

## **The Mechanics of Financial Accounting Pratt, Financial Accounting 7e, Chapter 4**

Economic Events that are both relevant and can be objectively measured in monetary terms are called transactions and are recorded in the accounting system.

### Fundamental Accounting Equation

$$\text{Assets} = \text{Liabilities} + \text{Stockholders' Equity}$$

Assets – things you own – economic resources owned or controlled by the business

Liabilities – things you owe – obligations to pay assets in the future

Stockholders' Equity – two components

- Contributed Capital
- Retained Earnings

Or, The residual interest in assets after liabilities have been satisfied:

$$\text{Stockholders' Equity} = \text{Assets} - \text{Liabilities}$$

## Transactions and the Balance Sheet (E4-1)

| Trans. | Assets |                |      | Liabilities   | Stockholder's Equity |                  |
|--------|--------|----------------|------|---------------|----------------------|------------------|
|        | Cash   | Accts.<br>Rec. | Land | Notes<br>Pay. | Cont.<br>Cap.        | Ret.<br>Earnings |
| 1      |        |                |      |               |                      |                  |
| 2      |        |                |      |               |                      |                  |
| 3      |        |                |      |               |                      |                  |
| 4      |        |                |      |               |                      |                  |
| 5      |        |                |      |               |                      |                  |
| 6      |        |                |      |               |                      |                  |

## Accounts, Double Entry Accounting, T-Accounts and Journal Entries

Each type of financial statement item (assets, liabilities, stockholders' equity, revenue and expense) will be collected in an account.

Each account has two sides – a debit side and a credit side. A convenient way to visualize and account is with a T-account.

|               |             |
|---------------|-------------|
| Account Title |             |
| Debit Side    | Credit Side |

Each type of account follows a specific set debit and credit rules.

|             |   |             |   |             |
|-------------|---|-------------|---|-------------|
| Assets      | = | Liabilities | + | SHE         |
| Inc.   Dec. |   | Dec.   Inc. |   | Dec.   Inc. |

|                         |      |                         |      |
|-------------------------|------|-------------------------|------|
| Retained Earnings       |      |                         |      |
| <i>Dec.</i><br>Expenses |      | <i>Inc.</i><br>Revenues |      |
| Inc.   Dec.             | Dec. | Dec.                    | Inc. |
| Dividends               |      |                         |      |
| Inc.                    | Dec. |                         |      |

## Journal Entries and Double Entry Accounting

T-accounts are a great way to summarize transactions, but not a good way to record them. Journal Entries are used for this purpose.

| Date | Account Titles | Debit  | Credit |
|------|----------------|--------|--------|
|      | Debit Account  | Amount |        |
|      | Credit Account |        | Amount |
|      |                |        |        |

Note that every single journal entry will include at least one debit and one credit and that for every entry debits=credits.



Posting is the process of moving information from the journal entries to the accounts. This is necessary to accumulated account balances in order to prepare financial statements.

## Cash

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Adjusting Entries – Many of the important economic events of the period are captured in the transactions that recorded during the period. However, before financial statements are prepared all of the accounts need to be examined and a set of adjustments need to be made.

Adjustments are needed for (1) accruals, (2) deferrals, and (3) revaluations.

Accruals are entries to record assets/liabilities and revenues/expenses that have built up during the period but have not yet been recorded.

Deferrals are entries to adjust assets/liabilities and revenues/expenses for transactions that have occurred, but do not yet need to be reported in income.

Revaluations are required for all accounts that are measured at something other than original cost.







## Step 2 – Post Transactions to T-Accounts

|      |                |                |
|------|----------------|----------------|
| Cash | Acct. Rec.     | Supplies       |
|      | Prepaid Ins.   | Equipment      |
|      | Acc. Depr.     | Land           |
|      | Acct. Pay.     | Int. Pay.      |
|      | Un. Rev.       | Other S-T Pay. |
|      | L-T Notes Pay. | Cont. Cap.     |
|      | Ret. Earn.     |                |
|      |                |                |
|      |                |                |
|      |                |                |
|      |                |                |

Tybee Corporation  
Income Statement  
For the Month Ended January 31, 2009

Tybee Corporation  
Statement of Stockholders' Equity  
For the Month Ended January 31, 2009

Tybee Corporation  
Balance Sheet  
January 31, 2009

Tybee Corporation  
Statement of Cash Flows  
For the Month Ended January 31, 2009