Lesson 5.

Classification of accounting accounts

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AGENDA

I. Permanent accounting accounts:

- ✓ Current and non-current asset accounts.
- ✓ Current and non-current liability accounts
- ✓ Capital accounts.

II. Temporary Accounting Accounts:

Revenue and expense accounts

I. Permanent accounting accounts:

Types of Permanent Accounts:

1. Asset Accounts:

1. **Cash**: Tracks the company's cash on hand and in bank accounts.
2. **Accounts Receivable**: Represents amounts owed to the company by customers.
3. **Inventory**: The value of goods available for sale.
4. **Property, Plant, and Equipment (PP&E)**: Long-term tangible assets used in the business.

2. Liability Accounts:

1. **Accounts Payable**: Represents amounts the company owes to suppliers and creditors.
2. **Notes Payable**: Short-term or long-term borrowings that the company needs to repay.
3. **Accrued Liabilities**: Expenses that have been incurred but not yet paid.

3. Equity Accounts:

1. **Common Stock**: Represents the capital contributed by shareholders.
2. **Retained Earnings**: Accumulated net income not distributed to shareholders as dividends.
3. **Additional Paid-In Capital**: The excess amount paid by investors over the par value of stock.

Permanent accounts, also known as real accounts, are balance sheet accounts that carry their ending balances into the next accounting period. These accounts are not closed at the end of an accounting period and continue to accumulate balances over time. They are essential for reflecting a company’s ongoing financial position.

Key Characteristics of Permanent Accounts:

1. **Ongoing Balance**: The balances in permanent accounts do not reset to zero at the end of the accounting period; instead, they carry over into the next period.
2. **Found on the Balance Sheet**: Permanent accounts are typically balance sheet accounts, which include assets, liabilities, and equity accounts.
3. **Track Long-Term Financial Position**: These accounts are used to monitor the company’s financial position over the long term, unlike temporary accounts (like revenue and expense accounts), which are closed out at the end of each period to calculate net income for that period.

Example of How Permanent Accounts Work:

- **Beginning Balance**: Suppose at the beginning of the year, the company's cash account (a permanent account) has a balance of $50,000.
- **Transactions During the Year**: Throughout the year, the company receives $100,000 from sales and pays $80,000 in expenses.
- **End of Year Balance**: At the end of the year, the cash account balance would be $70,000 ($50,000 beginning balance + $100,000 receipts - $80,000 payments).
- **Carry Forward**: The $70,000 cash balance would be carried forward as the beginning balance for the next year.

Importance of Permanent Accounts:

- **Long-Term Financial Management**: Permanent accounts are crucial for understanding a company’s financial health over time.
- **Balance Sheet Integrity**: They ensure the accuracy of the balance sheet, which is critical for stakeholders who rely on it for decision-making.
- **Cumulative Nature**: They help in tracking the accumulation of assets, liabilities, and equity over multiple accounting periods.

II. Temporary Accounting Accounts:
Revenue and expense accounts

Revenue, expense, and withdrawal accounts are used to collect information for a single accounting period. These accounts are called Temporary Accounts.

Dollar amounts in Temporary Accounts are not carried forward from one accounting period to the next. Temporary Accounts start each new accounting period with a zero balance.

Assets, liabilities, and owner's capital accounts are Permanent Accounts.

Dollar amounts in Permanent Accounts are carried forward from one accounting period to the next. Permanent Accounts are continuous from one accounting period to the next.

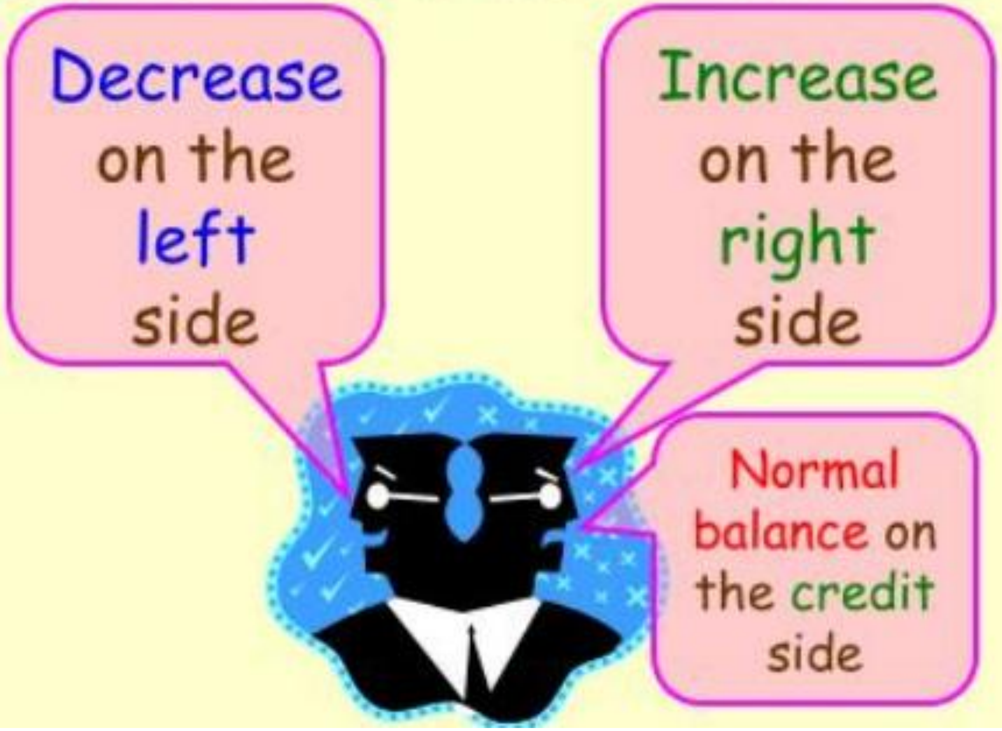
Rules for Revenue accounts

A revenue account is increased on the credit side.

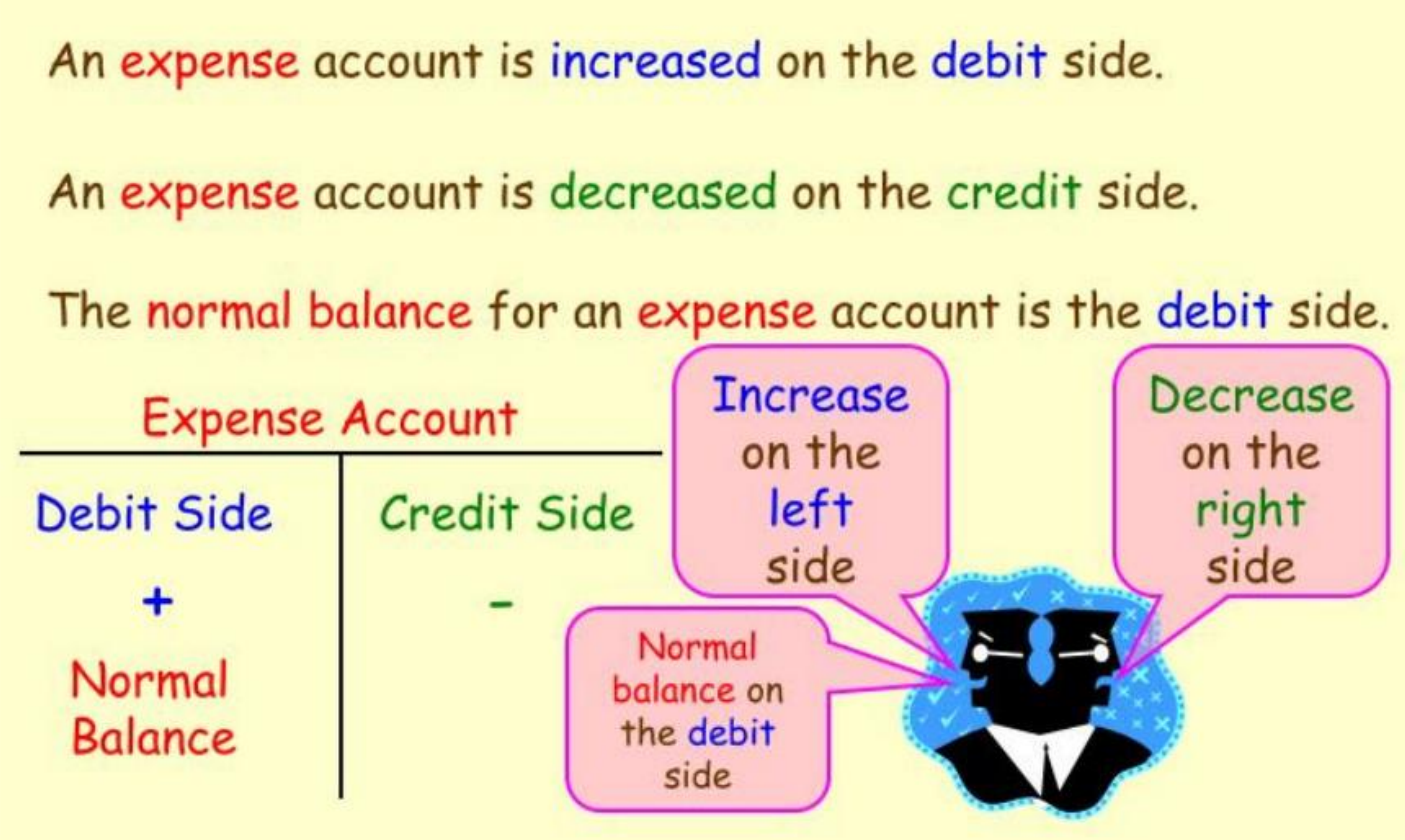
A revenue account is decreased on the debit side.

The normal balance for a revenue account is the credit side.

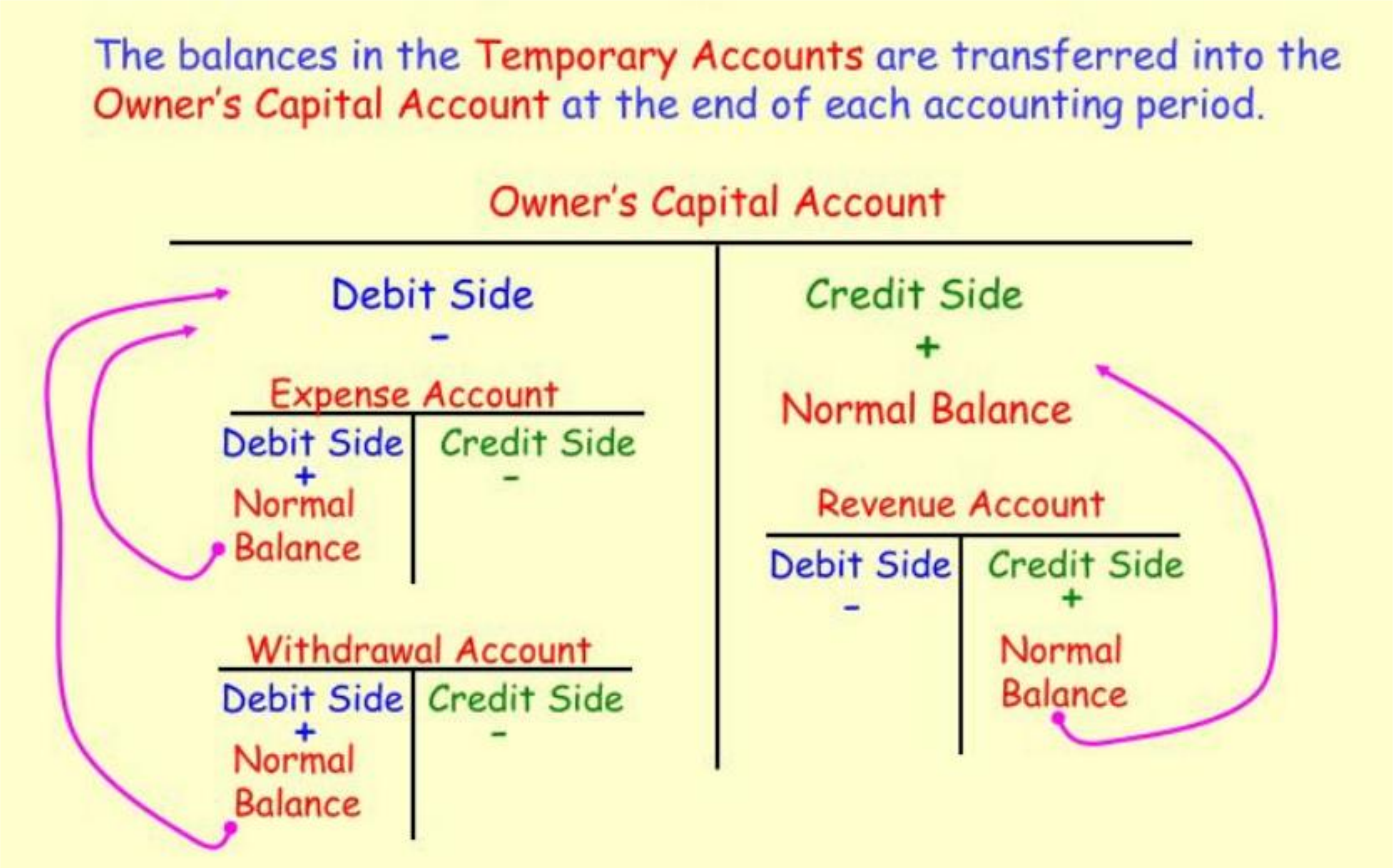
Revenue Account	
Debit Side	Credit Side
-	+
	Normal Balance



Rules for Expence accounts



Summary of Rules for Temporary accounts



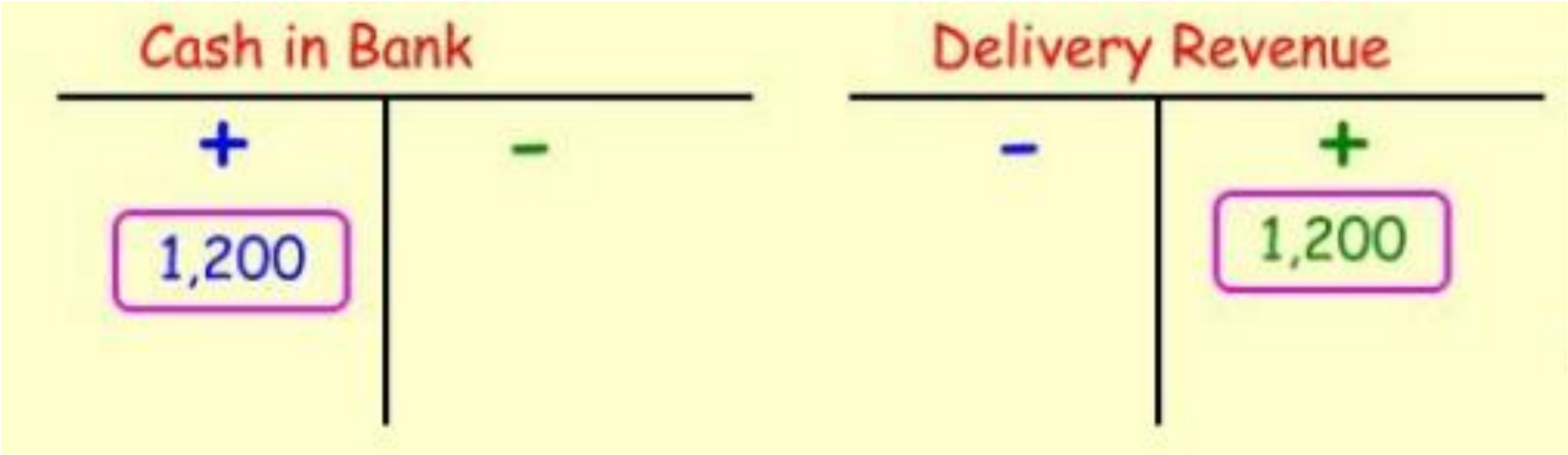
In contrast, **temporary accounts** like revenues, expenses, and dividends are closed at the end of each accounting period, and their balances are transferred to retained earnings or other equity accounts, so they start the new period with a zero balance.

REVENUE TRANSACTION

Ex.1

Roadrunner received a check for $1,200 from a customer, Sims Corporation, for delivery services.

1) Identify	➡	Accounts affected are Cash in Bank and Delivery Revenue
2) Classify	➡	Cash in Bank is an asset account and Delivery Revenue is a revenue account
3) Increase or Decrease	➡	Cash in Bank is increased by $1,200 and Delivery Revenue is increased by $1,200
4) Debit and Credit Rule	➡	Asset accounts are increased on the debit side and revenue accounts are increased on the credit side
5) Do Debits Equal Credits	➡	Debits equal credits



1,200 Debit = 1,200 Credit

EXPENSE TRANSACTION

Ex.2

Roadrunner wrote a check for $700 to pay the rent for the month .

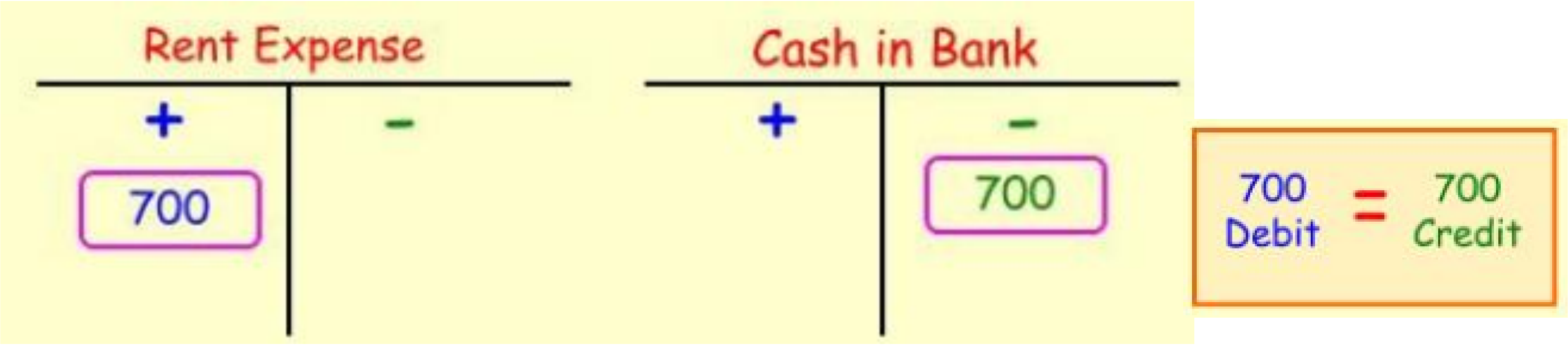
1) Identify → Accounts affected are Rent Expense and Cash in Bank

2) Classify → Rent Expense is an expense account and Cash in Bank is an asset account

3) Increase or Decrease → Rent Expense is increased by $700 and Cash in Bank is decreased by $700

4) Debit and Credit Rule → Expense accounts are increased on the debit side and asset accounts are decreased on the credit side

5) Do Debits Equal Credits → Debits equal credits


Rent Expense
+
-
700
Cash in Bank
+
-
700
700
Debit
=
700
Credit

CREDIT EXPENSE TRANSACTION

Ex.3

Beacon Advertising prepared an advertisement for Roadrunner. Roadrunner will pay Beacon's $75 fee later .

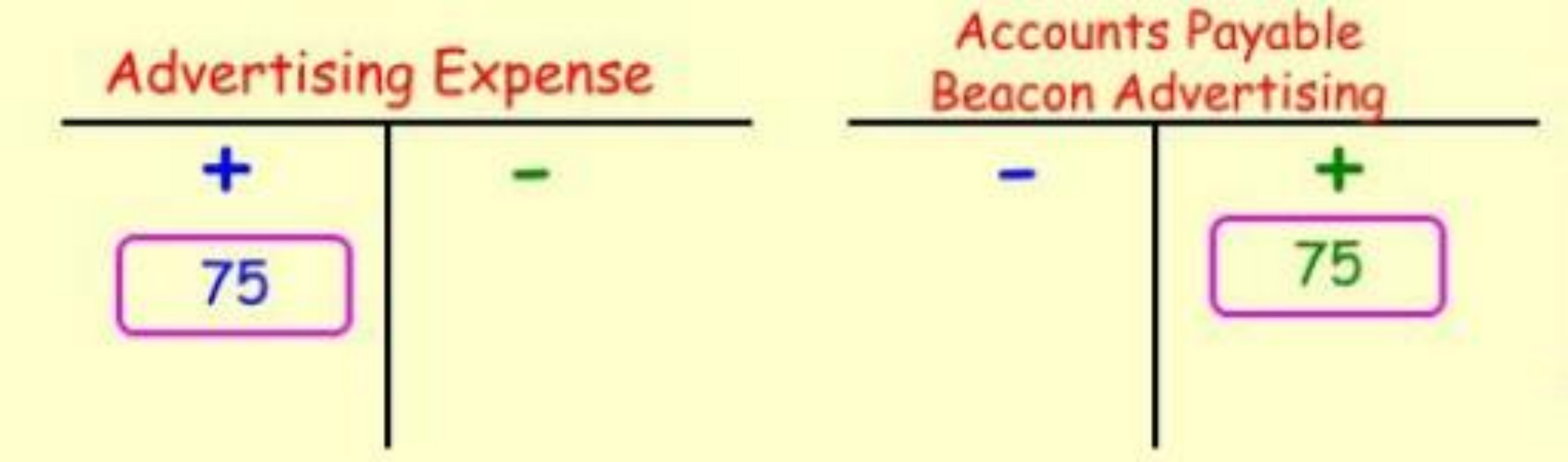
1) Identify → Accounts affected are Advertising Expense and Accounts Payable - Beacon Advertising

2) Classify → Advertising Expense is an expense account and Accounts Payable - Beacon Advertising is a liability account

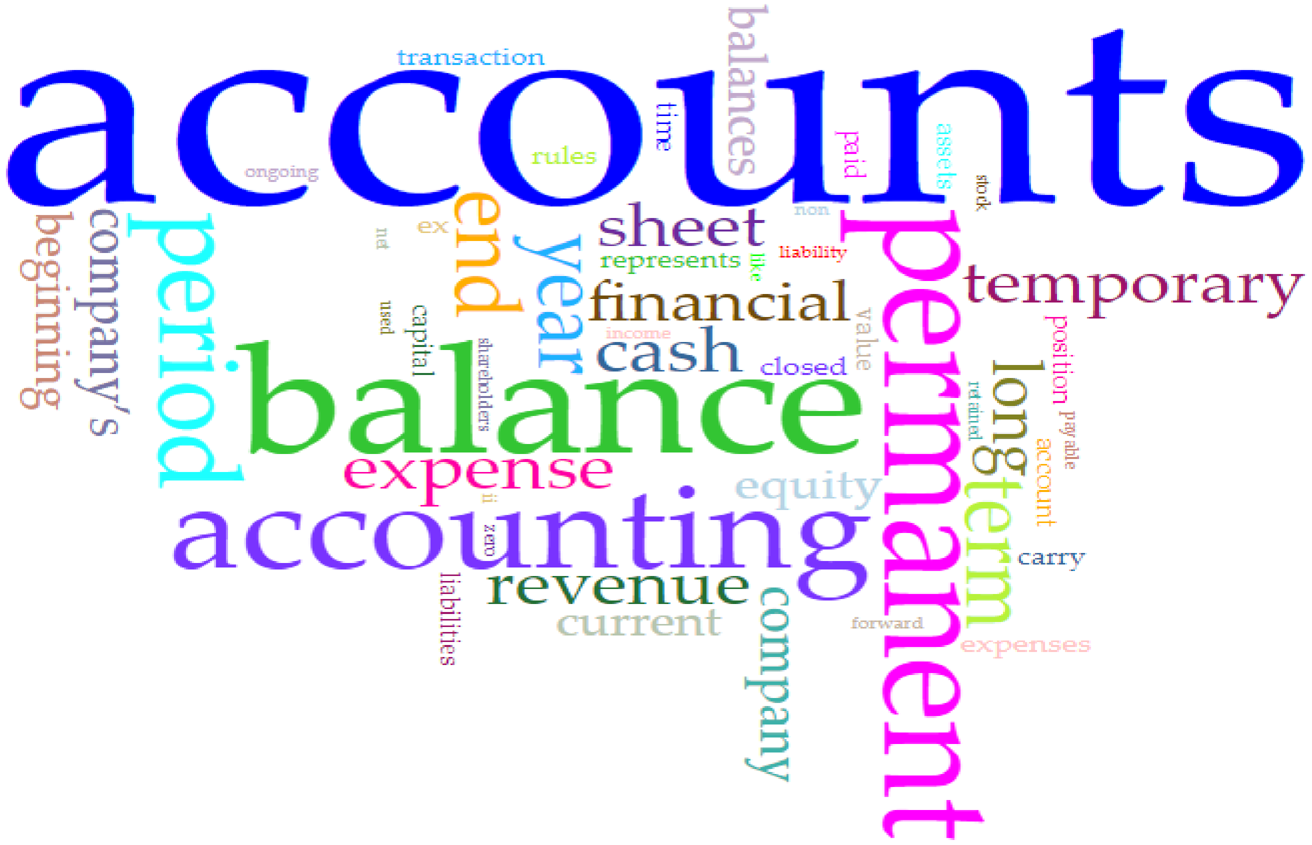
3) Increase or Decrease → Advertising Expense is increased by $75 and Accounts Payable - Beacon Advertising is increased by $75

4) Debit and Credit Rule → Expense accounts are increased on the debit side and liability accounts are increased on the credit side

5) Do Debits Equal Credits → Debits equal credits



75 Debit = 75 Credit



Thanks for your attention !