ACC250: Intro to Financial Accounting

Ch2. The Balance Sheet

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Business Activities

Three different types of business activities:

1. Financing - The raising and repayment of capital.
   - Selling stocks to shareholders
   - Borrowing money from banks
   - Paying dividends to shareholders

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   - Buying equipment
   - Buying land
   - Buying a new building
3. Operating - The core activities of a business that generate revenue (incl. R & E).
   - Selling products
   - Buying supplies
   - Paying employees' salaries
   - Paying rent for office space

Business Activities - Classification exercise

- **F I O**: Choose F (Financing), I (Investing), or O (Operating).
- **NI**: O if the activity affects Net Income (through Revenue or Expense), otherwise X.

Business Activities	**F I O**	**NI**
Two owners of the NoodleCake decided to contribute $5,000 each.		
NoodleCake received $20,000 cash in exchange for its promise to repay the loan in two years.		
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Transactions

Transactions

Financial activities that involve the exchange of goods, services, or money.

- All transactions affect the basic accounting equation: **A= L + SHE**.
- Two types:
  - **Operating** activities: Affect NI (mainly covered in Ch3).
  - **Financing** and **Investing** activities: Do not affect NI (covered in Ch2).
- **Acitivites but not transactions**:
  - Promising to hire employees
  - Exchange of stocks between shareholders

A chart of accounts

A company manages its own **chart of accounts** to record transactions.
Examples of common accounts:

Account	Class	Definition
Cash	_	Money available for immediate use, including currency, coins, and balances in checking and savings accounts.
Supplies	_	Items used in the course of business operations that are expected to be consumed within a short period.
Equipment	_	Long-term assets such as machinery, computers, or vehicles used in business operations.
Logo and Trademarks	_	Intangible assets representing the company's brand identity and legally protected symbols or names.
Software	_	Computer programs and applications owned or licensed by the company for business use.
Accounts Payable	_	Amounts the company owes to suppliers for goods or services purchased on credit.
Notes Payable	_	Written promises to pay a specific amount of money at a future date, often with interest.
Common Stock	____	The basic ownership shares issued to investors, representing ownership in the company.
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Software	A	Computer programs and applications owned or licensed by the company for business use.
Accounts Payable	L	Amounts the company owes to suppliers for goods or services purchased on credit.
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Duality of Effects

Each transaction has at least two effects on the basic accounting equation:

- **A= L + SHE**

Analyze the effects of the following transactions:

Business Activities	A	L	SHE
1. Two owners of the NoodleCake decided to contribute $5,000 each.	+		+
2. NoodleCake received $20,000 cash in exchange for its promise to repay the loan in two years.	−	−	
3. NoodleCake purchased a logo by paying $300 cash to a designer.	−		
4. NoodleCake bought $9,600 of Equipment on credit.	−	−	
5. NoodleCake paid $1,000 cash to employees for salaries.	-		-
6. NoodleCake received $2,000 cash from customers for products sold.	−		−

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5. NoodleCake paid $1,000 cash to employees for salaries.	-		-
6. NoodleCake received $2,000 cash from customers for products sold.	+		+

Debit/Credit Framework: 1. What are Debit and Credit?

Debit(DR): Left **Credit (CR): Right**

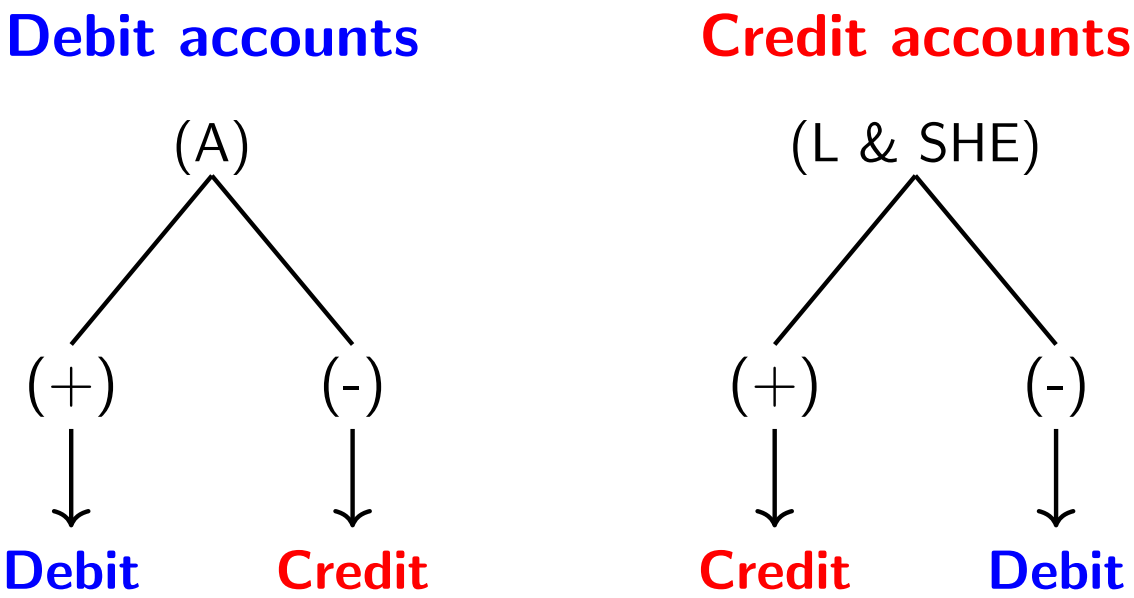
Debit/Credit Framework: 2. What are Debit and Credit Accounts?

$$A = L + \textbf{SHE}$$

Those on
the **left-hand** side:
Debit Accounts

Those on
the **right-hand** side:
Credit Accounts

Debit/Credit Framework: 3. Where to record?



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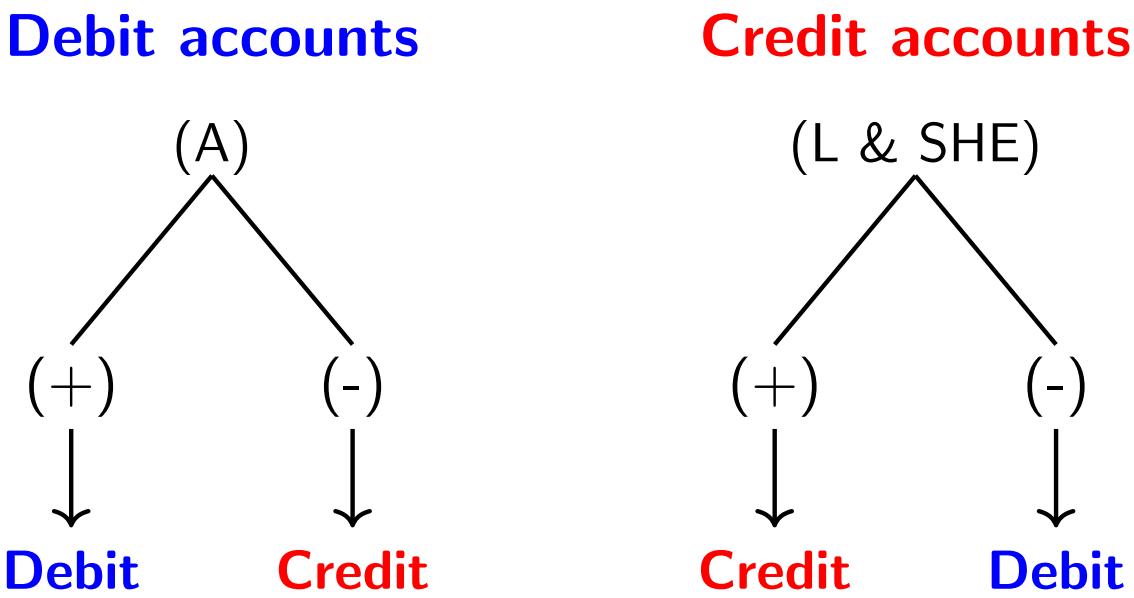

- When **Debit** accounts increase: **Debit**.
- When **Debit** accounts decrease: **Credit**.
- When **Credit** accounts increase: **Credit**.
- When **Credit** accounts decrease: **Debit**.

Debit/Credit Framework

	A	L	SHE
Debit / Credit account	**Debit acc.**	**Credit acc.**	**Credit acc.**
Increase	**D (L)**	**C (R)**	**C (R)**
Decrease	**C (R)**	**D (L)**	**D (L)**

Debit/Credit Framework - Examples

EX. Prepare journal entries for the following transactions under the debit/credit framework:

1. Two owners of NoodleCake each contributed $5,000.

2. Noodlecake pays $300 cash to create the company's logo.

Debit/Credit Framework - Examples

EX. Prepare journal entries for the following transactions under the debit/credit framework:

1. Two owners of NoodleCake each contributed $5,000.

Cash (+A)	10,000	
Common Stock (+SHE)		10,000

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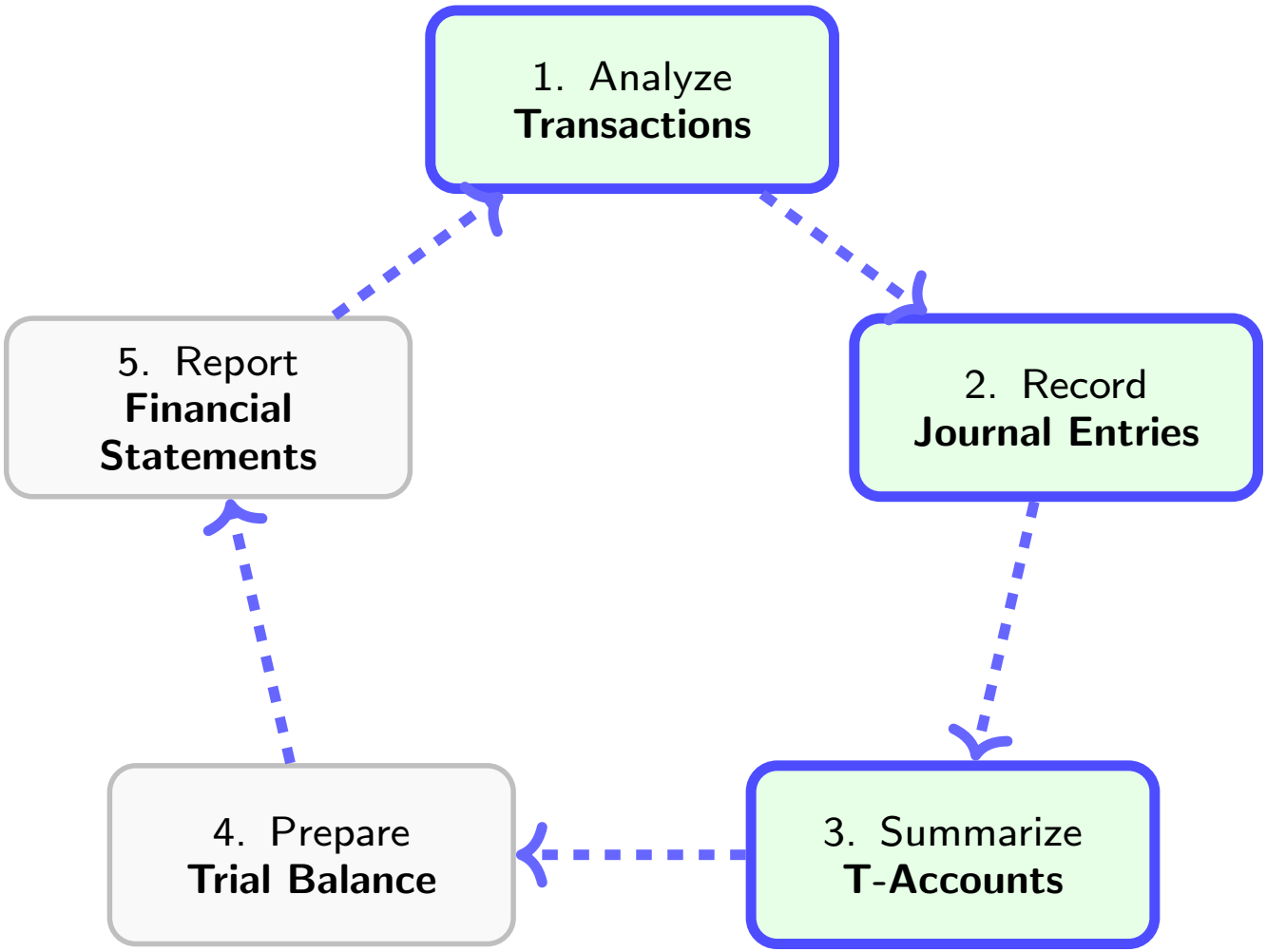
Logo and Trademarks (+A)	300	
Cash (-A)		300

Accounting Cycle

A systematic accounting process is used to capture and report the financial effects of a company's transactions.



Note: Steps 1–3 are covered in this chapter.

Step 1. Analyze Transactions

Questions for Every Transaction

1. Is it a transaction?
2. Which accounts are affected?
3. How are they affected? (increase or decrease)

Example: You bought $500 worth of supplies and paid cash.

- **Transaction?** It affects the **basic accounting equation**, so it's a transaction.
- **What accounts?** Supplies (Asset) and Cash (Asset) are affected.
- **How affected?** Supplies increases, Cash decreases.

A	= L	+ SHE

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A	= L	+ SHE
Supplies +500		
Cash -500		

Step 1. Analyze Transactions - Examples

1. Two owners of the NoodleCake decided to contribute $5,000 each.

A	= L	+ SHE
_____		_____

2. NoodleCake received $20,000 cash in exchange for its promise to repay the loan in two years.

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3. NoodleCake bought $9,600 of Equipment on credit.

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Cash +20,000	Notes Payable +20,000	

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Cash +20,000	Notes Payable +20,000	

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A	= L	+ SHE
Equipment +9,600	Accounts Payable +9,600	

Step 2. Record Journal Entries

EX. Consider the following transactions. Prepare journal entries for each:

1. Two owners of NoodleCake each contributed $5,000.

2. Noodlecake pays $300 cash to create the company's logo.

3. NoodleCake received $20,000 cash in exchange for a promise to repay the loan in 2 years.

4. Noodlecake purchases and receives $9,600 in equipment (e.g., computers), in exchange for its promise to pay $9,600 at the end of the month.

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Cash (-A)		300

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Cash (-A)		300

3. NoodleCake received $20,000 cash in exchange for a promise to repay the loan in 2 years.

Cash (+A)	20,000	
Notes Payable (+L)		20,000

4. Noodlecake purchases and receives $9,600 in equipment (e.g., computers), in exchange for its promise to pay $9,600 at the end of the month.

Step 2. Record Journal Entries

EX. Consider the following transactions. Prepare journal entries for each:

1. Two owners of NoodleCake each contributed $5,000.

Cash (+A)	10,000	
Common Stock (+SHE)		10,000

2. Noodlecake pays $300 cash to create the company's logo.

Logo and Trademarks (+A)	300	
Cash (-A)		300

3. NoodleCake received $20,000 cash in exchange for a promise to repay the loan in 2 years.

Cash (+A)	20,000	
Notes Payable (+L)		20,000

4. Noodlecake purchases and receives $9,600 in equipment (e.g., computers), in exchange for its promise to pay $9,600 at the end of the month.

Equipment (+A)	9,600	
Accounts Payable (+L)		9,600

5. Noodlecake pays $5,000 to the equipment supplier in (d).

6. Noodlecake signs a contract with a programmer for program code for the Enchanted World game app for $9,000. No code has been received yet.

7. Noodlecake receives the $9,000 of app game code ordered in (f), pays $4,000 cash, and promises to pay the remaining $5,000 next month.

8. Noodlecake receives supplies costing $600 on account.

5. Noodlecake pays $5,000 to the equipment supplier in (d).

Accounts Payable (-L)	5,000	
Cash (-A)		5,000

6. Noodlecake signs a contract with a programmer for program code for the Enchanted World game app for $9,000. No code has been received yet.

7. Noodlecake receives the $9,000 of app game code ordered in (f), pays $4,000 cash, and promises to pay the remaining $5,000 next month.

8. Noodlecake receives supplies costing $600 on account.

5. Noodlecake pays $5,000 to the equipment supplier in (d).

Accounts Payable (-L)	5,000	
Cash (-A)		5,000

6. Noodlecake signs a contract with a programmer for program code for the Enchanted World game app for $9,000. No code has been received yet.

No journal entries required.

7. Noodlecake receives the $9,000 of app game code ordered in (f), pays $4,000 cash, and promises to pay the remaining $5,000 next month.

8. Noodlecake receives supplies costing $600 on account.

5. Noodlecake pays $5,000 to the equipment supplier in (d).

Accounts Payable (-L)	5,000	
Cash (-A)		5,000

6. Noodlecake signs a contract with a programmer for program code for the Enchanted World game app for $9,000. No code has been received yet.

No journal entries required.

7. Noodlecake receives the $9,000 of app game code ordered in (f), pays $4,000 cash, and promises to pay the remaining $5,000 next month.

Software (+A)	9,000	
Cash (-A)		4,000
Accounts Payable (+L)		5,000

8. Noodlecake receives supplies costing $600 on account.

5. Noodlecake pays $5,000 to the equipment supplier in (d).

Accounts Payable (-L)	5,000	
Cash (-A)		5,000

6. Noodlecake signs a contract with a programmer for program code for the Enchanted World game app for $9,000. No code has been received yet.

No journal entries required.

7. Noodlecake receives the $9,000 of app game code ordered in (f), pays $4,000 cash, and promises to pay the remaining $5,000 next month.

Software (+A)	9,000	
Cash (-A)		4,000
Accounts Payable (+L)		5,000

8. Noodlecake receives supplies costing $600 on account.

Supplies (+A)	600	
Accounts Payable (+L)		600

Step 3. Summarize T-Accounts

Ledger Accounts, T-Accounts, and General Ledger

- Transactions are posted to (i.e., summarized by) (**Ledger Accounts**).
- A complete list of Ledger Accounts is called **General Ledger**.
- **T-account** is a visual representation of the (Ledger Accounts).
- We use T-accounts in this course.

Cash

Beg. 0	
(a) 10,000	300 (b)
(c) 20,000	5,000 (e)
	4,000 (g)
End. 20,700	

Step 3. Summarize T-Accounts

Balances of T-accounts

- **Debit** accounts have normally **debit** balances.
- **Credit** accounts have normally **credit** balances.

Step 3. Summarize T-Accounts

Balances of T-accounts

- **Debit** accounts have normally **debit** balances.
- **Credit** accounts have normally **credit** balances.

How to get transactions (in journal entries) posted to T-accounts?

- Get the **beginning balance** of the T-account from the previous period.

Step 3. Summarize T-Accounts

Balances of T-accounts

- **Debit** accounts have normally **debit** balances.
- **Credit** accounts have normally **credit** balances.

How to get transactions (in journal entries) posted to T-accounts?

- Get the **beginning balance** of the T-account from the previous period.
- For each account, go through transactions that affect the account.

Step 3. Summarize T-Accounts

Balances of T-accounts

- **Debit** accounts have normally **debit** balances.
- **Credit** accounts have normally **credit** balances.

How to get transactions (in journal entries) posted to T-accounts?

- Get the **beginning balance** of the T-account from the previous period.
- For each account, go through transactions that affect the account.
  - For those with **debit** values, add the **debit** value to the T-account.

Step 3. Summarize T-Accounts

Balances of T-accounts

- **Debit** accounts have normally **debit** balances.
- **Credit** accounts have normally **credit** balances.

How to get transactions (in journal entries) posted to T-accounts?

- Get the **beginning balance** of the T-account from the previous period.
- For each account, go through transactions that affect the account.
  - For those with **debit** values, add the **debit** value to the T-account.
  - For those with **credit** values, add the **credit** value to the T-account.

Step 3. Summarize T-Accounts

Balances of T-accounts

- **Debit** accounts have normally **debit** balances.
- **Credit** accounts have normally **credit** balances.

How to get transactions (in journal entries) posted to T-accounts?

- Get the **beginning balance** of the T-account from the previous period.
- For each account, go through transactions that affect the account.
  - For those with **debit** values, add the **debit** value to the T-account.
  - For those with **credit** values, add the **credit** value to the T-account.
- Get the **ending balance** of the T-account.

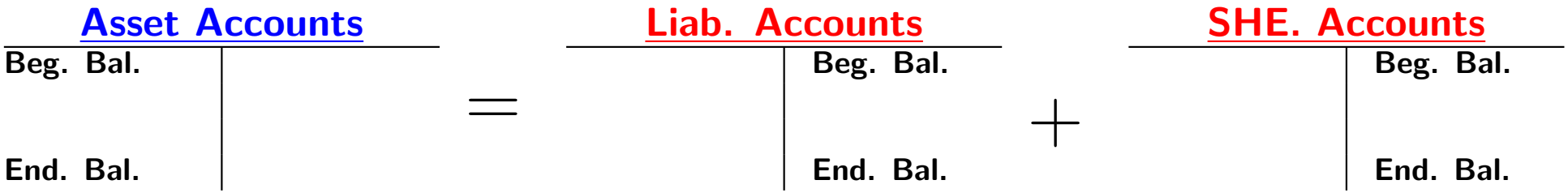
Step 3. Summarize T-Accounts

Balances of T-accounts

- **Debit** accounts have normally **debit** balances.
- **Credit** accounts have normally **credit** balances.

How to get transactions (in journal entries) posted to T-accounts?

- Get the **beginning balance** of the T-account from the previous period.
- For each account, go through transactions that affect the account.
  - For those with **debit** values, add the **debit** value to the T-account.
  - For those with **credit** values, add the **credit** value to the T-account.
- Get the **ending balance** of the T-account.



Step 3. Summarize T-Accounts

ASSETS

Cash

Beg. 0	
(a) 10,000	300 (b)
(c) 20,000	5,000 (e)
	4,000 (g)
End. 20,700	

Step 3. Summarize T-Accounts

ASSETS

Cash

Beg. 0	
(a) 10,000	300 (b)
(c) 20,000	5,000 (e)
	4,000 (g)
End. 20,700	

Supplies

Beg. 0	
(h) 600	
End. 600	

Step 3. Summarize T-Accounts

ASSETS

Cash

Beg. 0	
(a) 10,000	300 (b)
(c) 20,000	5,000 (e)
	4,000 (g)
End. 20,700	

Supplies

Beg. 0	
(h) 600	
End. 600	

Equipment

Beg. 0	
(d) 9,600	
End. 9,600	

Step 3. Summarize T-Accounts

ASSETS

Cash

Beg. 0	
(a) 10,000	300 (b)
(c) 20,000	5,000 (e)
	4,000 (g)
End. 20,700	

Supplies

Beg. 0	
(h) 600	
End. 600	

Equipment

Beg. 0	
(d) 9,600	
End. 9,600	

Logo & Trademarks

Beg. 0	
(b) 300	
End. 300	

Step 3. Summarize T-Accounts

ASSETS

Cash

Beg. 0	
(a) 10,000	300 (b)
(c) 20,000	5,000 (e)
	4,000 (g)
End. 20,700	

Supplies

Beg. 0	
(h) 600	
End. 600	

Equipment

Beg. 0	
(d) 9,600	
End. 9,600	

Logo & Trademarks

Beg. 0	
(b) 300	
End. 300	

Software

Beg. 0	
(g) 9,000	
End. 9,000	

Step 3. Summarize T-Accounts

ASSETS

Cash

Beg. 0	
(a) 10,000	300 (b)
(c) 20,000	5,000 (e)
	4,000 (g)
End. 20,700	

Supplies

Beg. 0	
(h) 600	
End. 600	

Equipment

Beg. 0	
(d) 9,600	
End. 9,600	

Logo & Trademarks

Beg. 0	
(b) 300	
End. 300	

Software

Beg. 0	
(g) 9,000	
End. 9,000	

LIABILITIES

Step 3. Summarize T-Accounts

ASSETS

Cash

Beg. 0	
(a) 10,000	300 (b)
(c) 20,000	5,000 (e)
	4,000 (g)
End. 20,700	

Supplies

Beg. 0	
(h) 600	
End. 600	

Equipment

Beg. 0	
(d) 9,600	
End. 9,600	

Logo & Trademarks

Beg. 0	
(b) 300	
End. 300	

Software

Beg. 0	
(g) 9,000	
End. 9,000	

LIABILITIES

Accounts Payable

	Beg. 0
(e) 5,000	9,600 (d)
	5,000 (g)
	600 (h)
	End. 10,200

Step 3. Summarize T-Accounts

ASSETS

Cash

Beg. 0	
(a) 10,000	300 (b)
(c) 20,000	5,000 (e)
	4,000 (g)
End. 20,700	

Supplies

Beg. 0	
(h) 600	
End. 600	

Equipment

Beg. 0	
(d) 9,600	
End. 9,600	

Logo & Trademarks

Beg. 0	
(b) 300	
End. 300	

Software

Beg. 0	
(g) 9,000	
End. 9,000	

LIABILITIES

Accounts Payable

	Beg. 0
(e) 5,000	9,600 (d)
	5,000 (g)
	600 (h)
	End. 10,200

Notes Payable

	Beg. 0
	20,000 (c)
	End. 20,000

Step 3. Summarize T-Accounts

ASSETS

Cash

Beg. 0	
(a) 10,000	300 (b)
(c) 20,000	5,000 (e)
	4,000 (g)
End. 20,700	

Supplies

Beg. 0	
(h) 600	
End. 600	

Equipment

Beg. 0	
(d) 9,600	
End. 9,600	

Logo & Trademarks

Beg. 0	
(b) 300	
End. 300	

Software

Beg. 0	
(g) 9,000	
End. 9,000	

LIABILITIES

Accounts Payable

	Beg. 0
(e) 5,000	9,600 (d)
	5,000 (g)
	600 (h)
	End. 10,200

Notes Payable

	Beg. 0
	20,000 (c)
	End. 20,000

SHAREHOLDERS' EQUITY

Common Stock

	Beg. 0
	10,000 (a)
	End. 10,000

Step 4. Prepare Trial Balance

- Take all the debits and credits from the T-Accounts
- Put them in the Trial Balance.
- Calculate the total debits and credits.
- Check if the **total debits** equal the **total credits**.
- **If it does not, there is an error in the journal entries.**

Account Title	Debit ($)	Credit ($)
Cash	20,700	
Supplies	600	
Equipment	9,600	
Logo & Trademarks	300	
Software	9,000	
Accounts Payable		10,200
Notes Payable		20,000
Common Stock		10,000
Total	_____	_____

Step 4. Prepare Trial Balance

- Take all the debits and credits from the T-Accounts
- Put them in the Trial Balance.
- Calculate the total debits and credits.
- Check if the **total debits** equal the **total credits**.
- **If it does not, there is an error in the journal entries.**

Account Title	Debit ($)	Credit ($)
Cash	20,700	
Supplies	600	
Equipment	9,600	
Logo & Trademarks	300	
Software	9,000	
Accounts Payable		10,200
Notes Payable		20,000
Common Stock		10,000
Total	40,200	40,200

Step 4. Prepare Trial Balance

- If the total debits do not equal the total credits, there's an error in the journal entries.
- If the total debits equal the total credits, the journal entries are **likely** correct.
- Having the same balances **does not guarantee** the journal entries are correct.

Classified Balance Sheet

Classified Balance Sheet

- **Assets** are grouped into **current assets** and **non-current assets**.
  - **Current assets**: those expected to be converted to cash or used up within 1 year (e.g., Cash, Supplies).
  - **Non-current assets**: those expected to provide benefits for more than 1 year (e.g., Equipment, Logo & Trademarks, Software).

Classified Balance Sheet

- **Assets** are grouped into **current assets** and **non-current assets**.
  - **Current assets**: those expected to be converted to cash or used up within 1 year (e.g., Cash, Supplies).
  - **Non-current assets**: those expected to provide benefits for more than 1 year (e.g., Equipment, Logo & Trademarks, Software).

- **Liabilities** are grouped into **current liabilities** and **non-current liabilities**.
  - **Current liabilities**: those expected to be paid within 1 year (e.g., Accounts Payable, Notes Payable).
  - **Non-current liabilities**: those expected to be paid more than 1 year from now (e.g., Notes Payable).

Classified Balance Sheet

NoodleCake Studio, Inc.
Balance Sheet
As of August 31, 20XX

Assets	
Current Assets	
Cash	$20,700
Supplies	600
Total Current Assets	$21,300
Equipment	9,600
Logo & Trademarks	300
Software	9,000
Total Assets	**$40,200**
Liabilities and Shareholders' Equity	
Current Liabilities	
Accounts Payable	$10,200
Total Current Liabilities	$10,200
Notes Payable	20,000
Total Liabilities	**$30,200**
Stockholders' Equity	
Common Stock	$10,000
Retained Earnings	$0
Total Stockholders' Equity	**$10,000**
Total Liabilities and Shareholders' Equity	**$40,200**

Current Ratio

Current Ratio

A measure of a company's ability to pay its short-term obligations.
Calculated as: $\frac{\text{Current Assets}}{\text{Current Liabilities}}$

- *Current Ratio* > 1: the company is able to pay its current liabilities.
- *Current Ratio* < 1: the company is **not** able to pay its current liabilities.

EX. From the previous example:

- Current assets: _____
- Current liabilities: _____
- Current Ratio: _____
- Implications: The company _____ its current liabilities (to suppliers, employees, etc.) using its current assets (e.g., Cash, Accounts Receivable).

Current Ratio

Current Ratio

A measure of a company's ability to pay its short-term obligations.
Calculated as: $\frac{\text{Current Assets}}{\text{Current Liabilities}}$

- *Current Ratio* > 1: the company is able to pay its current liabilities.
- *Current Ratio* < 1: the company is **not** able to pay its current liabilities.

EX. From the previous example:

- Current assets: \$21,300
- Current liabilities: \$10,200
- Current Ratio: $\frac{\$21,300}{\$10,200} = 2.09$
- Implications: The company **is able to pay** its current liabilities (to suppliers, employees, etc.) using its current assets (e.g., Cash, Accounts Receivable).

Cost Principle - Assets

Cost Principle

Assets are initially recorded at their **acquisition cost**, which includes all costs necessary to acquire the asset and prepare it for its intended use.

- Asset values are initially determined by the **cost principle**.
  (i.e., how much the company paid to acquire the assets.)
- **Not** the current market value of the assets.
- Subsequently, the value is adjusted for depreciation and other factors.
  (will be covered later.)

Cost Principle - Assets

EX. Think about this:

- The firm paid $9,600 to acquire the equipment.

Cost Principle - Assets

EX. Think about this:

- The firm paid $9,600 to acquire the equipment.
  - Hitorical acquisition cost: $9,600 (following the **cost principle**).

Cost Principle - Assets

EX. Think about this:

- The firm paid \$9,600 to acquire the equipment.
  - Hitorical acquisition cost: \$9,600 (following the **cost principle**).
- To buy the same one today, the firm would need to pay \$10,000.

Cost Principle - Assets

EX. Think about this:

- The firm paid \$9,600 to acquire the equipment.
  - Hitorical acquisition cost: \$9,600 (following the **cost principle**).
- To buy the same one today, the firm would need to pay \$10,000.
  - Current market value: \$10,000.

Cost Principle - Assets

EX. Think about this:

- The firm paid \$9,600 to acquire the equipment.
  - Hitorical acquisition cost: \$9,600 (following the **cost principle**).
- To buy the same one today, the firm would need to pay \$10,000.
  - Current market value: \$10,000.
- Historical acquisition cost is **not** the current market value of the asset.

Cost Principle - Assets

EX. Think about this:

- The firm paid \$9,600 to acquire the equipment.
  - Hitorical acquisition cost: \$9,600 (following the **cost principle**).
- To buy the same one today, the firm would need to pay \$10,000.
  - Current market value: \$10,000.
- Historical acquisition cost is **not** the current market value of the asset.
- In B/S, the asset value is the **historical acquisition cost**.