

Express Video Transcript

Recording Entries with Journal Entry Approach

Topics

- Creating journal entries from balance-sheet-equation (BSE) entries
- Creating T-accounts from BSE matrix columns
- Take-aways

Transcript

There are two ways to record entries. One is the BSE approach that we've already discussed. The other is using journal entries. Every concept you need to understand in accounting and every entry can be understood through the balance sheet equation approach using the mini matrices that we've looked at in the last section. So the question is why learn a second language because they're really just the same thing?

Well, imagine yourself going to a foreign country and you only knew your language and not their language. You might be smart as a whip, but you wouldn't be able to communicate. The same problem happens here. It turns out for generations, people learned journal entries and many accountants and chief financial officers, and people you'll be working with on a regular basis, their language is journal entries. BSE is a relatively new approach. So if you're showing up for a job interview and they ask you how to record an entry, and all you know is the balance sheet equation approach, and all they know is the journal entry approach, they're going to think you don't understand accounting.

Now, that means there's another language out there that you have to understand. That would be remarkably challenging, for example, if you understood Italian and you wanted to go to England and you had to speak in English, but it's really, really simple. There's almost no cost to learning how to get from the balance sheet equation entries to the journal entries.

And so what we're going to do in *Navigating Accounting* is we're going to teach you the balance sheet equation approach for every entry because we like the way it shows how entries flow into the financial statements. Then, we're also going to teach you how to record journal entries and it's actually a very, very simple conversion. It's like having a dictionary to get from one language to the other and the whole dictionary fits on one page. And we're also going to show you something called T-accounts which are tied to the notion of a journal entry. So people who speak in journal entries also speak in T-accounts, and we're going to tie that concept over to the balance sheet equation columns.

Creating journal entries from balance-sheet-equation (BSE) entries

We begin with a very quick review of an entry recorded in the prior section. How do you issue common stock if you're Bischoff? Well, Bischoff issued \$10 million worth of common stock and you might recall the mini matrix looked like this.

Characterize accounts

Now, the first thing we have to do is characterize the accounts. We did that with the BSE approach. Each account had a positive sign here in this particular entry.

Now, that was called the adjective sign, remember, because it described the account. Well, students often get confused when they hear the words "debits" and "credits" because they're used in several different ways. Debits can be adjectives or debits can be verbs. They can also be nouns by the way. But for right now, we want to look at debit as an adjective. If you have a positively signed account on the left side of the balance sheet equation, that's a debit account. So here we have a positively signed account. It's on the left side of the equation. That's called a debit account. That's an adjective that describes the account; cash is a debit account regardless of the entry we're recording.

Just the opposite is true if you're on the other side of the equation. A positively signed account on the right side of the BSE is a credit account. Share capital is a credit account. Again, think of debit and credit as adjectives. They're describing the account. We're soon going to look at them also as verbs and you need to keep those straight.

Well, we can expand our rules, and actually, there's four cases. A positively signed account on the left side is a debit account. A positively signed account on the right side is a credit account. Well, that's these first two cases. Another case, a negatively signed account on the left side is a credit account. So if we have a negatively signed account over here, and we will in the next chapter, then that's going to be a credit account. And a negatively signed account over here is going to be a debit account. So there's only two kinds of accounts — debit accounts or credit accounts — and there's only four cases.

We can actually come up with a little memory helper here. Now, you're not supposed to make sense of this helper; but it will allow you to memorize these four steps we think a little easier. Changing one of the two bold words in the first case, this is the first case, changes the italicized word at the end. Now, let me explain. This sounds complicated. But if we look at the first case, it says a positively, that's bold, signed account; positively signed account on the left side is a debit. Debit here is italicized, bold left. Now, what happens if we move down to the next one? If we change one of these two bold words, either one, then we're going to change the debit to a credit. So a positively signed account on the right, ah, we changed one word, so it becomes credit.

What about if we move down a little further? Well, a negatively signed account on the left side, so we keep left side the same as up here at the top, the first case, but we change positive to negative. So again, we change one of the bold words from the first case and what we notice is debit once again goes to credit. On the other hand, if we change both words that are bold from the first case, then we end up with a debit.

Now, why do we give you that rule? Because actually, you only have to understand the first rule, right? If you understand the first case, positively signed account on the left side is a

debit account; then if I change either one of these words, but only one of them, it becomes credit.

So over here, positively signed account, still positive, it didn't change that word, but went from left side to right side so it becomes credit. If we change just one word, then it will always change to credit, but if we change both words, it changes to debit. Again, there's no sense to that. There's not intended to be a why here. It's just a rule that will help you learn these four cases. If that rule doesn't help you, pick up the four cases.

Determine entry effects

Next we're going to look to the entry signs; which is the entry effects. You might recall that the entry sign tells us how the entry affects the account. So we have positive entry signs on both accounts. Well, how does that relate to debits and credits as verbs? An increase to a debit account debits the account. Remember, cash was a debit account. Why? Because it was a positively signed account on the left side. So cash is a debit account and that debit account increases. When a debit account increases, the verb is you debit, take an action, you debit the account. So cash is going to get debited.

On the other side, an increase to a credit account credits the account. So here, share capital was a credit account because it was positively signed, but on the right side. So we have a credit account and that credit account increased so that credits the account. Again, this is the adjective that describes the account. We need to know that to determine the action on the account is a credit or a debit verb.

Well, once again we got four cases and we have a memory helper. An increase to a debit account debits the account. That's over here. But an increase to a credit account credits the account. That's over here. If we decrease a debit account then we credit the account. The verb becomes credit. So a decrease to a debit account credits the account. So if cash was to decrease rather than increase, and it would, for example we paid a bill, then that would be crediting cash. The verb would be crediting cash. A decrease to a credit account debits the account. Again, that seems crazy when you first hear it, but if you think about the adjective and you think about the verb, it's really simple. So a decrease to share capital, for example, which would happen if a company bought back its stock, a decrease to share capital would be a debit to that account.

Now, the memory helper here is simple. You do exactly the same as the last time. If you change one of the bold words here, you change debit to credit. But if you change two of them, then it goes back to debit. Really simple rule and what that means is you only have one thing to learn here and that's this one over here. You can put all of this together on this one page and summarize everything you need to know about getting to debits and credits from the balance sheet equation entry. And that's all you need to know to record the entry, so let's learn how to record the entry.

Record entry

This is the form of a journal entry as distinct from the form of the balance sheet equation entry. First of all, we describe the entry just as we describe the entry up here. Next, we put a column over here for debits and a column over here for credits. Debits are always first. Credits are second. Then we put the account that's debited. So what account gets debited?

Well, we already discovered that, right? Because cash was a debit account, that's the adjective, and it increased so it got debited. So there is your cash debited. Cash and cash equivalents debited for \$10.

Share capital gets credited for \$10 so it falls under the credit column. And what we typically do is we indent the credit account, leave the debit account over here. So that is essentially what a journal entry looks like and we'll be learning how to record them. And one of the reasons we have two signs [in the BSE approach] is to make it simple to do this conversion, to see the connection between what characterizes the accounts; and therefore, it's the same for every entry and differs for each entry which is the entry effects.

Quality checks

Time for quality checks. So remember, we're assuming here you're starting with the balance sheet equation entry already done and you want to get to the journal entry.

- Does the entry reflect what happened? Well, that's exactly the same quality check as we had before and the answer is yes.
- Were accounts properly characterized as debit or credit accounts? Yes, they were. Over here, we had a debit account, why, positively signed account on the left side of the equation and that is a debit account. And on the right hand side, positively signed is a credit account.
- Were debit accounts debited, that's a verb, or credited, when they increased or decreased? Yes, here we have a debit account. It increased so it got debited. Over here we have a credit account and it increased so it got credited.
- Are the debits and credits properly indicated with the debit accounts listed first? Here's the debit account. Here's the credited account.
- Do the total debits equal the total credits? That's kind of like asking does the balance sheet equation balanced? Are the debits totaling to the credits? They're both \$10. Great entry.

Creating T-accounts

Now, the next thing we want to learn is how to create T-accounts. When you show up on the job and you walk into the office where all the accountants are, they're going to be drawing these crazy T-accounts everywhere and having discussions. That's the way they think and you are not going to be really trained to do that. We're not going to be using T-accounts a lot in *Navigating Accounting*, and that's because we're going to be relying on the columns in the matrix and every column in the matrix is going to give you a T-account. And that's really all you need to understand, and we just need to teach you how to convert a column into a T-account and then you'll be able to follow the conversations.

But before we do this, let us try to motivate why it is that there are things called T-accounts and why it is accounting didn't get founded around these columns. Well, it turns out that accounting was invented before there were negative numbers. So someone came up with the concept of T-accounts. There are different T-accounts for debit accounts from credit accounts. So cash is a debit account because it's positively signed on the left side. So its T-account balances, beginning balance, ending balance, and account increases are on the debit side of the T-account. This is called the debit side of the T-account. This is called the credit side. This is the verb. You debit over here. You credit over here. If you have a debit

account, its balances are going to be on the debit side of the account. It's going to get debited, verb, on the debit side of the account, left side, and it's going to get credited on the credit side, right side.

So what's different for a credit account? Well, share capital is a credit account so its T-account balances and its increases are on the right side of the account or the credit side. So again, this is still the credit side of the account. This is the same. This is the debit side of the account. You'll often hear people say debits are on the left, credits are on the right. What they mean is T-accounts. Well, what's different between the cash account and the share capital? Well, whereas the cash account has beginning balances on the left side, debit side, and it increased on the debit side because it was a debit account, share capital is a credit account, so its beginning balance is on the credit side, its ending balance is on the credit side, and it increases on the credit side. It decreases, over here, on the debit side. We don't have any decreases here.

Take-aways

So what will we have you know by now? Everything fits on one page in terms of recording entries. You can learn all the rules you need right here to get from a balance sheet equation entry, which we'll be recording regularly, the journal entries, which will allow you to communicate much more effectively with people who understand journal entries and may very well be your boss when you take a job. If you look at the resources on the right side of most *Navigating Accounting* pages, what you're going to find is you can click over and find a Record Keeping Quick Reference. These are all the rules you need, both for doing balance sheet equation and journal entries, and then converting balance sheet equations to debits and credits.

Where are we heading? Well, the same place we're heading with the balance sheet equation approach. It's a skill. You've got to practice. You've got to go slow at first. Speed comes with practice and you've got to learn how to do this.

Well, I hope you're going to walk away with the confidence that if you know how to record entries with the balance sheet equation matrix, it is easy and low cost to learn how to communicate in the second language, which is called journal entries and T-accounts, and you want to learn how to do that because there's going to be plenty of folks out there who are going to think you simply don't understand accounting unless you know their language.

See you in the next video.