Case Study: Journal Entries

by Sophia

WHAT'S COVERED

This lesson will cover the topic of journal entries in the context of a case study, using a hypothetical business.

Our discussion breaks down as follows:

1. Case Study: Legacy Realty

The subject company for our case study is called Legacy Realty. Legacy Realty is a sole proprietorship, which is a type of company that is owned by one single individual, and where that individual and the business are legally treated as the same.

The purpose of Legacy Realty as a business is to own, lease, and manage its own rental properties. It purchases houses and condominiums and leases them out to tenants. They also perform their own management of their units. Legacy Realty is located in Washington DC, and they have a small staff of five people.

Legacy Realty	
Type of company	Sole proprietorship
Business purpose	Own, lease, and manage rental properties
Business location(s)	Washington, D.C. Staff of 5 people

Legacy Realty needs journal entries to track accounting events and determine specific changes to their accounts. Journal entries allow the business to be able to tell their story. Therefore, journal entries are very important for a company in order to perform their accounting functions.

2. Case Study: Journal Entries

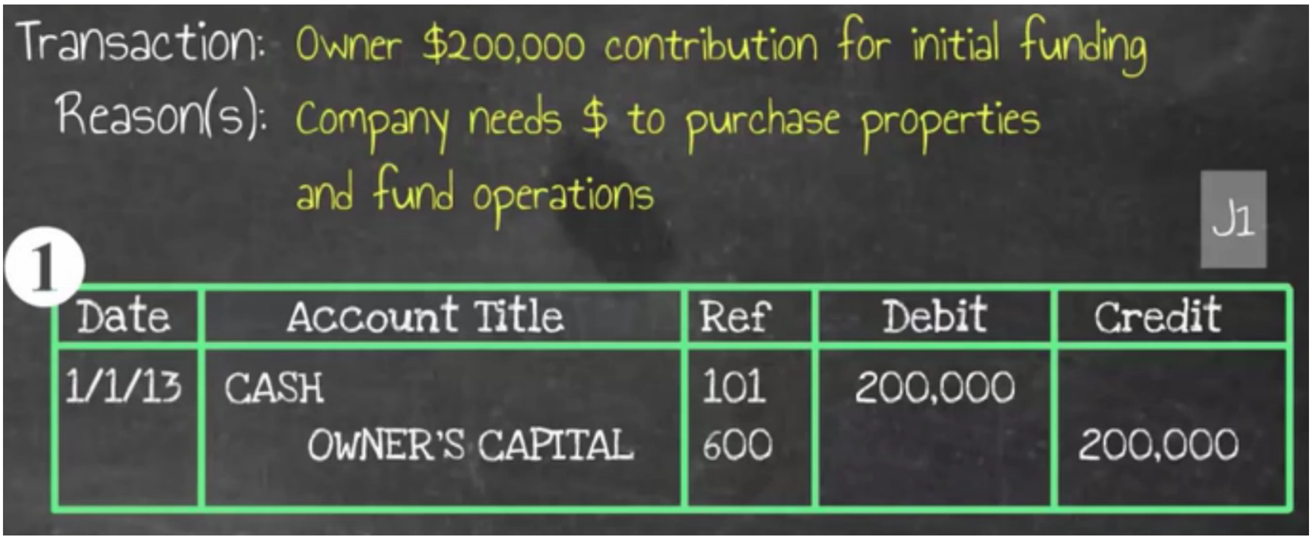
Now let's look at some journal entry examples for our subject company, using some case study transactions.

In the first transaction, the owner contributes $200,000 for the initial funding of the company. The reason behind this transaction is that the company needs money to purchase the properties and fund their operations.

So, what does this first journal entry look like? Let's assume this transaction occurs on the first day of the year. The owner puts cash into the business, so there is a debit to their cash account of $200,000. It follows, then, that there is a credit to owner's capital of $200,000, for this cash that the owner is putting into the business.

HINT

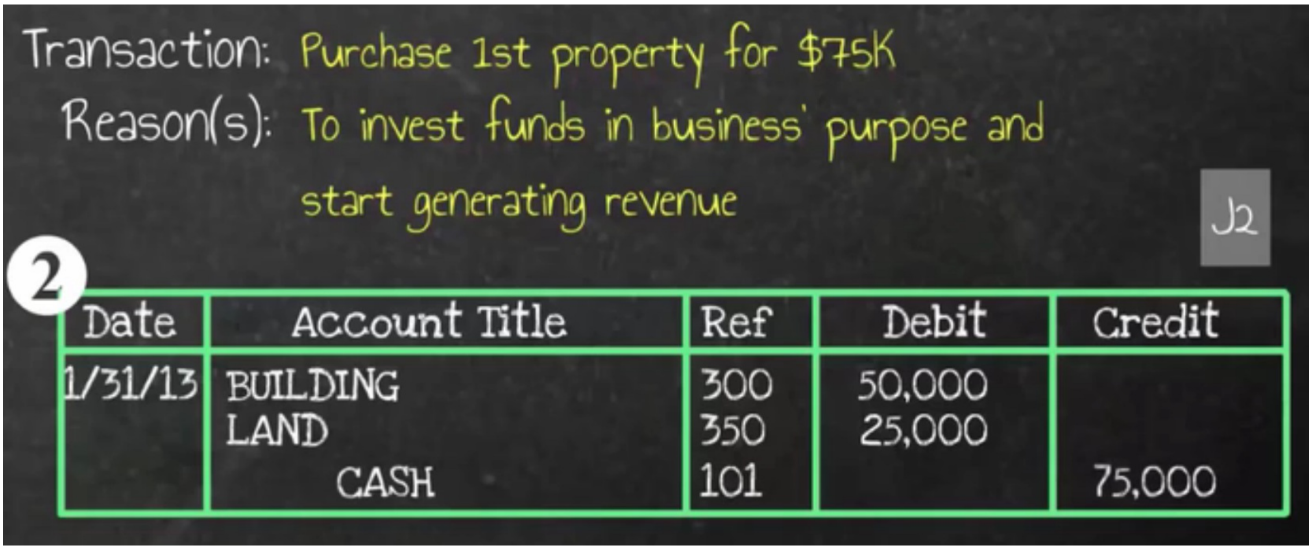
Keep in mind that the reference column contains the actual account number that is used to identify that cash account within the accounting system.



Let's look at our next transaction, which is the purchase of the first property for $75,000. This is to invest funds in the business's primary purpose and to start generating revenue--and they need to have a rental unit in order to generate income. We're going to assume that the company pays cash for this purchase. This becomes the second journal entry.

The transaction happened at the end of the month. On January 31st, the company purchased a building, which is an asset, for $50,000. The purchase price of a property also includes land, so some of that total purchase price of $75,000 is land. Therefore, you can see a debit to building of $50,000 and a debit to land of $25,000.

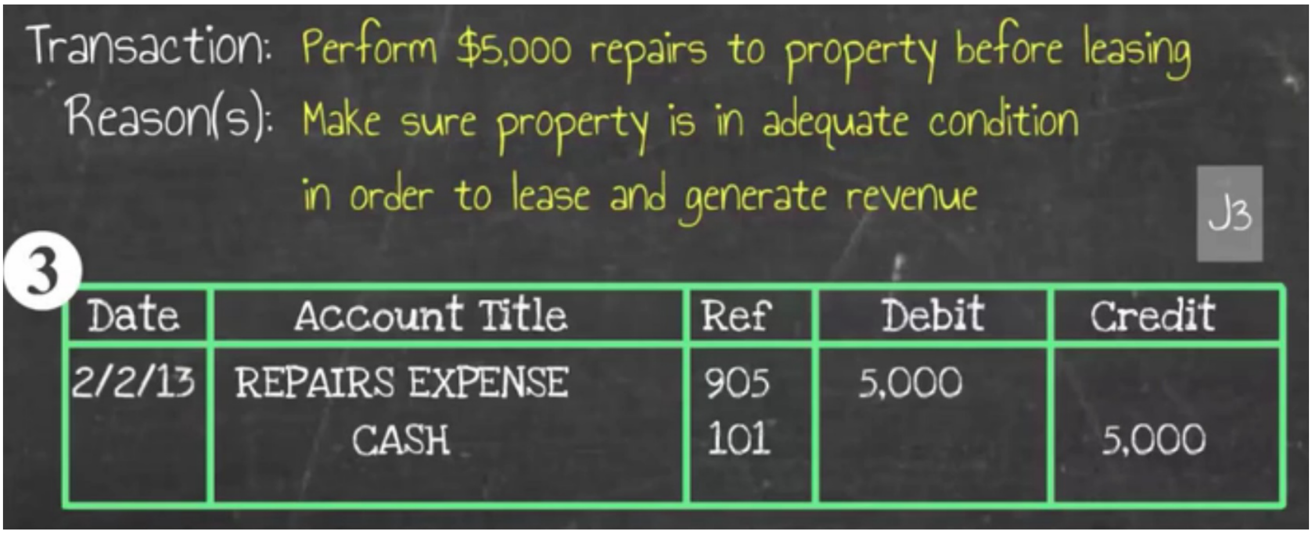
Since they are paying cash, there will be a credit to cash, because that is an asset and assets are reduced with credits. The credit to cash is $75,000, or the total purchase price of the building and land.



Date	Account Title	Ref	Debit	Credit
1/31/13	BUILDING	300	50,000	
	LAND	350	25,000	
	CASH	101		75,000

The third transaction involves performing $5,000 of repairs to the property before it is leased to a tenant. This is necessary to make sure the property is in adequate condition in order to lease and generate revenue. The business is going to pay cash for these repairs.

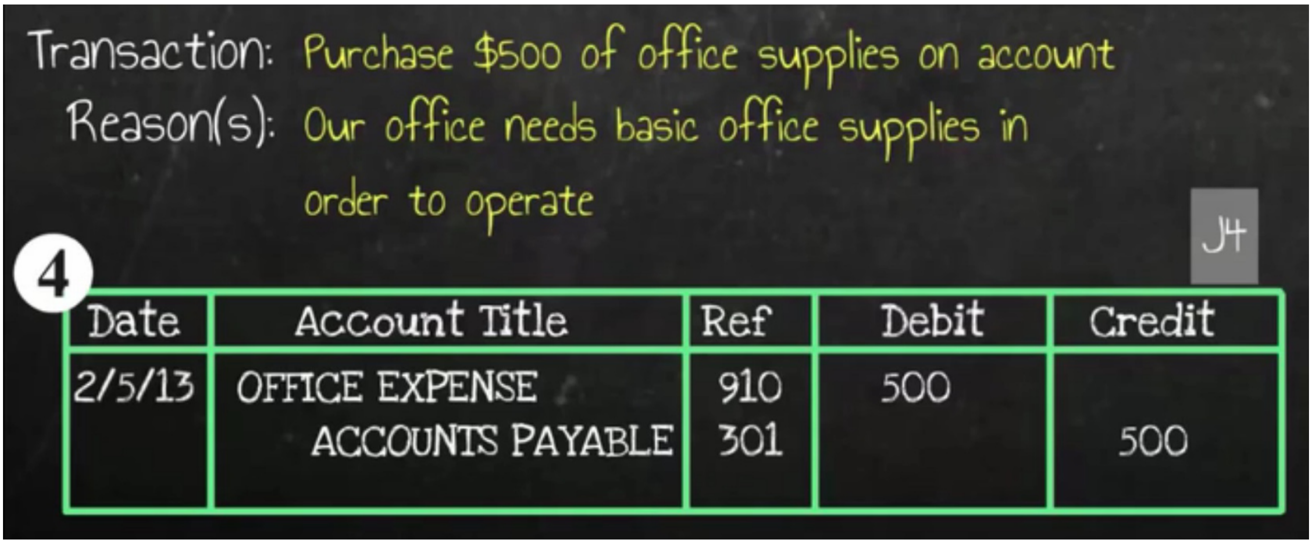
This is the third journal entry. It happened on the 2nd of February, and it reflects incurring an expense--in this case, repairs. Expenses are increased by debits, so there will be a $5,000 debit to the expense account. As mentioned, the business will pay cash for these expenses, so cash is the credit; cash is going down by $5,000.



Date	Account Title	Ref	Debit	Credit
2/2/13	REPAIRS EXPENSE	905	5,000	
	CASH	101		5,000

Next, the business is going to purchase $500 worth of office supplies, on account. The office needs basic supplies in order to operate. Therefore, the fourth journal entry is dated February 5th. Once again, there is an expense, because this is money that the business is spending--in this case, on account. Expenses are increased with debits, so they debit their expense of $500.

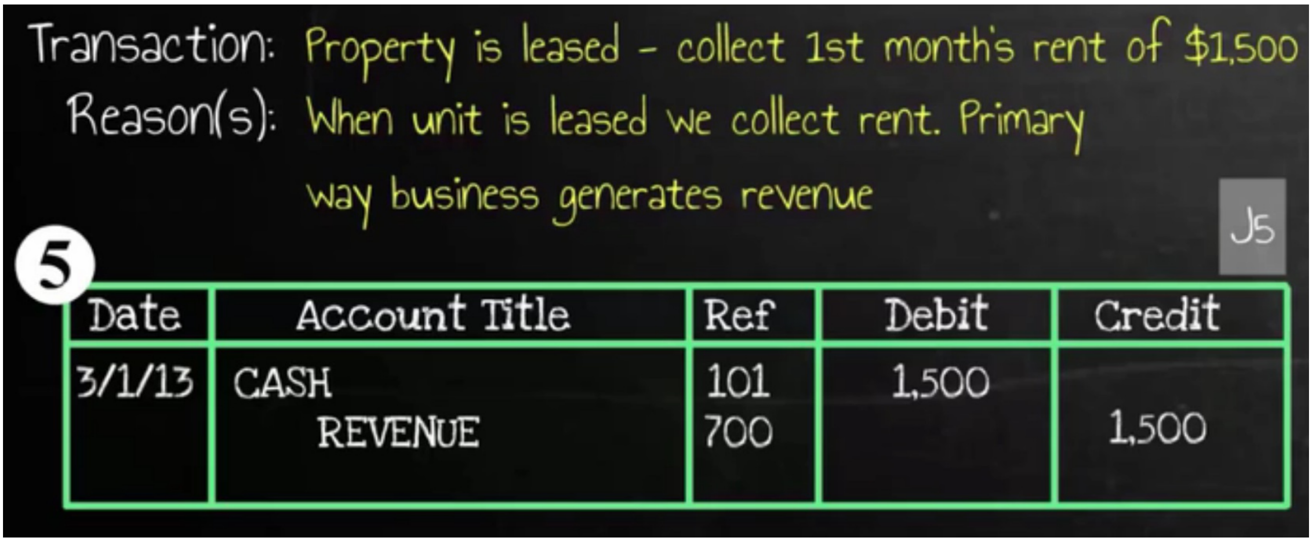
Now, what is the credit going to be? Well, since it's on account, it's not going to be cash. It's going to be accounts payable. It's a liability, so they have a credit to their liability accounts payable of $500.



Transaction number five involves the leasing of the business's properties. Now they are going to collect their first month's rent of $1,500. This is the primary way that the business generates its revenue.

Let's look at journal entry number five. On the 1st of March, the business is going to collect rent. When they collect rent, they receive cash, so they are going to debit their cash account for $1,500.

In this case, they are generating revenue, so their credit is going to be to revenue, because revenues are increased with credits. Therefore, $1,500 credit to revenue is the last transaction.



SUMMARY

Today we introduced a **case study** company called **Legacy Realty**, that is in the business of owning and leasing their own rental properties. We looked at several examples of **journal entries**: cash contribution by the owner, purchase of a property for the business, incurring repairs expense in order to bring the property up to rentable condition, purchasing office supplies in order to run the small office, and lastly, collecting rent on the property.

Source: Adapted from Sophia instructor Evan McLaughlin.