

FINANCE AT A GLANCE

Applying the balance sheet-income statement relationship equation to transactions (continuation)

Lesson 37

Type 2. Transactions that affect only one side of the balance sheet-income statement relationship equation. Since there are no entries for the unaffected side of the equation, the value of that side is zero. For the equality to hold, the affected side must add up to zero as well. Therefore, the entries on that side must offset each other.

Example 2.1 The company pays the salaries of its people amounting to \$90,000. This involves a general and administrative expense of \$90,000, and a reduction in cash of the same amount.

Change in Cash	-90	+	Cost of goods sold (Cost of sales)		=	Change in Accounts payable		+	Change in Capital stock etc.		+	Sales	
Change in Accounts receivables			Sales and marketing expenses			Change in Accrued liabilities						Rent Income	
Change in Inventories			General and administrative expenses	+90		Change in Long-term debts etc.						Income from investments	
Change in Prepaid expenses			Interest expense									Interest income	
Change in Net fixed assets			Income tax									etc.	
etc.			Dividends										
			etc.										
<hr/>			<hr/>		=	<hr/>			<hr/>			<hr/>	
	-90			+90			0			0			0

Example 2.2 The company collects \$15,000 of accounts receivable. That reduces the accounts receivable by \$15,000, and increases the cash by the same amount

Change in Cash	+15	+	Cost of goods sold (Cost of sales)		=	Change in Accounts payable		+	Change in Capital stock etc.		+	Sales	
Change in Accounts receivables	-15		Sales and marketing expenses			Change in Accrued liabilities						Rent Income	
Change in Inventories			General and administrative expenses			Change in Long-term debts etc.						Income from investments	
Change in Prepaid expenses			Interest expense									Interest income	
Change in Net fixed assets			Income tax									etc.	
etc.			Dividends										
			etc.										
<hr/>			<hr/>		=	<hr/>			<hr/>			<hr/>	
	0			0			0			0			0

Example 2.3 The company pays dividends of \$75,000 to the shareholders.
This decreases the cash by the amount of the dividend paid out.

Change in Cash	-75	+	Cost of goods sold (Cost of sales)		=	Change in Accounts payable		+	Change in Capital stock etc.		+	Sales	
Change in Accounts receivables			Sales and marketing expenses			Change in Accrued liabilities						Rent Income	
Change in Inventories			General and administrative expenses			Change in Long-term debts etc.						Income from investments	
Change in Prepaid expenses			Interest expense									Interest income etc.	
Change in Net fixed assets			Income tax										
etc.			Dividends	+75									
	-75			+75	=		0			0			0

Example 2.4 The bank from which the company owes \$700,000 in long-term debt is invited to be a shareholder of the company, using the amount of what is owed to it as capital.
This reduces the long-term debt by \$700,000, which is converted to capital stock.

Change in Cash		+	Cost of goods sold (Cost of sales)		=	Change in Accounts payable		+	Change in Capital stock etc.	+700	+	Sales	
Change in Accounts receivables			Sales and marketing expenses			Change in Accrued liabilities						Rent Income	
Change in Inventories			General and administrative expenses			Change in Long-term debts	-700					Income from investments	
Change in Prepaid expenses			Interest expense			etc.						Interest income etc.	
Change in Net fixed assets			Income tax										
etc.			Dividends										
	0			0	=		-700			+700			0

Once again, we have seen how the equality expressed by the balance sheet-income statement relationship equation remains true as the effects of the transactions are accounted for.

Until then,

Info Solutions International