FINANCE AT A GLANCE

Analyzing transactions : making *debit* and *credit* entries (2)

Lesson 41

We shall have more practice in analyzing transactions and making accounting entries in this lesson.
The definitions of debits and credit are being repeated here (and are being numbered 1 through 8) in order to facilitate making references to them in the transaction analysis.

1. An increase in an Asset	is called a	*debit*
2. A decrease in an Asset	is called a	*credit*
3. An Expense or a Dividend	is called a	*debit*
4. A reversal of an Expense or a Dividend	is called a	*credit*

5. An increase in a Liability or Equity	is called a	*credit*
6. A decrease in a Liability or Equity	is called a	*debit*
7. A Revenue	is called a	*credit*
8. A reversal of a Revenue	is called a	*debit*

The transactions that we shall analyze in this lesson are as follows:

Transaction 3: January 12, 2010
The Company buys merchandise for its Inventories worth $50,000. Half of that is paid with Cash. The rest is on credit.

Transaction 4: January 15, 2010
The owners of the Company invest an additional $200,000. Of this amount $80,000 is used to buy office equipment and $50,000 is used to pay off some of the Long-term debt.

Transaction 5: January 20, 2010
The Company sells $30,000 worth of merchandise for $40,000. The buyer will pay after 60 days from the invoice date.

Here's how we analyse these transactions.
Under the column "Applicable Definition", you will see a number that refers to one of the eight definitions of debit and credit as displayed above. Using the relevant definition, plus the information under the columns "Account Type" and "Type of Change", you will readily see why the entry is a debit or a credit.

Trans-action	Analysis	Account Affected	Account Type	Type of Change	Applicable Definition	Accounting Entries			
3	There is an addition to *Inventories* amounting to $50,000. Half of that is $25,000, and that is the amount of *Cash* disbursement, or decrease in Cash balance. The other half, which is on credit, increases the *Accounts payables* balance.	Inventories	Asset	increase	1	Dr	Inventories	50,000	
		Cash	Asset	decrease	2	Cr	Cash		25,000
		Accounts payables	Liability	increase	5	Cr	Accounts payables		25,000
4	The additional investment of $200,000 increases the *Capital Stock*. The newly acquired office equipment worth $80,000 is an addition to *Net fixed assets*. The amount of $50,000 used to pay off some of the *Long-term debt* reduces the balance of that liability. The unused portion of the additional investment ($200,000 minus $80,000 minus $50,000, which is equal to $70,000) goes to the *Cash* balance.	Capital stock	Equity	increase	5	Cr	Capital stock		200,000
		Net fixed assets	Asset	increase	1	Dr	Net fixed assets	80,000	
		Long-term debt	Liability	decrease	6	Dr	Long-term debt	50,000	
		Cash	Asset	increase	1	Dr	Cash	70,000	
5	There is a *Sales* revenue amounting to $40,000. Since the buyer will pay in the future, the *Accounts receivables* increase by the amount of the Sales. The amount $30,000, is a reduction in the amount of *Inventories*. This $30,000 is now recognized as the expense to match the revenue, and it falls under *Cost of goods sold.*	Sales	Revenue		7	Cr	Sales		40,000
		Accounts receivables	Asset	increase	1	Dr	Accounts receivables	40,000	
		Inventories	Asset	decrease	2	Cr	Inventories		30,000
		Cost of goods sold	Expense		3	Dr	Cost of good sold	30,000	

All of the three transactions that we analyzed here involved more than two entries (not just one debit and one credit).

An important observation from the analysis: In each transaction, *the total of the debit entries equals the total of the credit entries.*