	Cash		600
	(Paid one-year insurance policy; effective October 1)		
9	Supplies	2,500	
	Accounts Payable		2,500

SIERRA CORPORATION
General Ledger

Cash				Unearned Revenue					
Oct.	1	10,000	Oct.	1	5,000		Oct.	2	1,200
	1	5,000		2	900		Bal.		1,200
	2	1,200		3	600				
	30	10,000		19	4,000				
				26	500				
Bal.		15,200							
Accounts Receivable				Notes Payable					
Oct.	13	10,000	Oct.	1	5,000				
Bal.		0	Bal.		5,000				
Supplies				Common Shares					
Oct.	9	2,500	Oct.	1	10,000				
Bal.		2,500	Bal.		10,000				
Prepaid Insurance				Dividends					
Oct.	3	600	Oct.	26	500				
Bal.		600	Bal.		500				
Equipment				Service Revenue					
Oct.	1	5,000	Oct.	13	10,000				
Bal.		5,000	Bal.		10,000				
Accounts Payable				Salaries Expense					
			Oct.	19	4,000				
			Bal.		4,000				
Rent Expense									
			Oct.	2	900				
			Bal.		900				

Trial Balance

- Fourth step in the accounting cycle is to prepare a trial balance
- **trial balance** is a list of general ledger accounts and their balances at a specific time
- prepared at the end of an accounting period - usually monthly
 - could be quarterly or annually
- Accounts are listed in the order that they appear in the ledger
 - debit balances on the left
 - credit balances on the right
- debits and credits should be equal
- purpose of the trial balance **is to prove (check) that the debits equal the credits after posting**
- if debits do not equal credits on the trial balance - > it reveals errors in posting
- useful in the preparation of financial statements
- Procedure for preparing a trial balance
 - list account titles and their balances in the same order as the

chart of accounts

- total debits and credits
- ensure that they total to the same number
- when a trial balance is first prepared, retained earnings account balances listed on the trial balance is not the retained earnings at the end of the period
 - rather, it is the retained earnings at the beginning of the period

Limitations of a Trial Balance

- a trial balance does not prove that all transactions have been recorded or that the general ledger is correct
- Errors still exist even when the trial balance balances
- possibilities of the trial balance still balancing with errors
 - when a transaction is not journalized
 - a correct journal entry is not posted
 - a journal entry is posted twice
 - incorrect accounts used in journalizing or posting
 - errors that cancel each others effect are made in recording the amount of a transaction