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Develop experience in recognizing and properly recording basic accounting transactions

TRANSACTIONS

Not all events affect the accounting equation

EXAMPLE



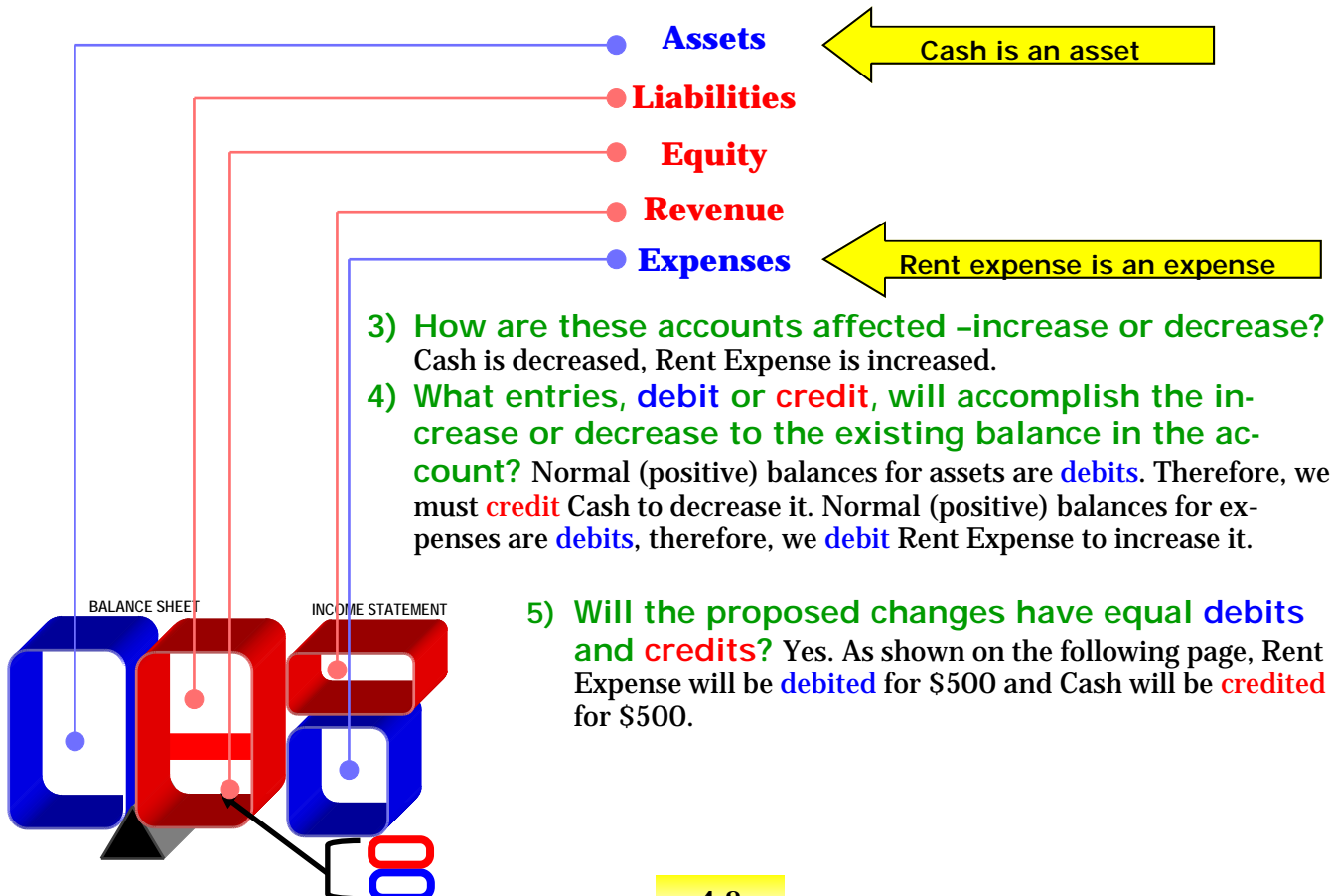
The art of recording accounting transactions takes practice. The following steps are helpful.

- 1) What accounts are involved?
- 2) What classification are these accounts?
- 3) How will the transaction affect each of these accounts -increase or decrease?
- 4) What entries, debit or credit, will accomplish the desired increase or decrease to the existing balance in the account?
- 5) Will the proposed changes have equal debits and credits?

On May 4 Penny & Lee sign a lease for a new espresso location. They will pay \$500 per month. There is no effect on any accounts, therefore, nothing is recorded.

On June 1 Penny & Lee pay their first month's rent of \$500. Accounts are affected, therefore the step by step analysis should be used to determine the correct journal entry.

- 1) What accounts are involved? The firm has given up cash, so Cash is involved. The expense of facility rent was paid, so Rent Expense is involved.
- 2) What classification are these accounts?



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| EXAMPLE (continued) | | JOURNAL | | | Page 16 |
|------------------------|--|---------|-------|--------|---------|
| | Description | PR | Debit | Credit | |
| 20x7 | | | | | |
| 6/1/x7 | ■ Rent Expense | | 500 | | |
| | ■ Cash | | | 500 | |
| | <i>Record the first month's rent expense</i> | | | | |

Equal debits and credits



How can I possibly remember all the debit and credit rules?



It isn't necessary to memorize the debit and credit rules for every account. The important thing to remember is that the classification of the accounts involved must be identified first. Debits and credits work the same way for all accounts in any particular classification. Further, there are only two ways debits and credits are used:

1. Account classifications where debits are the normal positive balance
2. Account classifications where credits are the normal positive balance

Therefore,

- to increase an account balance we journalize the normal balance type of entry, debit or credit.
- to decrease an account balance we journalize the opposite of the normal balance type debit or credit.

The color map below provides a picture that can serve as a visualization to remind us of the normal balance for each of the five account classifications. The skill level then comes from properly classifying. Debit and credit rules are simply mechanics that follow the classification. The use of debits and credits is extremely valuable because we instantly know if the accounting equation will remain in balance from any proposed journal entry:

$$\text{Assets} = \text{Liabilities} + \text{Equity} + \text{Revenue} - \text{Expenses.}$$

