**Step 2 Script**

Slide 2: This time, we will take those same transactions from step 1 and prepare what is known as journal entries. Before we do that, there are two rules we need to follow. It takes a while to memorize these rules, and practice is the best way.

Slide 3: If you look at the top row, we can see Balance Sheet accounts. For Assets, increases are effected with debits and decreases are effected with credits. For Liability and Equity accounts, the opposite is true.

For Revenue and expense accounts, refer back to slides 7 and 8 in the Step 1 video – we want to think about how these accounts ultimately affect Owners’ Equity. So, Revenue increases are effected with credits – as credits increase equity accounts and expense increases are effected with debits. Debits decrease equity accounts – an increase in an expense ultimately leads to a decrease in equity. Distributions (in our transaction k, dividends) affect equity similarly, but are not expenses.

You’ll also notice the term “normal balance” – this means that, after journalizing several transactions, we would expect that the balance to be on the “normal” side. For Example, if we credit revenue in January and again in February we credit revenues and again in March, we would expect there to be a credit balance in the Revenue account. Similarly, if we debit rent expense for the first three months of the year, we’d expect there to be a debit balance – the normal balance – at the end of that period.

Slide 4: a review of our 12 transactions before we proceed to journalizing

Slide 5: For this transaction, we record the 35,000 increase in cash with a debit, as debits increase asset accounts. We record the 35,000 increase in common stock with a credit, as the rules tell us we need to increase equity accounts with credits. Total debits equal total credits, as the rules tell us they should and we can continue.

Slide 6: For transaction b, we need to record an increase in prepaid insurance and a decrease in cash. Since both of these accounts are Assets, We record the increase in prepaid insurance with a debit and a decrease in cash with a credit. Again, total debits equal total credits.

Slide 7: for transaction c, we record the increase in rent expense with a debit (as this will ultimately reduce owners’ equity; equity reductions are effected with debits) and record the decrease in the asset cash with a credit. As they should, total debits equal total credits.

Slide 8: In transaction d, we have three accounts affected, first the asset furniture is increased with a debit, the liability account A/P is increased with a credit and the asset cash is decreased with another credit. Total Debits equal total credits, as they are supposed to, and we can proceed with the next transaction.

Slide 9: In transaction e, we are increasing our liability through borrowing and that borrowing increases cash. We debit cash to reflect the increase f that asset and credit notes payable to reflect the increase in liability. Total debits, once again, equal total credits.

Slide 10: Here we are using cash to purchase office supplies. Office supplies have probable future benefits; therefore are an asset (those supplies are not an expense until we use them up – we’ll cover that in step 5). We record the increase in the Asset Office Supplies with a debit and record the decrease in the asset cash with a credit. As you would expect, total debits equal total credits.

Slide 11: Here, in transaction g, we earn revenues and receive cash. The increase in the asset cash is debited and the increase in revenues is credited. Total debits equal total credits, as they should, and we can proceed with to transaction h.

Slide 12: In this transaction, we are using cash to pay our assistant. Paying an assistant would fall under Wages Expense; any time we increase an expense, we’re going to debit that account. As we have before, we record the decrease in the asset cash with a credit. Total debits equal total credits, once again.

Slide 13: in transaction I, we once again earn revenues, but, we won’t be paid for 30 days. This promise to pay from our customer is an Account receivable, which is an asset account (remember, an assets has ‘probable future benefit’). Increase to an asset requires a debit and the increase to revenue will require a credit. Of course, total debits equal total credits and we can proceed.

Slide 14: In transaction j, we are paying down Accounts Payable with cash -- both accounts being reduced. So, a decrease in the liability A/P will require that we debit that account and to reflect the decrease in cash, we will use a credit. As we can see, total debits once again equal total credits.

Slide 15: For transaction k, we are paying cash for dividends. A dividend is a contra-equity account; this means it behaves opposite of an equity account. Therefore, an increase in dividends requires a debit. This makes sense as we have to credit cash to record the reduction of that asset. Total debits do equal total credits. On to the last transaction!

Slide 16: In this last transaction, transaction l, we see that the asset cash is increased as the A/R customer pays down that receivable. Increase cash with a debit and decrease the asset A/R with a credit. As it should be, total debits equal total credits.

Slide 17: On this slide, we see a sample journal – the place we record journal entries. We can see the first three transactions from slides 5, 6 and 7. We identify the transaction by date, normally, but for this exercise we’ll use our letter identifiers. Debits go first and are listed on the left side of the page. Credits are indented to go along with the debit and credit columns. We include a description below the transaction to help us remember details of the transaction, should we ever have to go back and investigate.

Don’t use dollar signs in the debit and credit columns and NEVER use negative signs. The use of debits and credits indicate whether accounts are increasing or decreasing.

Finally, the PR or post reference column is used to indicate that a transaction part has been posted to the proper account ledger.

Slide 18: Once all journal entries for the period are entered in the journal, or “journalized” we move to step 3 which is called posting and will be covered in the next presentation.