

SM.pdf

Chapter_02_H&P_22e.pdf

Heintz, 22e_Ch02_IRM.pdf

Heintz22e_Ch02_SM_Final.pdf

Heintz22e_Comp Prob 1_SM Part 1_Final.pdf

CHAPTER 2

REVIEW QUESTIONS

- | | |
|------------------------|---------------------------------|
| 1. accounting equation | 11. expense |
| 2. business entity | 12. net income |
| 3. asset | 13. net loss |
| 4. liability | 14. fiscal year |
| 5. account payable | 15. drawing |
| 6. owner's equity | 16. income statement |
| 7. business entity | 17. statement of owner's equity |
| 8. Owner's Equity | 18. balance sheet |
| 9. Liabilities | 19. liquidity |
| 10. Owner's Equity | |

EXERCISES

Exercise 1

- | | | |
|--------------|--------------|--------------|
| (a) \$24,000 | (b) \$17,000 | (c) \$40,000 |
|--------------|--------------|--------------|

Exercise 2

- | | | |
|--------------|--------------|--------------|
| (a) \$90,000 | (c) \$60,000 | (e) \$50,000 |
| (b) \$35,000 | (d) \$55,000 | (f) \$10,000 |

Exercise 3

Net income = \$7,000

Exercise 4

Owner's equity = \$13,120

Exercise 5

- | | |
|--------------|------------------------|
| (a) \$16,000 | (b) \$2,880 net income |
|--------------|------------------------|

Exercise 6

	ASSETS	=	LIABILITIES	+	OWNER'S EQUITY
(a)	15,000				15,000
Bal.	15,000				15,000
(b)	(4,000)				
	4,000				
Bal.	15,000				15,000
(c)	9,000		9,000		
Bal.	24,000		9,000		15,000
(d)	(2,000)		(2,000)		
Bal.	<u>22,000</u>	=	<u>7,000</u>	+	<u>15,000</u>

Exercise 7

	ASSETS (Items Owned)	=	LIABILITIES + (Amts. Owed)	+	OWNER'S EQUITY (Owner's Investment)	+	OWNER'S EQUITY (Earnings)					
	Cash		Accounts Payable		Glen Ross, Capital	-	Glen Ross, Drawing	+	Revenues	-	Expenses	Description
Bal.	28,000		8,000		20,000							
(a)	4,000								4,000			Service Fees
(b)	(1,200)										1,200	Rent Exp.
(c)	(200)										200	Utilities Exp.
(d)	(600)						600					
Bal.	<u>30,000</u>	=	<u>8,000</u>	+	<u>20,000</u>	-	<u>600</u>	+	<u>4,000</u>	-	<u>1,400</u>	
	<u>30,000</u>	=			<u>30,000</u>							

Exercise 8

1.

	ASSETS (Items Owned)		=	LIABILITIES + (Amts. Owed)		OWNER'S EQUITY (Owner's Investment)			OWNER'S EQUITY (Earnings)		
	Cash	Office + Equipment	=	Accounts Payable	J. Moore, + Capital	J. Moore, - Drawing	+	Revenues	-	Expenses	Description
(a)	10,000				10,000						
(b)		5,500		5,500							
(c)	900							900			Service Fees
(d)	(6,000)	6,000									
(e)	1,500							1,500			Service Fees
(f)	(800)									800	Rent Exp.
(g)	(75)									75	Phone. Exp.
(h)	(100)			(100)							
(i)	(500)					500					
Bal.	<u>4,925</u>	+ <u>11,500</u>	=	<u>5,400</u>	+ <u>10,000</u>	- <u>500</u>	+	<u>2,400</u>	-	<u>875</u>	
	<u>16,425</u>		=	<u>16,425</u>							

2.

Total assets.....	\$ 16,425
Total liabilities.....	\$ 5,400
Owner's equity.....	\$ 11,025
Owner's equity in excess of original investment.....	\$ 1,025
Total revenues.....	\$ 2,400
Total expenses.....	\$ 875
Net income.....	\$ 1,525

Exercise 9**Judith Moore Enterprises****Income Statement****For Month Ended July 31, 20--**

Revenue:		
Service fees		\$2,400
Expenses:		
Rent expense	\$800	
Phone expense	75	
Total expenses		875
Net income		\$1,525

Exercise 10**Judith Moore Enterprises****Statement of Owner's Equity****For Month Ended July 31, 20--**

Judith Moore, capital, July 1, 20--		\$ —
Investment in July		10,000
Total investment		\$10,000
Net income for July	\$1,525	
Less withdrawals for July	500	
Increase in capital		1,025
Judith Moore, capital, July 31, 20--		\$11,025

Exercise 11**Judith Moore Enterprises****Balance Sheet****July 31, 20--**

ASSETS		LIABILITIES	
Cash	\$ 4,925	Accounts payable	\$ 5,400
Office equipment	11,500		
		OWNER'S EQUITY	
		Judith Moore, capital	11,025
Total assets	\$16,425	Total liabilities and owner's equity	\$16,425

PROBLEMS

Problem 12

	ASSETS	=	LIABILITIES	+	OWNER'S EQUITY
1.	\$18,800		\$4,700		\$14,100
2.	\$23,400		\$7,200		\$16,200
3.	\$21,900		\$6,000		\$15,900
4.	Net income for January = \$2,100				
	Net loss for February = \$300				

Problem 13

1.

	ASSETS			=	LIABILITIES		+	OWNER'S EQUITY							
	Cash	(Items Owned)			(Amts. Owed)	(Owner's Investment)		(Earnings)							
	+	Office Equip.	+ Prepaid Insur.	=	Accounts Payable	+	J. Moore, Capital	-	J. Moore, Drawing	+	Revenues	-	Expenses	Description	
(a)	12,000						12,000								
(b)		7,500			7,500										
(c)	(800)	800													
(d)	700									700				Cons. Fees	
(e)	(600)											600		Rent Exp.	
(f)	(150)											150		Wages Exp.	
(g)	(200)		200												
(h)	(3,000)				(3,000)										
(i)	(100)								100						
Bal.	<u>7,850</u>	+	<u>8,300</u>	+	<u>200</u>	=	<u>4,500</u>	+	<u>12,000</u>	-	<u>100</u>	+	<u>700</u>	-	<u>750</u>
	<u>16,350</u>			=	<u>16,350</u>										

Problem 13 (Concluded)

2.

Total assets.....	\$ 16,350
Total liabilities	\$ 4,500
Owner's equity.....	\$ 11,850
Change in owner's equity from original investment.....	\$ (150)
Total revenues.....	\$ 700
Total expenses.....	\$ 750
Net income (loss).....	\$ (50)

Problem 14**Susan Cole Consulting Services****Income Statement****For Month Ended October 31, 20—**

Revenue:		
Consulting fees		\$700
Expenses:		
Rent expense	\$600	
Wages expense	150	
Total expenses		750
Net income (loss)		\$ (50)

Problem 15**Susan Cole Consulting Services****Statement of Owner's Equity****For Month Ended October 31, 20--**

Susan Cole, capital, October 1, 20--		\$ —
Investment in October		12,000
Total investment		\$12,000
Less: Net loss for October	\$ 50	
Withdrawals for October	100	
Decrease in capital		(150)
Susan Cole, capital, October 31, 20--		\$11,850

Problem 16**Susan Cole Consulting Services****Balance Sheet****October 31, 20--**

ASSETS		LIABILITIES	
Cash	\$ 7,850	Accounts payable	\$ 4,500
Prepaid insurance	200		
Office equipment	8,300	OWNER'S EQUITY	
		Susan Cole, capital	11,850
Total assets	\$16,350	Total liabilities and owner's equity	\$16,350

Problem 17

1.

	ASSETS			=	LIABILITIES +		OWNER'S EQUITY			Description
	(Items Owned)				(Amts. Owed)	(Owner's Investment)		(Earnings)		
	Cash	Accounts Receivable.	Office Supplies	=	Accounts Payable	+ S. Cassady, Capital	- S. Cassady, Drawing	+ Revenues	- Expenses	
(a)	10,000					10,000				
(b)	(200)		200							
(c)	(400)		800		400					
(d)	300							300		Typing Fees
(e)	(600)								600	Rent Exp.
(f)	(100)						100			
(g)	200	400						600		Typing Fees
(h)	(200)				(200)					
(i)	200	(200)								
Bal.	<u>9,200</u>	+ <u>200</u>	+ <u>1,000</u>	=	<u>200</u>	+ <u>10,000</u>	- <u>100</u>	+ <u>900</u>	- <u>600</u>	
	<u>10,400</u>			=	<u>10,400</u>					

Problem 17 (Concluded)

2.

Stuart Cassady Typing Service**Income Statement****For Month Ended April 30, 20--**

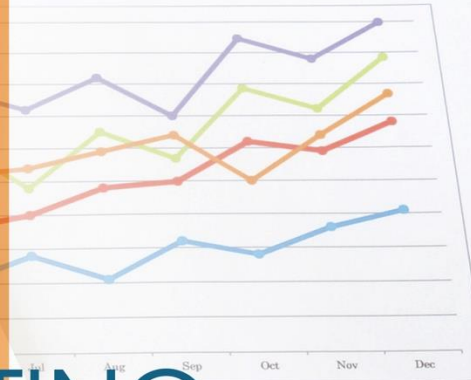
Revenue:		
Typing fees		\$900
Expense:		
Rent expense		600
Net income		\$300

Stuart Cassady Typing Service**Statement of Owner's Equity****For Month Ended April 30, 20--**

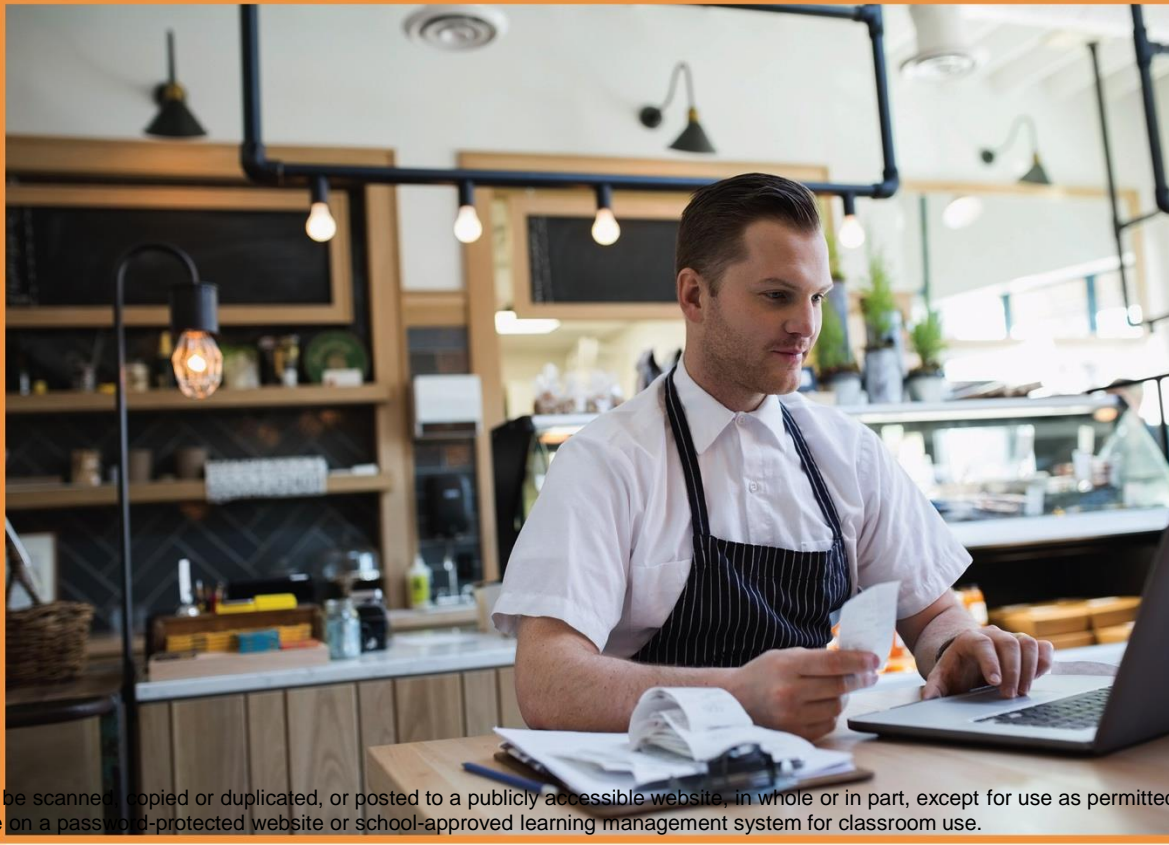
Stuart Cassady, capital, April 1, 20--		\$ —
Investment in April		10,000
Total investment		\$10,000
Net income for April	\$300	
Less withdrawals for April	100	
Increase in owner's equity		200
Stuart Cassady, capital, April 30, 20--		\$10,200

Stuart Cassady Typing Service**Balance Sheet****April 30, 20--**

ASSETS		LIABILITIES	
Cash	\$ 9,200	Accounts payable	\$ 200
Accounts receivable	200		
Office supplies	1,000	OWNER'S EQUITY	
		Stuart Cassady, capital	10,200
Total assets	\$10,400	Total liabilities and owner's equity	\$10,400



COLLEGE ACCOUNTING 22e



Chapter 2

Analyzing Transactions: The Accounting Equation



A table of numerical data, likely representing financial figures, arranged in a grid. The numbers are in a light blue font on a white background. The table is tilted slightly to the right.

48.71	132.94	112.4
9.28	134.36	111.4
82	135.71	110.6
34	136.99	110.00
3	138.22	109.36
	139.40	108.76
	140.52	108.20
	141.60	107.67
	142.63	107.17
	143.62	106.70
	144.58	106.26
	45.49	105.83
	6.37	105.43
	22	105.05
	04	104.69
	2	104.35
		104.02

Learning Objective 1

Define the accounting elements.

Business Entity

- An individual, association, or organization that engages in economic activities and controls specific economic resources
- The business entity's finances are kept separate from the owner's nonbusiness assets and liabilities (business entity concept)

Assets

- Items owned by a business that will provide future benefits.

*MUST BE "OWNED"
NOT RENTED*

Assets (cont.)

- Items owned by a business that will provide future benefits.

*BUT DOESN'T HAVE TO BE PAID
OFF, COULD STILL BE MAKING
PAYMENTS ON IT*

Assets (cont.)

- Examples:
 - Cash
 - Merchandise
 - Furniture
 - Fixtures
 - Machinery
 - Buildings
 - Land
 - Accounts Receivable

Accounts Receivable

- The amount of money owed to the business by its customers as a result of making sales “on account” or “on credit”
- Simply put, the customers have promised to pay sometime in the future.

Liabilities

- Something owed to another business entity
- A probable future outflow of assets as a result of a past transaction or event.

IN OTHER WORDS, DEBTS OR OBLIGATIONS OF THE BUSINESS THAT CAN BE PAID WITH CASH, GOODS, OR SERVICES.

Liabilities (cont.)

- Examples:
 - Accounts Payable
 - Notes Payable

Accounts Payable

- An unwritten promise to pay a supplier for assets purchased or services received
- Referred to as making a purchase “on account” or “on credit”

*Be careful!! Don't confuse accounts receivable and accounts payable. Ask yourself: Are we waiting to receive?
Or waiting to pay?*

Notes Payable

- Formal written promises to pay suppliers or lenders specified sums of money at definite future times

Owner's Equity

- Amount by which the business assets exceed the business liabilities.

Also called:

NET WORTH

OR

CAPITAL

Business Entity Concept

- The owner of a business may have business assets and liabilities as well as nonbusiness assets and liabilities.
- Nonbusiness assets and liabilities are not included in the business entity's accounting records.
- If the owner invests money or other assets in the business, the investment is now reclassified as a business asset.

A Broader View

Assets and the Cost of Products We Buy

Next time you buy something, think of all the assets a company needs to produce that product. If the product comes from a capital-intensive industry, one that requires heavy investments in assets, the company must price the product high enough to cover the cost of using the assets and replacing them when they wear out. For example, AT&T recently reported that the cost of property, plant, and equipment used for operating purposes came to over \$274 billion.

Learning Objective 2

Construct the accounting equation.

The Accounting Equation

$$\text{Assets} = \text{Liabilities} + \text{Owner's Equity}$$

The left side shows the assets.

The Accounting Equation (cont.)

$$\text{Assets} = \text{Liabilities} + \text{Owner's Equity}$$

The right side shows where the money came from to buy the assets.

Example

- If a business has total assets of \$60,400 and total liabilities of \$5,400, what is the owner's equity?

Once the debts are paid, the remaining assets belong to the owner (owner's equity).

Example

- If a business has total assets of \$60,400 and total liabilities of \$5,400, what is the owner's equity?

ASSETS – LIABILITIES = OWNER'S EQUITY

$$\$60,400 - \$5,400 = \$55,000$$

Can also be expressed as:

Assets = Liabilities + Owner's Equity

Learning Objective 3

Analyze business transactions.

Business Transaction

- An economic event that has a direct impact on the business
- Usually requires an exchange with an outside entity.
- We must be able to measure this exchange in dollars.
- All business transactions affect the accounting equation through specific accounts.

Account

- A separate record used to summarize changes in each asset, liability, and owner's equity of a business.

Analyzing Business Transactions

- **Three Questions:**
 - What happened?
 - Which accounts are affected?
 - How is the accounting equation affected?

Question #1

- **What happened?**
 - Make certain you understand the event that has taken place.

Question #2

- **Which accounts are affected?**
 - Identify the accounts that are affected.
 - Classify these accounts as assets, liabilities, or owner's equity.

Question #3

- **How is the accounting equation affected?**
 - Determine which accounts have increased or decreased.
 - Make certain that the accounting equation remains in balance after the transaction has been entered.

Learning Objective 4

Show the effects of
business transactions on
the accounting equation.

Rohan's Campus Delivery

- Let's analyze the effect of transactions on the accounting equation.

Investment Example

- Rohan Macsen, the owner, invested \$2,000 in the business.

Question #1

- **What happened?**

Rohan took \$2,000 from his personal bank account and deposited it in a new account in the business's name.

Question #2A

- Identify the accounts that are affected.

CASH

R.M.,
CAPITAL

Question #2B

- Classify these accounts as assets, liabilities, or owner's equity.

CASH
ASSET

R.M.,
CAPITAL
**OWNER'S
EQUITY**

Question #3A

- Determine which accounts have increased or decreased.

INCREASED

CASH

INCREASED

R.M.,
CAPITAL

Question #3B

- Does the accounting equation balance?

ASSETS = LIABILITIES + OWNER'S EQUITY

CASH = R.M., CAPITAL
+\$2,000 = +\$2,000

It balances!

Assets of \$2,000 = Liabilities of \$0

+ Owner's Equity of \$2,000

Cash Purchase Example

Question #1

- **What happened?**
 - Purchased delivery equipment for \$1,200 cash.

Question #2

- **Which accounts are affected?**
 - Identify the accounts that are affected.
 - Classify these accounts as assets, liabilities, or owner's equity.

DELIVERY
EQUIPMENT
ASSET

CASH
ASSET

Question #3A

- Determine which accounts have increased or decreased.

INCREASED

DELIVERY
EQUIPMENT
ASSET

DECREASED

CASH
ASSET

Question #3B

- Let's look at the accounting equation

ASSETS		=	LIAB.	+	O. E.
CASH	+	DEL. EQUIP.	=		
-\$1,200	+	+\$1,200	=		

The right hand side of the equation is not affected.

Question #3B (cont.)

- Does the accounting equation balance?

ASSETS		=	LIAB.	+	O. E.
CASH	+	DEL. EQUIP.	=		
-\$1,200	+	+\$1,200	=		

Yes!

Total assets stayed the same. One asset increased, the other decreased. No change in liabilities or owner's equity.

Proving the Accounting Equation Balances

ASSETS

	CASH	DEL. EQUIP.
BAL.	\$2,000	
	- 1,200	+ \$1,200
BAL.	\$ 800	\$1,200

LEFT SIDE OF EQUATION:

CASH	\$ 800
DEL. EQUIP.	1,200
TOTAL ASSETS	\$2,000

Proving the Accounting Equation Balances (cont.)

	LIABILITIES	OWNER'S EQUITY
BAL.	\$ 0	\$2,000

BAL.	\$ 0	\$2,000
-------------	------	---------

RIGHT SIDE OF EQUATION:

LIABILITIES	\$ 0
OWNER'S EQUITY	2,000
TOTAL LIAB. & O.E.	\$2,000

Purchase On Account Example

- Purchased delivery equipment on account for \$900.

Question #1

- **What happened?**

Rohan is buying this delivery equipment “on account.” He will be making payments on it over the next three months.

NO CASH WAS EXCHANGED TODAY.

Question #2

- **Which accounts are affected?**
 - Identify the accounts that are affected.
 - Classify these accounts as assets, liabilities, or owner's equity.

DEL.
EQUIP.
ASSET

ACCOUNTS
PAYABLE
LIABILITY

Question #3A

- Determine which accounts have increased or decreased.

DEL.
EQUIP.
ASSET

INCREASED

ACCOUNTS
PAYABLE
LIABILITY

INCREASED

Question #3B

- Let's look at the accounting equation.

$$\begin{array}{rcl} \text{ASSETS} & = & \text{LIABILITIES} + \text{OWNER'S EQUITY} \\ \hline \text{DEL. EQUIP.} & = & \text{ACCOUNTS} \\ & & \text{PAYABLE} \\ +\$900 & = & +\$900 \end{array}$$

This transaction had no effect on owner's equity.

Question #3B (cont.)

- Does the accounting equation balance?

$$\begin{array}{rcl} \text{ASSETS} & = & \text{LIABILITIES} + \text{OWNER'S EQUITY} \\ \hline \text{DEL. EQUIP.} & = & \text{ACCOUNTS} \\ & & \text{PAYABLE} \\ +\$900 & = & +\$900 \end{array}$$

It balances!

*Assets increased by \$900 =
Liabilities increased by \$900*

Proving the Accounting Equation Balances

ASSETS

CASH + DEL. EQUIP.

\$2,000

– 1,200

\$1,200

BAL. \$ 800

\$1,200

+ 900

BAL. \$ 800

\$2,100



$\$800 + (\$1,200 + \$900) =$

$\$2,900$ TOTAL ASSETS

Proving the Accounting Equation Balances (cont.)

	LIABILITIES	OWNER'S EQUITY
	ACCTS. PAY.	R.M., CAPITAL
		+\$2,000
BAL.		\$2,000
	+\$900	
BAL.	\$900	\$2,000

$$\$900 + \$2,000 = \$2,900$$

TOTAL LIABILITIES AND OWNER'S EQUITY

Loan Payment Example

Question #1

- **What happened?**
 - Made \$300 payment on equipment loan.

Question #2

- **Which accounts are affected?**
 - Identify the accounts that are affected.
 - Classify these accounts as assets, liabilities, or owner's equity.

CASH
ASSET

ACCOUNTS
PAYABLE
LIABILITY

Question #3A

- Determine which accounts have increased or decreased.

CASH
ASSET

DECREASED

ACCOUNTS
PAYABLE
LIABILITY

DECREASED

Question #3B

- Let's look at the accounting equation.

ASSETS = LIABILITIES + OWNER'S EQUITY

CASH = ACCOUNTS
PAYABLE

-\$300 = -\$300

*This transaction had
no effect on owner's
equity.*

Question #3B (cont.)

- Does the accounting equation balance?

ASSETS = LIABILITIES + OWNER'S EQUITY

CASH = ACCOUNTS
PAYABLE

-\$300 = -\$300

It balances!

*Assets decreased by \$300 =
Liabilities decreased by \$300*

Proving the Accounting Equation Balances

ASSETS		
	CASH	DEL. EQUIP.
	\$2,000	
	– 1,200	\$1,200
BAL.	\$ 800	\$1,200
		+ 900
BAL.	\$ 800	\$2,100
	– 300	
BAL.	\$ 500	\$2,100

\$2,600

Owner's Equity Transactions

FOUR TYPES:

DECREASE:

EXPENSES

DRAWING

INCREASE:

REVENUES

INVESTMENTS

Revenues

- The amount a business charges customers for products sold or services performed
- Recognized when earned (even if cash has not yet been received)
- Increase both assets (cash or accounts receivable) and owner's equity

Revenues (cont.)

- **Examples:**
 - Delivery Fees
 - Consulting Fees
 - Rent Revenue (if the business rents space to others)
 - Interest Revenue (for interest earned on bank deposits)
 - Sales (for sales of merchandise)

Expenses

- Represent the decrease in assets (or increase in liabilities) as a result of efforts made to produce revenues
- Separate accounts are maintained for each type of expense.
- Either *decrease* assets or *increase* liabilities, but **ALWAYS decrease** owner's equity.

Expenses (cont.)


- **Examples:**
 - Rent
 - Salaries
 - Supplies consumed
 - Taxes

Net Income

REVENUES greater than EXPENSES = NET INCOME

EXAMPLE: Luke Perkins performed \$6,000 of tax services (revenue) this year and incurred expenses of \$1,500 for rent, \$500 for supplies, and \$3,000 in salaries.

$$\begin{array}{r r r r r} \text{REVENUE} & - & \text{EXPENSES} & = & \text{NET INCOME} \\ \$6,000 & - & \$5,000 & = & \$1,000 \end{array}$$


\$1,500 + \$500 + \$3,000

Net Loss

EXPENSES greater than REVENUES = NET LOSS

EXAMPLE: John Atwood performed \$8,000 of delivery services (revenue) this year and incurred expenses of \$3,500 for rent, \$500 for supplies, \$3,000 in salaries, and \$2,500 for gasoline.

$$\begin{array}{rccccccc} \text{REVENUE} & - & \text{EXPENSES} & = & \text{NET LOSS} \\ \$8,000 & - & \$9,500 & = & (\$1,500) \end{array}$$


$$\$3,500 + \$500 + \$3,000 + \$2,500$$

Accounting Period Concept

- The concept that income determination can be made on a periodic basis (month, quarter, year, etc.)
- Any accounting period of 12 months is called a fiscal year.

Withdrawals

- The owner taking (withdrawing) cash or other assets from the business for personal use
- Reduces owner's equity and assets
- Also referred to as drawing

Revenue Example

Question #1

- **What happened?**
 - Rohan performed services and received \$500 in cash.

Question #2

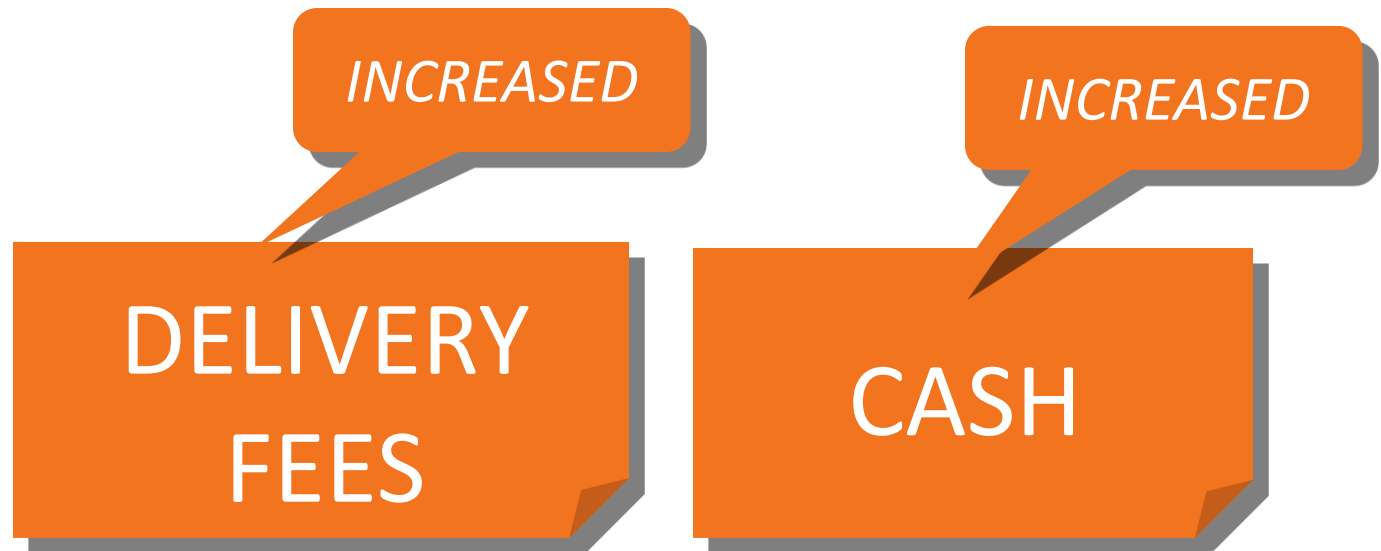
- **Which accounts are affected?**
 - Identify the accounts that are affected.
 - Classify these accounts as assets, liabilities, or owner's equity.

DELIVERY
FEES
O.E.
REVENUE

CASH
ASSET

Question #3A

- Determine which accounts have increased or decreased.



Question #3B


- Does the accounting equation balance?

ASSETS	=	LIAB.	+	OWNER'S EQUITY
CASH	=			DELIVERY FEES
+\$500	=			+\$500

It balances!

*Assets increased by \$500 =
Owner's equity increased by \$500*

Proving the Accounting Equation Balances

			ASSETS	
			CASH	DEL. EQUIP.
BAL.	\$	500		\$2,100
	+	500		
<hr/>				
BAL.	\$	1,000		\$2,100
				

Proving the Accounting Equation Balances (cont.)

	LIAB.		OWNER'S EQUITY
	ACCTS. PAY.	R.M., CAPITAL	DELIVERY FEES
BAL.	\$600	\$2,000	
			+\$500
BAL.	\$600	\$2,000	\$500



Expense Example

Question #1

- **What happened?**
 - Rohan paid \$200 for office rent.

Question #2

- **Which accounts are affected?**
 - Identify the accounts that are affected.
 - Classify these accounts as assets, liabilities, or owner's equity.

RENT
EXPENSE
O.E.
EXPENSE

CASH
ASSET

Question #3A

- Determine which accounts have increased or decreased.

INCREASED

RENT
EXPENSE

DECREASED

CASH

Question #3A (cont.)

- Determine which accounts have increased or decreased.

RENT
EXPENSE

CASH

BE CAREFUL! While incurring an expense will increase the expense account, it will cause an overall DECREASE in OWNER'S EQUITY.

Question #3B

- Does the accounting equation balance?

ASSETS	=	LIAB. +	OWNER'S EQUITY
CASH	=		RENT EXPENSE
-\$200	=		-\$200

It balances!

*Assets decreased by \$200 =
Owner's equity decreased by \$200*

Proving the Accounting Equation Balances

ASSETS

	CASH	DEL. EQUIP.
BAL.	\$1,000	\$2,100
	— 200	

BAL.	\$ 800	\$2,100
------	--------	---------

\$2,900

Proving the Accounting Equation Balances (cont.)

	LIAB.		OWNER'S EQUITY	
	ACCTS. PAY.	R.M., CAPITAL	REVENUES	EXPENSES
BAL.	\$600	\$2,000	\$500	
				+\$200
BAL.	\$600	\$2,000	\$500	\$200

$$\$600 + \$2,000 + \$500 - \$200 = \$2,900$$

Expense Example

Question #1

- **What happened?**
 - Rohan paid \$50 for phone service.

Question #2

- **Which accounts are affected?**
 - Identify the accounts that are affected.
 - Classify these accounts as assets, liabilities, or owner's equity.

PHONE
EXPENSE
O.E.
EXPENSE

CASH
ASSET

Question #3A

- Determine which accounts have increased or decreased.

INCREASED

PHONE
EXPENSE

DECREASED

CASH

Question #3B

- Does the accounting equation balance?

ASSETS	=	LIAB.	+	OWNER'S EQUITY
CASH	=			PHONE EXPENSE
-\$50	=			-\$50

It balances! Assets decreased by \$50 = Owner's equity decreased by \$50

Proving the Accounting Equation Balances

ASSETS

	CASH	DEL. EQUIP.
BAL.	\$ 800	\$2,100

— 50

BAL.	\$ 750	\$2,100
------	--------	---------

\$2,850

Proving the Accounting Equation Balances (cont.)

	LIAB.	OWNER'S EQUITY		
	ACCTS. PAY.	R.M., CAPITAL	REVENUES	EXPENSES
BAL.	\$600	\$2,000	\$500	\$ 200 + 50
BAL.	\$600	\$2,000	\$500	\$ 250

$$\$600 + \$2,000 + \$500 - \$250 = \$2,850$$

Revenue On Account Example

- Rohan performed \$600 of delivery services on account.

Question #1

- **What happened?**

Rohan has performed services for a client. The client will be paying Rohan at a later date.

IT IS REVENUE EVEN THOUGH NO CASH CHANGES HANDS TODAY!

Question #2

- **Which accounts are affected?**
 - Identify the accounts that are affected.
 - Classify these accounts as assets, liabilities, or owner's equity.

DELIVERY
FEES
O.E.
REVENUE

ACCOUNTS
RECEIVABLE
ASSET

Question #3A

- Determine which accounts have increased or decreased.

INCREASED

INCREASED

DELIVERY
FEES

ACCOUNTS
RECEIVABLE

Question #3B

- Does the accounting equation balance?

ASSETS	=	LIAB.	+	OWNER'S EQUITY
ACCTS. RECEIVABLE	=			DELIVERY FEES
+\$600	=			+\$600

It balances!

*Assets increased by \$600 =
Owner's equity increased by \$600*

Proving the Accounting Equation Balances

ASSETS

	CASH	ACCTS. REC.	DEL. EQUIP.
BAL.	\$750		\$2,100

+ \$600

BAL.	\$750	\$600	\$2,100
-------------	-------	-------	---------

\$3,450

Proving the Accounting Equation Balances (cont.)

	LIAB.		OWNER'S EQUITY	
	ACCTS. PAY.	R.M., CAPITAL	REVENUES	EXPENSES
BAL.	\$600	\$2,000	\$ 500 + 600	\$250
BAL.	\$600	\$2,000	\$1,100	\$250

$$\$600 + \$2,000 + \$1,100 - \$250 = \$3,450$$

Purchase Of Supplies Example

Question #1

- **What happened?**
 - Purchased supplies for \$80 cash.

Question #2

- **Which accounts are affected?**
 - Identify the accounts that are affected.
 - Classify these accounts as assets, liabilities, or owner's equity.

SUPPLIES

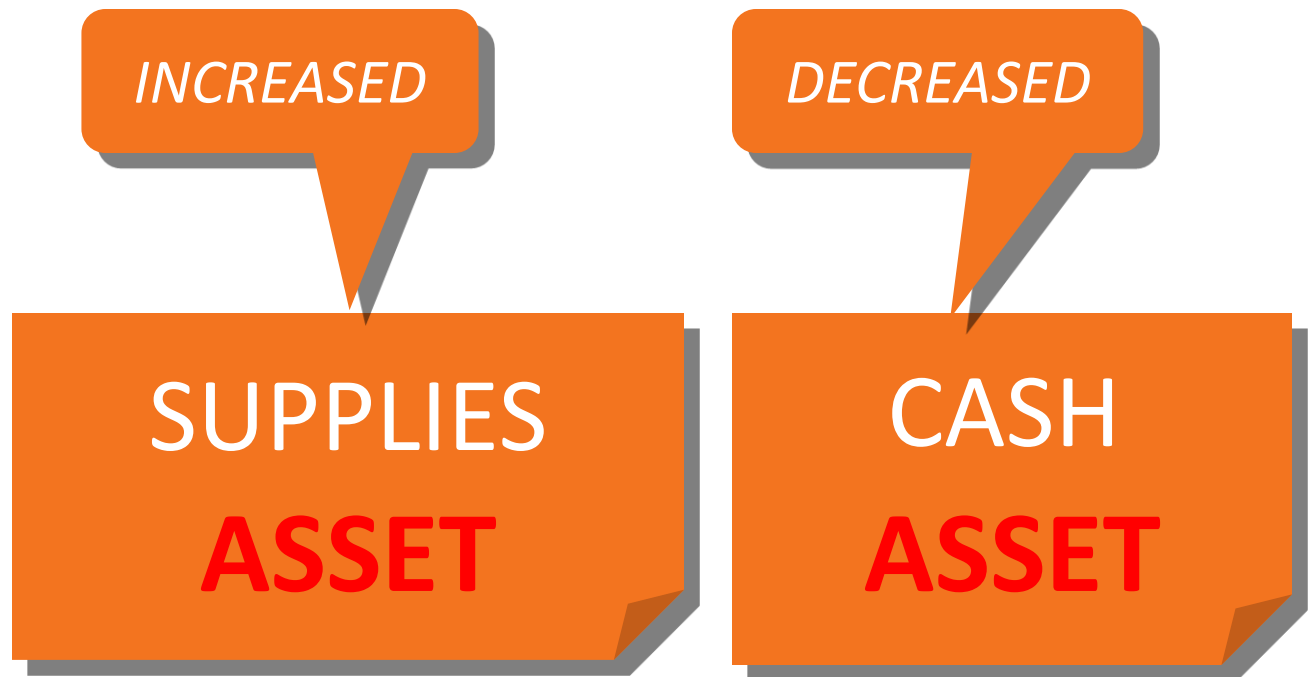
ASSET

CASH

ASSET

Question #3A

- Determine which accounts have increased or decreased.



Question #3B

- Does the accounting equation balance?

ASSETS		=	LIAB.	+	O. E.
CASH	+	SUPPLIES	=		
-\$80	+	+\$80	=		


It balances!

Total assets stayed the same. One asset increased, the other decreased. No change in liabilities or owner's equity.

Proving the Accounting Equation Balances

ASSETS

	CASH	ACCTS. REC.	SUPPLIES	DEL. EQUIP.
BAL.	\$750	\$600		\$2,100
	- 80		+\$80	
BAL.	\$670	\$600	\$80	\$2,100

**\$3,450**

Proving the Accounting Equation Balances (cont.)

	LIAB.		OWNER'S EQUITY	
	ACCTS. PAY.	R.M., CAPITAL	REVENUES	EXPENSES
BAL.	\$600	\$2,000	\$1,100	\$250
BAL.	\$600	\$2,000	\$1,100	\$250



$$\$600 + \$2,000 + \$1,100 - \$250 = \$3,450$$

Prepaid Insurance Premium Example

Question #1

- **What happened?**
 - Rohan paid for an eight-month liability insurance policy with \$200 cash.
 - Insurance is paid in advance and will provide future benefits.

Question #2

- **Which accounts are affected?**
 - Identify the accounts that are affected.
 - Classify these accounts as assets, liabilities, or owner's equity.

PREPAID
INSURANCE
ASSET

CASH
ASSET

Question #3A

- Determine which accounts have increased or decreased.

INCREASED

PREPAID
INSURANCE

ASSET

DECREASED

CASH

ASSET

Question #3B

- Does the accounting equation balance?

ASSETS		=	LIAB.	+	O. E.
CASH	+ PREPAID INS.	=			
-\$200	+ \$200	=			

It balances!

*Total assets stayed the same.
One asset increased, the other
decreased. No change in
liabilities or owner's equity.*

Proving the Accounting Equation Balances

	ASSETS				
	CASH	ACCTS. REC.	SUPPLIES	PREPD. INS.	DEL. EQUIP.
BAL.	\$670	\$600	\$80		\$2,100
	- 200			+\$200	
BAL.	\$470	\$600	\$80	\$200	\$2,100



Proving the Accounting Equation Balances (cont.)

	LIAB.		OWNER'S EQUITY	
	ACCTS. PAY.	R.M., CAPITAL	REVENUES	EXPENSES
BAL.	\$600	\$2,000	\$1,100	\$250
BAL.	\$600	\$2,000	\$1,100	\$250



$$\$600 + \$2,000 + \$1,100 - \$250 = \$3,450$$

Customer Payment Example

- Received \$570 in cash for services recognized in an earlier transaction.

Question #1

- **What happened?**

When Rohan performed the delivery services, the client agreed to pay at a later date.

TODAY HE RECEIVED CASH OF \$570 AS A PARTIAL PAYMENT.

Question #2

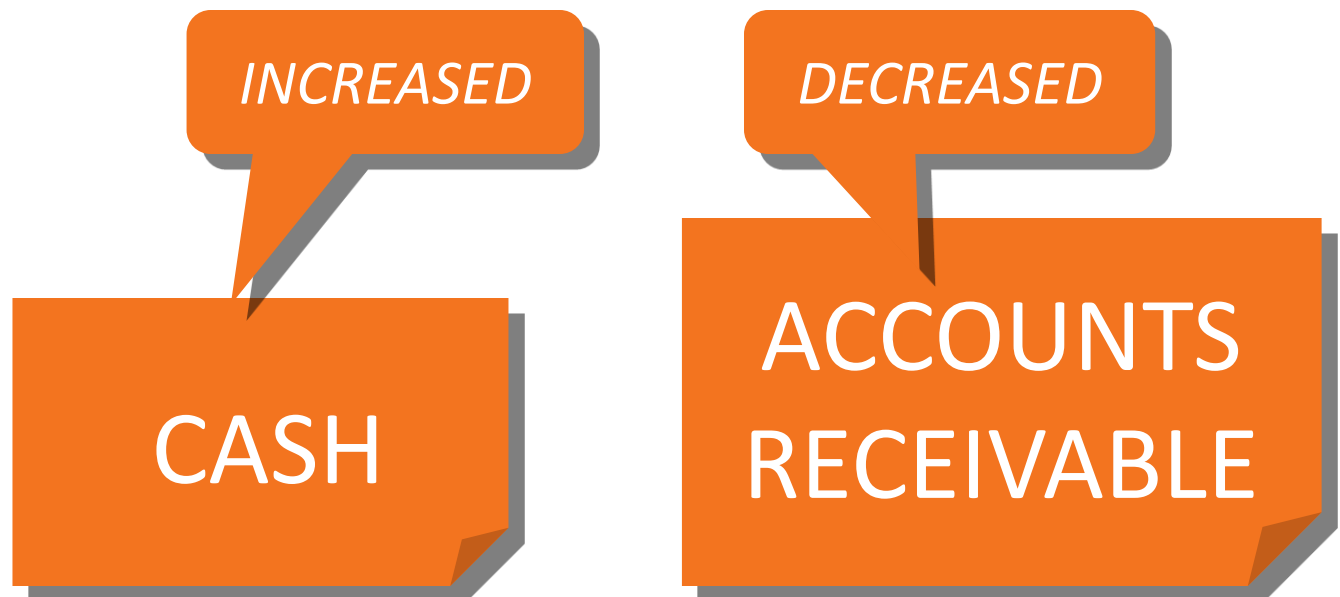
- **Which accounts are affected?**
 - Identify the accounts that are affected.
 - Classify these accounts as assets, liabilities, or owner's equity.

CASH
ASSET

**ACCOUNTS
RECEIVABLE**
ASSET

Question #3A

- Determine which accounts have increased or decreased.



Question #3B

- Does the accounting equation balance?

ASSETS		=	LIAB.	+	O. E.
CASH	+	ACCTS. REC.	=		
+\$570	+	-\$570	=		

It balances!

*Total assets stayed the same.
One asset increased, the other
decreased. No change in
liabilities or owner's equity.*

Proving the Accounting Equation Balances

ASSETS					
	CASH	ACCTS. REC.	SUPPLIES	PREPD. INS.	DEL. EQUIP.
BAL.	\$ 470	\$600	\$80	\$200	\$2,100
	+ 570	- 570			
BAL.	\$1,040	\$ 30	\$80	\$200	\$2,100

\$3,450

Proving the Accounting Equation Balances (cont.)

	LIAB.	OWNER'S EQUITY		
	ACCTS. PAY.	R.M., CAPITAL	REVENUES	EXPENSES
BAL.	\$600	\$2,000	\$1,100	\$250

BAL. \$600 \$2,000 \$1,100 \$250


$$\$600 + \$2,000 + \$1,100 - \$250 = \$3,450$$

Purchase by Partial Payment and On Account Example

- Purchased delivery equipment for \$300 cash and \$1,200 on account.

Question #1

- **What happened?**

Rohan is buying this delivery equipment by paying some cash now and the rest “on account.” He will be making payments on it over the next four months.

Question #2

- **Which accounts are affected?**
 - Identify the accounts that are affected.
 - Classify these accounts as assets, liabilities, or owner's equity.

CASH

ASSET

DELIVERY
EQUIP.

ASSET

ACCOUNTS
PAYABLE

LIABILITY

Question #3A

- Determine which accounts have increased or decreased.

DECREASED

CASH
ASSET

INCREASED

DELIVERY
EQUIP.
ASSET

INCREASED

ACCOUNTS
PAYABLE
LIABILITY

Question #3B

- Does the accounting equation balance?

ASSETS		=	LIABILITIES	+	OWNER'S EQUITY
CASH	+ DEL. EQUIP.	=	ACCOUNTS PAYABLE		
-\$300	+ \$1,500	=	+\$1,200		

It balances!

Assets increased by \$1,200 = Liabilities increased by \$1,200

Proving the Accounting Equation Balances

ASSETS

	CASH	ACCTS. REC.	SUPPLIES	PREPD. INS.	DEL. EQUIP.
BAL.	\$1,040	\$30	\$80	\$200	\$2,100
	- 300				+1,500
BAL.	\$ 740	\$30	\$80	\$200	\$3,600

\$4,650

Proving the Accounting Equation Balances (cont.)

	LIAB.	OWNER'S EQUITY		
	ACCTS. PAY.	R.M., CAPITAL	REVENUES	EXPENSES
BAL.	\$ 600 +1,200	\$2,000	\$1,100	\$250
BAL.	\$1,800	\$2,000	\$1,100	\$250

$$\begin{aligned}
 & \$1,800 + \$2,000 + \$1,100 - \$250 = \\
 & \quad \quad \quad \$4,650
 \end{aligned}$$

Payment Of Wages Example

Question #1

- **What happened?**
 - Rohan paid his part-time employees \$650 in wages.

Question #2

- **Which accounts are affected?**
 - Identify the accounts that are affected.
 - Classify these accounts as assets, liabilities, or owner's equity.

WAGES
EXPENSE
O.E.
EXPENSE

CASH
ASSET

Question #3A

- Determine which accounts have increased or decreased.

INCREASED

WAGES
EXPENSE

DECREASED

CASH

Question #3B

- Does the accounting equation balance?


ASSETS	=	LIAB.	+	OWNER'S EQUITY
CASH	=			WAGES EXPENSE
-\$650	=			-\$650

It balances!

*Assets decreased by \$650 =
Owner's equity decreased by \$650*

Proving the Accounting Equation Balances

	ASSETS				
	CASH	ACCTS. REC.	SUPPLIES	PREPD. INS.	DEL. EQUIP.
BAL.	\$740	\$30	\$80	\$200	\$3,600
	-650				
<hr/>					
BAL.	\$ 90	\$30	\$80	\$200	\$3,600



Proving the Accounting Equation Balances (cont.)

	LIAB.	OWNER'S EQUITY		
	ACCTS. PAY.	R.M., CAPITAL	REVENUES	EXPENSES
BAL.	\$1,800	\$2,000	\$1,100	\$250 + 650
BAL.	\$1,800	\$2,000	\$1,100	\$900



$$\begin{aligned}
 & \$1,800 + \$2,000 + \$1,100 - \$900 = \\
 & \quad \quad \quad \$4,000
 \end{aligned}$$

Deliveries for Cash and On Account

Question #1

- **What happened?**
 - Rohan received delivery fees as follows:
\$430 in cash and \$620 on account.

Question #2

- **Which accounts are affected?**
 - Identify the accounts that are affected.
 - Classify these accounts as assets, liabilities, or owner's equity.

CASH

ASSET

ACCTS.
REC.

ASSET

DELIVERY
FEES

O.E.
REVENUE

Question #3A

- Determine which accounts have increased or decreased.



Question #3B

- Does the accounting equation balance?


ASSETS		=	LIAB.	+	OWNER'S EQUITY
CASH	ACCTS. REC.	=			DELIVERY FEES
+\$430	+\$620	=			+\$1,050

It balances!

*Assets increased by \$1,050 =
Owner's equity increased by \$1,050*

Proving the Accounting Equation Balances

ASSETS				
CASH	ACCTS. REC.	SUPPLIES	PREPD. INS.	DEL. EQUIP.
BAL. \$ 90	\$ 30	\$80	\$200	\$3,600
+ 430	+ 620			
<hr/>				
BAL. \$520	\$650	\$80	\$200	\$3,600



\$5,050

Proving the Accounting Equation Balances (cont.)

	LIAB.	OWNER'S EQUITY		
	ACCTS. PAY.	R.M., CAPITAL	REVENUES	EXPENSES
BAL.	\$1,800	\$2,000	\$ 1,100 + 1,050	\$900
BAL.	\$1,800	\$2,000	\$ 2,150	\$900



$$\begin{aligned}
 & \$1,800 + \$2,000 + \$2,150 - \$900 = \\
 & \qquad \qquad \qquad \$5,050
 \end{aligned}$$

Cash Withdrawal Example

- Rohan withdrew \$150 for personal expenses.

Question #1

- **What happened?**

Rohan is withdrawing some of his equity in the business by taking home an asset (cash). This will reduce the assets and reduce his owner's equity.

Question #2

- **Which accounts are affected?**
 - Identify the accounts that are affected.
 - Classify these accounts as assets, liabilities, or owner's equity.

R.M.,
DRAWING
O.E.
DRAWING

CASH
ASSET

Question #3A

- Determine which accounts have increased or decreased.

INCREASED

R.M.,
DRAWING

DECREASED

CASH

Question #3A (cont.)

- Determine which accounts have increased or decreased.

R.M.,
DRAWING

CASH

BE CAREFUL! Just like expenses, the drawing account will increase in this situation, but it will cause an overall DECREASE IN OWNER'S EQUITY.

Question #3B

- Does the accounting equation balance?


ASSETS	=	LIAB.	+	OWNER'S EQUITY
CASH	=			R.M., DRAWING
-\$150	=			+\$150

It balances!

*Assets decreased by \$150 =
Owner's equity decreased by \$150*

Proving the Accounting Equation Balances

ASSETS					
	CASH	ACCTS. REC.	SUPPLIES	PREPD. INS.	DEL. EQUIP.
BAL.	\$ 520	\$650	\$80	\$200	\$3,600
	– 150				
<hr/>					
BAL.	\$370	\$650	\$80	\$200	\$3,600

**\$4,900**

Proving the Accounting Equation Balances (cont.)

	LIAB.		OWNER'S EQUITY		
	ACCTS. PAY.	R.M., CAP.	R.M., DRAWING	REV.	EXP.
BAL.	\$1,800	\$2,000		\$2,150	\$900
			+\$150		
BAL.	\$1,800	\$2,000	\$150	\$2,150	\$900

$$\$1,800 + \$2,000 - \$150 + \$2,150 - \$900 = \$4,900$$

Learning Objective 5

Prepare and describe the purposes of a simple income statement, statement of owner's equity, and balance sheet.

Financial Statements

- Three commonly prepared financial statements:
 - Income statement
 - Statement of owner's equity
 - Balance sheet

Income Statement

- Reports the profitability of business operations for a specific period of time
- Expenses are subtracted from revenues to determine net income/loss
- Also called the profit and loss statement or operating statement

Rohan's Campus Delivery Income Statement For Month Ended June 30, 20--

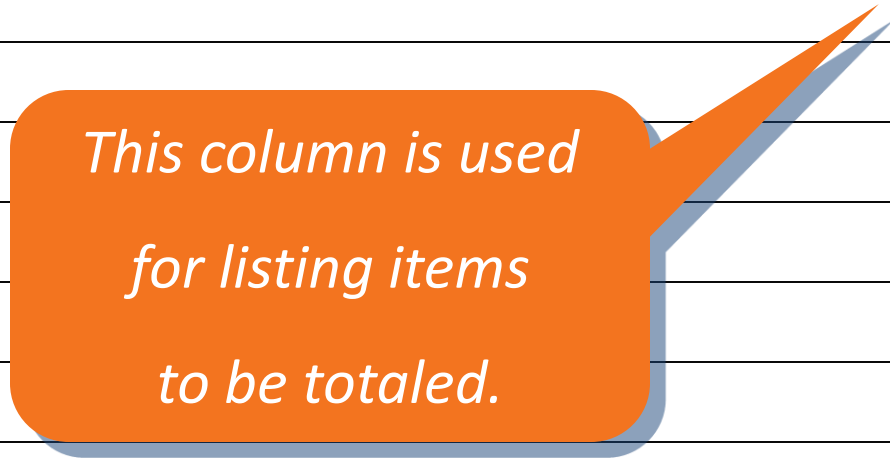
Financial statement headings:

1st line: The name of the company

2nd line: The title of the statement

*3rd line: The time period covered or the date of
the statement*

Rohan's Campus Delivery Income Statement For Month Ended June 30, 20--



*This column is used
for listing items
to be totaled.*

Rohan's Campus Delivery Income Statement For Month Ended June 30, 20--



*This column is used
for totals.*

Rohan's Campus Delivery Income Statement For Month Ended June 30, 20--

Revenues		
Delivery fees		\$2,150

*The first item at the top of
a column should include
a dollar sign.*

Rohan's Campus Delivery Income Statement For Month Ended June 30, 20--

Revenues

Delivery fees	\$2,150
---------------	---------

Expenses

Wages expense	\$ 650
---------------	--------

Rent expense	200
--------------	-----

Phone expense	50
---------------	----

Total expenses	900
-----------------------	------------

Underline before totaling.

Rohan's Campus Delivery

Income Statement

For Month Ended June 30, 20--

Revenues

Delivery fees	\$2,150
---------------	---------

Expenses

Wages expense	\$ 650
---------------	--------

Rent expense	200
--------------	-----

Phone expense	50
---------------	----

Total expenses	900
-----------------------	------------

Net income	\$1,250
-------------------	----------------

*Revenues are greater than expenses,
therefore the total is called NET INCOME.*

Rohan's Campus Delivery

Income Statement

For Month Ended June 30, 20--

Revenues

Delivery fees	\$2,150
---------------	---------

Expenses

Wages expense	\$ 650
---------------	--------

Rent expense	200
--------------	-----

Phone expense	50
---------------	----

Total expenses	900
-----------------------	------------

Net income	\$1,250
-------------------	----------------

Double underline the net income total.

The Statement Of Owner's Equity

- Reports the activities that affected owner's equity for a specific period of time
- Uses Net Income from the income statement

Rohan's Campus Delivery Statement of Owner's Equity For Month Ended June 30, 20--

Rohan Macsen, capital, June 1, 20--		\$2,000
Net Income for June	\$1,250	

Instead of showing revenue increasing and expenses decreasing the owner's equity, this statement uses the net effect (net income/loss) from the income statement.

Rohan's Campus Delivery Statement of Owner's Equity For Month Ended June 30, 20---

Rohan Macsen, capital, June 1, 20--		\$2,000
Net Income for June	\$1,250	
Less Withdrawals for June	150	
	<hr/>	1,100

*\$1,250 net income – \$150 withdrawal =
\$1,100 increase in capital*

Rohan's Campus Delivery Statement of Owner's Equity For Month Ended June 30, 20--

Rohan Macsen, capital, June 1, 20--		\$2,000
Net Income for June	\$1,250	
Less Withdrawals for June	150	
Increase in capital	<u> </u>	1,100
Rohan Macsen, capital, June 30, 20--		<u><u>\$3,100</u></u>

*\$2,000 beginning O. E. + \$1,100 increase =
\$3,100*

The Balance Sheet

- Reports a firm's assets, liabilities, and owner's equity on a specific date
- Confirms that the accounting equation has remained in balance
- Also referred to as a statement of financial position or statement of financial condition

Rohan's Campus Delivery Balance Sheet June 30, 20--

The balance sheet reports assets, liabilities, and owner's equity on a SPECIFIC DATE, not a period of time.

Rohan's Campus Delivery Balance Sheet June 30, 20--

Assets		Liabilities	
Cash	\$ 370	Accounts payable	\$1,800
Accounts receivable	650		
Supplies	80	Owner's Equity	
Prepaid insurance	200	Rohan Macsen, capital	3,100
Delivery equipment	3,600		
	Total assets		Total liabilities and owner's equity
	\$4,900		\$4,900

It balances!!!

Learning Objective 6

Define the three basic phases of the accounting process.

Accounting Process

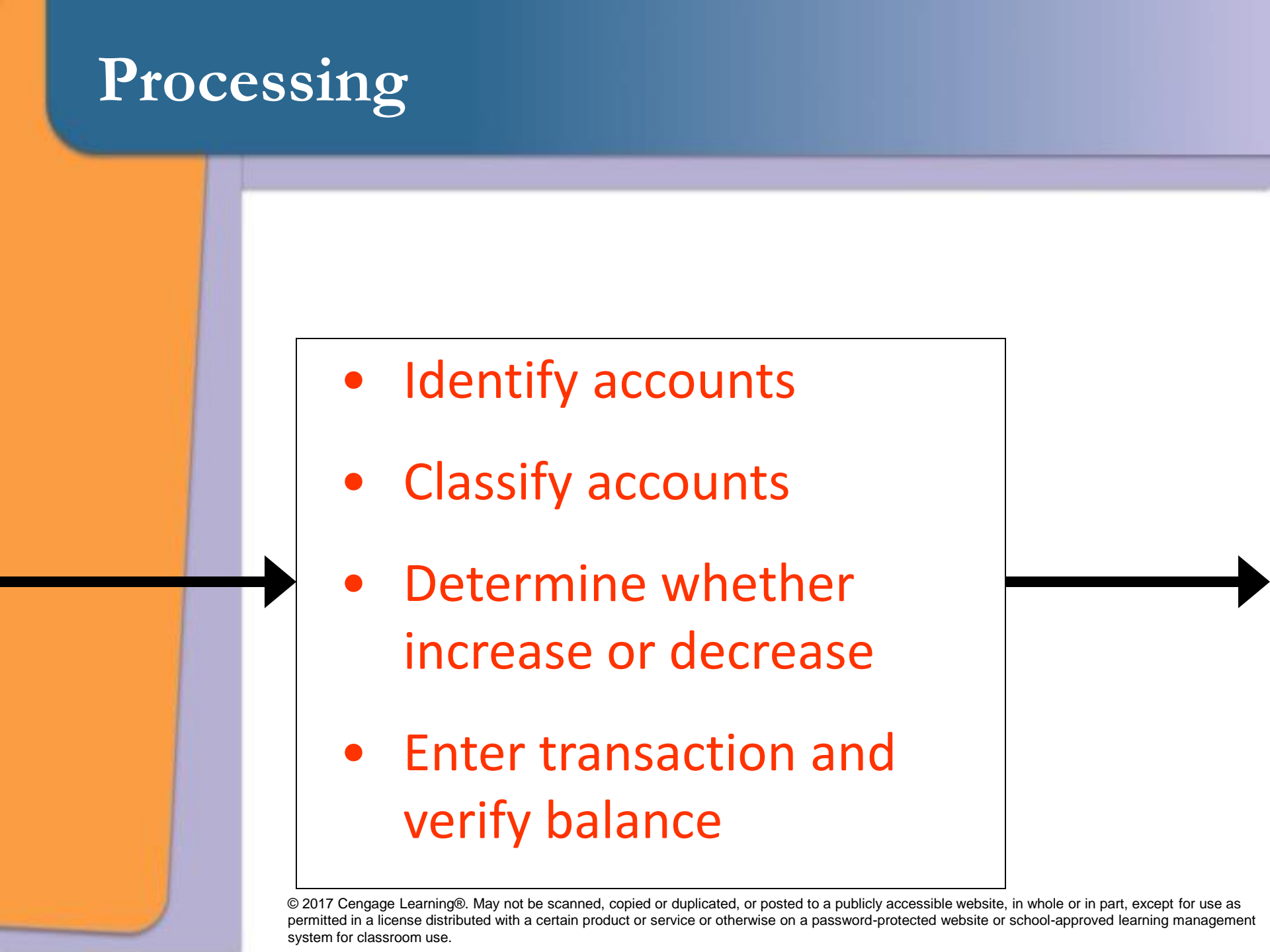
- Three basic phases:
 - Input
 - Processing
 - Output

Input

Transactions
provide the
necessary
input



Processing

- 
- Identify accounts
 - Classify accounts
 - Determine whether increase or decrease
 - Enter transaction and verify balance

Output

INCOME STATEMENT

REVENUES

–

EXPENSES

=

NET INCOME

STATEMENT OF OWNER'S EQUITY

BEGINNING CAPITAL

+

INVESTMENTS

+

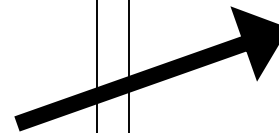
NET INCOME

–

WITHDRAWALS

=

ENDING CAPITAL



Output (cont.)

BALANCE SHEET

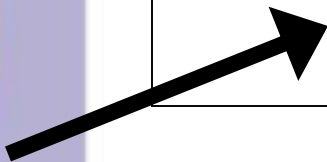
ASSETS

=

LIABILITES

+

**OWNER'S EQUITY
(Ending Capital)**



Chapter 2

Analyzing Transactions: The Accounting Equation

Learning Objectives

- LO1 Define the accounting elements.
- LO2 Construct the accounting equation.
- LO3 Analyze business transactions.
- LO4 Show the effects of business transactions on the accounting equation.
- LO5 Prepare and describe the purposes of a simple income statement, statement of owner's equity, and balance sheet.
- LO6 Define the three basic phases of the accounting process.

Teaching Tips

- The definitions for the accounting elements are very important. Often students find memorizing definitions to be boring. Be sure to spend sufficient class time to ensure a solid understanding of these definitions. Throughout the course, students should be expected to identify the accounting elements represented by the accounts used in transactions.
- Now would be a good time to point out to your students that, at the end of this chapter and all subsequent chapters, there is a fully worked-out demonstration problem, which will aid them in completing and understanding their assignments.

LO1

I. The Accounting Elements

A. A **business entity** is an individual, association, or organization that engages in economic activities and controls specific economic resources.

B. **Assets**

1. Items owned by the business entity and will provide future benefits.
2. Cash, merchandise, fixtures, machinery, buildings, and land are examples of assets.
3. **Accounts receivable**—money owed to the business by its customers “on account” or “on credit”

C. **Liabilities**

1. Amounts owed to another business entity.
2. **Accounts payable**—an unwritten promise to pay a supplier for assets.
3. **Notes payable**—a formal written promise to pay a supplier or lender.

D. **Owner's Equity**

1. The amount by which all business assets exceed the business liabilities.
2. Also called **net worth** and/or **capital**.
3. The owner may have business assets/liabilities and nonbusiness assets/liabilities. According to the **business entity concept**, nonbusiness

assets/liabilities must not be included in the business entity's accounting records.

In-Class Exercise: Complete Exercises E2-1A, E2-1B (5 minutes each)

LO2

II. The **Accounting Equation**

A. $\text{Assets} = \text{Liabilities} + \text{Owner's Equity}$

Teaching Tip

- The left side of the equation represents the assets. The right side of the equation shows where the money came from to buy the assets. When two elements are known, the third can always be calculated.

In-Class Exercise: Complete Exercises E2-2A, E2-2B (5 minutes each)

In-Class Exercise: Complete Problems P2-8A, P2-8B (5 minutes each)

LO3

III. Analyzing Business Transactions

A. A **business transaction** is an economic event; an event measured in dollars and has a direct impact on the business.

B. All transactions affect at least two **accounts**, which are separate records used to summarize changes in each asset, liability, and owner's equity of the business.

C. **Account titles** provide a description of each type of account.

D. Three basic questions must be answered for each transaction:

1. What happened?
2. Which accounts are affected?
 - a) Identify the accounts.
 - b) Classify the accounts.
3. How is the accounting equation affected?
 - a) Determine which accounts increased or decreased.
 - b) Ensure the accounting equation remains balanced.

LO4

Teaching Tip

- At the end of this Learning Objective (LO4), Figure 2-1 Summary of Transactions Illustrated can be used by students to see how the following transactions fit into the "big picture" on a step-by-step basis.

- IV. Summary of Transactions Illustrated (**See Figure 2-1**)
Effect of Transactions on the Accounting Equation
- A. Transaction (a): Investment by owner
1. An increase in an asset (Cash) is offset by an increase in owner's equity (Rohan Mactsen, Capital).

Teaching Tip

- Remember, Capital does not mean Cash. The cash is shown in the cash account.

- B. Transaction-(b): Purchase of an asset for cash
1. An increase in an asset (Delivery Equipment) is offset by a decrease in another asset (Cash).

Teaching Tip

- Students often think that both sides of the accounting equation must be affected by a transaction. Point out that this is not true.

- C. Transaction (c): Purchase of an asset on account
1. An increase in an asset (Delivery Equipment) is offset by an increase in a liability (Accounts Payable).

Teaching Tip

- Many students find Accounts Payable and Accounts Receivable and payments on those accounts confusing. It may be advisable to spend extra time explaining what "payment on account" means. One idea is to stress that whatever purchase or sale created the liability or receivable was in the past. The transaction has been completed. Accounts Receivable refers to a transaction between the business and its customers and Accounts Payable refers to a transaction between a vendor/creditor and the business.

- D. Transaction (d): Payment on a loan
1. A decrease in an asset (Cash) is offset by a decrease in a liability (Accounts Payable).

In-Class Exercise: Complete Exercises E2-3A, E2-3B (10 minutes each)

- V. Expanding the Accounting Equation: Revenue, Expenses, and Withdrawals
- A. **Revenues**
1. The amount charged to customers for goods and services.
 2. Separate revenue accounts may be used.
 3. Revenues increase both assets and owner's equity.

Teaching Tip

- Revenue is not Cash. Revenue is recorded when earned through the sale of a product or providing a service. If cash is received as a result, the cash

account is increased. If not, another asset, Accounts Receivable, is increased.

B. Expenses

1. Created as a result of business operating activities that involve selling a product or providing services.
2. Expenses either decrease assets or increase liabilities.
3. Expenses reduce owner's equity.

Teaching Tips

- Students often confuse expenses and liabilities. Reinforce the definitions. An expense is the outflow of resources (decrease in assets or increase in liabilities) as a result of efforts made to produce revenues. The main purposes of recognizing an expense are to keep track of the amount and types of expenses incurred and to show the reduction in owner's equity. Note that an expense can cause a reduction in assets or an increase in liabilities. Wages earned by employees is a good example. If paid, the expense reduces an asset, Cash. If not paid, it increases a liability, Wages Payable.
- Students often think that the expense account should be decreased when expenses are incurred. Stress that each time an expense is incurred, it is recorded and added to the previous amount so that total expenses can be determined.

4. **Net income or net loss**

- a) If revenues are greater than expenses, the business has a net income.
- b) If revenues are less than expenses, the business has a net loss.

5. **Fiscal year**

- a) The concept that income determination can be made on a periodic basis is the **accounting period concept**.
- b) Any accounting period for 12 consecutive months for which business records are kept; generally coinciding with a calendar year.

C. Withdrawals or Drawing

1. Amounts taken from the business by the owner for personal use.
2. Withdrawals reduce assets.
3. Withdrawals reduce owner's equity.

VI. Effect of Revenue, Expense, and Withdrawal Transactions on the Accounting Equation

A. Transaction (e): Delivery revenues earned in cash

1. An increase in an asset (Cash) is offset by an increase in owner's equity resulting from an increase in the revenue account (Delivery Fees).

B. Transaction (f): Paid rent for month

1. A decrease in an asset (Cash) is offset by a decrease in owner's equity resulting from an increase in an expense account (Rent Expense).

Teaching Tip

- Students often think that expenses and drawing should have minus signs. Point out that as these items increase, owner's equity decreases.
- C. Transaction (g): Paid phone bill
1. A decrease in an asset (Cash) is offset by a decrease in owner's equity resulting from an increase in an expense account (Phone Expense).
- D. Transaction (h): Delivery revenues earned on account
1. An increase in an asset (Accounts Receivable) is offset by an increase in owner's equity resulting from an increase in the revenue account (Delivery Fees).
- E. Transaction (i): Purchase of supplies
1. An increase in an asset (Supplies) is offset by a decrease in an asset (Cash).
- F. Transaction (j): Payment of insurance premium
1. An increase in an asset (Prepaid Insurance) is offset by a decrease in an asset (Cash).

Teaching Tip

- If you think that the students are ready, you might mention that supplies and insurance used (expired) during this accounting period will be recognized as expenses. These "adjustments" will be discussed later.
- G. Transaction (k): Cash receipts from prior sales on account
1. An increase in an asset (Cash) is offset by a decrease in an asset (Accounts Receivable).
 2. The accounting equation is unchanged, an asset, cash, increases and another, accounts receivable, decreases in an equal amount.
- H. Transaction (l): Purchase of an asset on account making a partial payment
1. An increase in an asset (Equipment) is offset by a decrease in an asset (Cash) and an increase in a liability (Accounts Payable).
- I. Transaction (m): Payment of wages
1. A decrease in an asset (Cash) is offset by a decrease in owner's equity resulting from an increase in an expense account (Wages Expense).
- J. Transaction (n): Deliveries made for cash and on account
1. An increase in two assets (Cash and Accounts Receivable) is offset by an increase in owner's equity from an increase in a revenue account (Delivery Fees).
- K. Transaction (o): Withdrawal of cash from business
1. A decrease in an asset (Cash) is offset by a decrease in owner's equity (Rohan Macsen, Drawing) resulting from a withdrawal by the owner.

Teaching Tip

- Point out that the owner does not receive a salary from the business. Cash or other assets are withdrawn to meet living expenses. The amount withdrawn depends on the personal needs of the owner. This amount may be more or less than net income in any given year.

In-Class Exercise: Complete Exercises E2-4A, E2-4B (20 minutes each)

In-Class Exercise: Complete Problems P2-9A, P2-9B (5 minutes each)

LO5

VII. Financial Statements

Teaching Tip

- It may be helpful to tell students that the headings to the financial statements answer three questions: Who? What? When?

A. The **Income Statement** (See Figure 2-2)

1. Sometimes called the **profit and loss statement** or **operating statement**.
2. Reports the profitability of a business for a specific time period.
3. Revenue – Expenses = Net Income or Net Loss.

In-Class Exercise: Complete Problems P2-10A, P2-10B (10 minutes each)

B. The **Statement of Owner's Equity** (See Figure 2-2)

1. Reports the activities in the owner's equity for a specific time period.
2. Investments and Net Income increase capital.
3. Withdrawals and Net Losses decrease capital. (See Figure 2-3)

In-Class Exercise: Complete Exercises E2-6A, E2-6B (10 minutes each)

In-Class Exercise: Complete Exercises E2-7A, E2-7B (10 minutes each)

In-Class Exercise: Complete Problems P2-11A, P2-11B (15 minutes each)

C. The **Balance Sheet** (See Figure 2-2)

1. Reports the assets, liabilities, and owner's equity on a specific date.
2. Sometimes called a **statement of financial position** or **statement of financial condition**.
3. Assets = Liabilities + Owner's Equity

In-Class Exercise: Complete Problems P2-12A, P2-12B (10 minutes each)

D. Guidelines for Preparing Financial Statements

1. Standard formats should be used.
2. Headings should be used on all statements.
3. Single underlines should be used to add or subtract numbers above the line; double underlines indicate a total.

4. Dollar signs are used at the top of columns and beneath single (subtotal) underlines.
5. Expenses may be listed from highest to lowest dollar amount.
6. Assets are listed from most liquid to least liquid.
7. Liabilities are listed from most current to the least current.

In-Class Exercise: Complete Exercises E2-5A, E2-5B (10 minutes each)

LO6

VIII. Overview of the Accounting Process (See Figure 2-4)

- A. **Input.** Business transactions provide the necessary information for input.
- B. **Processing.** Recognizing the effect of transactions on the assets, liabilities, owner's equity, revenues, and expenses of a business.
- C. **Output.** Recording the processed information on financial statements.

Learning Activities

1. Ask students to talk with the manager of a small business to identify the types of expenses in the business.
2. Students should be able to identify the difference between the six different types of accounts. Classifying accounts correctly in these early chapters is a must. The instructor should ask the students to give numerous examples of the types of accounts. Find out if the students know the difference between an asset and an expense. Ask the students to explain the difference between Accounts Payable and Accounts Receivable. Have them explain the effect of a "payment on account" by the business and by a customer.

Critical Thinking Activity

Mark Hahn invested \$26,000 in cash to open a law office on April 28 of the current year. On April 29, he purchased office equipment for \$10,800. He paid cash for all but \$1,550 of the office equipment. On April 30, Mark paid \$1,200 for six months' insurance for his law practice. Mark wants to know the financial condition of his business as of April 30.

Solution

Mark Hahn, Attorney at Law
Balance Sheet
April 30, 20--

Assets		Liabilities	
Cash	\$15,550	Accounts Payable	\$ 1,550
Prepaid Insurance	1,200	Owner's Equity	
Office Equipment	<u>10,800</u>	Mark Hahn, Capital	<u>\$26,000</u>
Total Assets	<u>\$27,550</u>	Total Liabilities and Owner's Equity	<u>\$27,550</u>

Homework Suggestions

- LO1 Study Guide Review Questions 2, 3, 4, 5, 7; End of Chapter Review Question 1, 2
 - LO2 Study Guide Review Questions 1, 6, 8, 9, 10; Study Guide Exercises 1, 4, 5; Study Guide Problem 12
 - LO3 End of Chapter Review Question 3
 - LO4 Study Guide Review Questions 11, 12, 13, 14, 15; Study Guide Exercises 2, 6, 7, 8; Study Guide Problem 13; End of Chapter Review Question 2
 - LO5 Study Guide Review Questions 16, 17, 18, 19; Study Guide Exercises 3, 9, 10, 11; Study Guide Problems 14, 15, 16, 17; End of Chapter Review Questions 4, 5, 6
 - LO6 End of Chapter Review Question 7
- Entire Chapter:
Managing Your Writing, Mastery Problem, and Challenge Problem

Ten Questions Your Students Will Always Ask

1. Can people be an asset?
2. Can an asset be something you cannot touch or see?
3. Is a lease you are obligated to pay a liability?
4. Do you always use two or more accounts in a journal entry?
5. Is capital the same as cash?
6. Shouldn't liabilities be subtracted?
7. How do we keep track of different receipts of cash from different people who owe us?
8. Whom do we ask if we don't understand what a particular transaction means?
9. Do all businesses use these formal statements?
10. Isn't this an unwieldy approach to keeping track of transactions?

CHAPTER 2

ANALYZING TRANSACTIONS: THE ACCOUNTING EQUATION

REVIEW QUESTIONS

1. It is necessary to distinguish between business assets and liabilities and nonbusiness assets and liabilities of a single proprietor because, according to the business entity concept, nonbusiness assets and liabilities are not included in the business entity's accounting records. These distinctions allow the owner to make decisions based on the financial condition and results of the business apart from nonbusiness activities.
2. The six major elements of the accounting equation are listed below.
 - a. Assets are items owned by a business that will provide future benefits.
 - b. Liabilities are items owed to another business.
 - c. Owner's equity is the amount by which the business assets exceed the business liabilities. Other terms used for owner's equity include net worth and capital.
 - d. Revenues represent the amount a business charges customers for products sold or services performed.
 - e. Expenses represent the decrease in assets (or increase in liabilities) as a result of efforts made to produce revenues.
 - f. Withdrawals, or drawing, reduce owner's equity as a result of the owner taking cash or other assets out of the business for personal use.
3. The three basic questions that must be answered when analyzing the effects of a business transaction on the accounting equation are as follows:
 - a. What happened?
 - b. Which accounts are affected?
 - c. How is the accounting equation affected?
4. The function of an income statement is to report the profitability of business operations for a specific period of time.
5. The function of a statement of owner's equity is to report the investments and withdrawals by the owner and the profits and losses generated through operating activities for a specific period of time.
6. The function of a balance sheet is to report the assets, liabilities, and owner's equity on a specific date. It is called a balance sheet because it confirms that the accounting equation is in balance.
7. The three basic phases of the accounting process are listed below.

Input—Business transactions are used as input to the accounting process.

Processing—The transactions are processed by recognizing their effects on assets, liabilities, owner's equity, revenues, and expenses.

Output—Output from the accounting process is provided in the form of financial statements.

Exercise 2-1A

<u>Item</u>	<u>Account</u>	<u>Classification</u>
Money in bank	Cash	<u>A</u>
Office supplies	Supplies	<u>A</u>
Money owed	Accounts Payable	<u>L</u>
Office chairs	Office Furniture	<u>A</u>
Net worth of owner	John Smith, Capital	<u>OE</u>
Money withdrawn by owner	John Smith, Drawing	<u>OE</u>
Money owed by customers	Accounts Receivable	<u>A</u>

Exercise 2-2A

<u>Assets</u>	=	<u>Liabilities</u>	+	<u>Owner's Equity</u>
<u>\$44,000</u>	=	\$27,000	+	\$17,000
\$32,000	=	\$18,000	+	<u>\$14,000</u>
\$27,000	=	<u>\$ 7,000</u>	+	\$20,000

Exercise 2-3A

	<u>Assets</u>	=	<u>Liabilities</u>	+	<u>Owner's Equity</u>
(a)	<u>27,000</u>				<u>27,000</u>
Bal.	<u>27,000</u>				<u>27,000</u>
(b)	<u>7,500</u>		<u>7,500</u>		
Bal.	<u>34,500</u>		<u>7,500</u>		<u>27,000</u>
(c)	<u>(1,600)</u>				
	<u>1,600</u>				
Bal.	<u>34,500</u>		<u>7,500</u>		<u>27,000</u>
(d)	<u>(2,300)</u>		<u>(2,300)</u>		
Bal.	<u>32,200</u>		<u>5,200</u>		<u>27,000</u>

Exercise 2-4A

	Owner's Equity						Description		
	Assets	=	Liabilities	+	Capital	- Drawing		+ Revenues	- Expenses
Bal. from E 2-3A (d)	32,200		5,200		27,000				
(e)	1,500						1,500		Service fees
(f)	(600)							(600)	Rent expense
(g)	(64)							(64)	Phone expense
(h)	(1,000)					(1,000)			
(i)	750						750		Service fees
(j)	(1,200)							(1,200)	Wages expense
(k)	400								
	(400)								
Bal.	<u>31,586</u>		<u>5,200</u>		<u>27,000</u>	<u>(1,000)</u>	<u>2,250</u>	<u>(1,864)</u>	
Total Assets			<u>\$31,586</u>		Total Liabilities		\$ 5,200		
					Capital		27,000		
					Drawing		(1,000)		
					Revenues		2,250		
					Expenses		(1,864)		
					Total Liabilities and Owner's Equity		<u>\$31,586</u>		

Exercise 2-5A

<u>Account</u>	<u>Classification</u>	<u>Financial Statement</u>
Cash	A	BS
Rent Expense	E	IS
Accounts Payable	L	BS
Service Fees	R	IS
Supplies	A	BS
Wages Expense	E	IS
Ramon Martinez, Drawing	OE	SOE
Ramon Martinez, Capital	OE	SOE, BS
Prepaid Insurance	A	BS
Accounts Receivable	A	BS

Exercise 2-6A

Betsy Ray's Accounting Service
Statement of Owner's Equity
For Month Ended June 30, 20--

Betsy Ray, capital, June 1, 20--		\$ —
Investment during June		20,000
Total investment		\$20,000
Net income for June	\$10,000	
Less withdrawals for June	8,000	
Increase in capital		2,000
Betsy Ray, capital, June 30, 20--		\$22,000

Exercise 2-7A

Betsy Ray's Accounting Service
Statement of Owner's Equity
For Month Ended June 30, 20--

Betsy Ray, capital, June 1, 20--		\$ —
Investment during June		20,000
Total investment		\$20,000
Less: Net loss for June	\$3,000	
Withdrawals for June	8,000	
Decrease in capital		(11,000)
Betsy Ray, capital, June 30, 20--		\$ 9,000

Problem 2-8A

	<u>Assets</u>	=	<u>Liabilities</u>	+	<u>Owner's Equity</u>
1.	\$26,960		\$ 7,550		\$19,410
2.	\$35,500		\$10,910		\$24,590
3.	\$32,040		\$12,910		\$19,130

Problem 2-9A: See page 10

Problem 2-10A

Jay Pembroke
Income Statement
For Month Ended April 30, 20--

Revenues:		
Service fees		\$3,300
Expenses:		
Rent expense		750
Net income		\$2,550

Problem 2-9A

	Assets				=	Liabilities	+	Owner's Equity				Description	
	(Items Owned)							(Amts. Owed)	(Owner's Investment)		(Earnings)		
	Cash	Accounts Receivable	Office Supplies	Prepaid Insurance					Accounts Payable	J. Pembroke, Capital	J. Pembroke, Drawing		Revenues
(a)	<u>18,000</u>						<u>18,000</u>						
(b)	<u>(2,000)</u>		<u>4,600</u>			<u>2,600</u>							
(c)	<u>(1,200)</u>			<u>1,200</u>									
(d)	<u>1,300</u>	<u>2,000</u>							<u>3,300</u>			Service fees	
(e)	<u>(2,300)</u>					<u>(2,300)</u>							
(f)	<u>(750)</u>									<u>750</u>		Rent expense	
(g)	<u>(100)</u>							<u>100</u>					
Bal.	<u>12,950</u>	<u>2,000</u>	<u>4,600</u>	<u>1,200</u>		<u>300</u>	<u>18,000</u>	<u>100</u>	<u>3,300</u>	<u>750</u>			

Cash	\$12,950	Accounts Payable	\$ 300
Accounts Receivable	2,000	Jay Pembroke, Capital	18,000
Office Supplies	4,600	Jay Pembroke, Drawing	(100)
Prepaid Insurance	<u>1,200</u>	Service Fees	3,300
Total Assets	<u>\$20,750</u>	Rent Expense	<u>(750)</u>
		Total Liabilities and Owner's Equity	<u>\$20,750</u>

Problem 2-11A

Jay Pembroke
Statement of Owner's Equity
For Month Ended April 30, 20--

Jay Pembroke, capital, April 1, 20--		\$ —
Investment during April		18,000
Total investment		\$18,000
Net income for April	\$2,550	
Less withdrawals for April	100	
Increase in capital		2,450
Jay Pembroke, capital, April 30, 20--		\$20,450

Problem 2-12A

Jay Pembroke
Balance Sheet
April 30, 20--

Assets		Liabilities	
Cash	\$12,950	Accounts payable	\$ 300
Accounts receivable	2,000		
Office supplies	4,600	Owner's Equity	
Prepaid insurance	1,200	Jay Pembroke, capital	20,450
Total assets	\$20,750	Total liab. & owner's equity	\$20,750

Exercise 2-1B

<u>Account</u>	<u>Classification</u>
Cash	<u>A</u>
Accounts Payable	<u>L</u>
Supplies	<u>A</u>
Bill Jones, Drawing	<u>OE</u>
Prepaid Insurance	<u>A</u>
Accounts Receivable	<u>A</u>
Bill Jones, Capital	<u>OE</u>

Exercise 2-2B

<u>Assets</u>	=	<u>Liabilities</u>	+	<u>Owner's Equity</u>
<u>\$25,000</u>	=	\$20,000	+	\$ 5,000
\$30,000	=	\$15,000	+	<u>\$15,000</u>
\$20,000	=	<u>\$10,000</u>	+	\$10,000

Exercise 2-3B

	<u>Assets</u>	=	<u>Liabilities</u>	+	<u>Owner's Equity</u>
(a)	<u>30,000</u>				<u>30,000</u>
Bal.	<u>30,000</u>				<u>30,000</u>
(b)	<u>4,500</u>		<u>4,500</u>		
Bal.	<u>34,500</u>		<u>4,500</u>		<u>30,000</u>
(c)	<u>1,600</u>				
	<u>(1,600)</u>				
Bal.	<u>34,500</u>		<u>4,500</u>		<u>30,000</u>
(d)	<u>(2,000)</u>		<u>(2,000)</u>		
Bal.	<u>32,500</u>		<u>2,500</u>		<u>30,000</u>

Exercise 2-4B

	Assets	=	Liabilities	+	Owner's Equity			Description
					Capital	- Drawing	+ Revenues	
Bal. from E 2-3B (d)	32,500		2,500		30,000			
(e)	3,000					3,000		Service fees
(f)	(1,000)						1,000	Rent expense
(g)	(68)						68	Phone expense
(h)	(800)				800			
(i)	900					900		Service fees
(j)	(500)						500	Wages expense
(k)	500							
	(500)							
Bal.	<u>34,032</u>		<u>2,500</u>		<u>30,000</u>	<u>800</u>	<u>3,900</u>	<u>1,568</u>
Total Assets			<u>\$34,032</u>		Total Liabilities		\$ 2,500	
					Capital		30,000	
					Drawing		(800)	
					Revenues		3,900	
					Expenses		(1,568)	
					Total Liabilities and Owner's Equity		<u>\$34,032</u>	

Exercise 2-5B

<u>Account</u>	<u>Classification</u>	<u>Financial Statement</u>
Cash	<u>A</u>	<u>BS</u>
Rent Expense	<u>E</u>	<u>IS</u>
Accounts Payable	<u>L</u>	<u>BS</u>
Service Fees	<u>R</u>	<u>IS</u>
Supplies	<u>A</u>	<u>BS</u>
Wages Expense	<u>E</u>	<u>IS</u>
Amanda Wong, Drawing	<u>OE</u>	<u>SOE</u>
Amanda Wong, Capital	<u>OE</u>	<u>SOE, BS</u>
Prepaid Insurance	<u>A</u>	<u>BS</u>
Accounts Receivable	<u>A</u>	<u>BS</u>

Exercise 2-6B

Lopez Financial Consulting

Statement of Owner's Equity

For Month Ended June 30, 20--

<i>Efran Lopez, capital, June 1, 20--</i>		<i>\$ —</i>
<i>Investment during June</i>		<i>15,000</i>
<i>Total investment</i>		<i>\$15,000</i>
<i>Net income for June</i>	<i>\$6,000</i>	
<i>Less withdrawals for June</i>	<i>7,000</i>	
<i>Decrease in capital</i>		<i>(1,000)</i>
<i>Efran Lopez, capital, June 30, 20--</i>		<i>\$14,000</i>

Exercise 2-7B

Lopez Financial Consulting
Statement of Owner's Equity
 For Month Ended June 30, 20--

<i>Efran Lopez, capital, June 1, 20--</i>		\$ —
<i>Investment during June</i>		15,000
<i>Total investment</i>		\$15,000
<i>Less: Net loss for June</i>	\$2,000	
<i>Withdrawals for June</i>	7,000	
<i>Decrease in capital</i>		(9,000)
<i>Efran Lopez, capital, June 30, 20--</i>		\$ 6,000

Problem 2-8B

	<u>Assets</u>	=	<u>Liabilities</u>	+	<u>Owner's Equity</u>
1.	\$22,860		\$ 4,605		\$18,255
2.	\$27,425		\$ 8,515		\$18,910
3.	\$25,235		\$10,165		\$15,070

Problem 2-9B: See page 16

Problem 2-10B

David Segal
Income Statement
 For Month Ended October 31, 20--

<i>Revenues:</i>		
<i>Service fees</i>		\$2,700
<i>Expenses:</i>		
<i>Rent expense</i>		650
<i>Net income</i>		\$2,050

Problem 2-9B

Assets				=	Liabilities	+	Owner's Equity				
(Items Owned)					(Amts. Owed)		(Owner's Investment)		(Earnings)		
Cash	+ Accounts Receivable	+ Office Supplies	+ Prepaid Insurance	=	Accounts Payable	+	D. Segal, Capital	- D. Segal, Drawing	+ Revenues	- Expenses	Description
(a) 15,000							15,000				
(b) (1,800)		3,800			2,000						
(c) (1,000)			1,000								
(d) 1,700	1,000								2,700		Service fees
(e) (1,800)					(1,800)						
(f) (650)										650	Rent expense
(g) (150)							150				
Bal. 11,300	1,000	3,800	1,000		200		15,000	150	2,700	650	

Cash \$11,300
Accounts Receivable 1,000
Office Supplies 3,800
Prepaid Insurance 1,000
Total Assets \$17,100

Accounts Payable \$ 200
David Segal, Capital 15,000
David Segal, Drawing (150)
Service Fees 2,700
Rent Expense (650)
Total Liabilities and Owner's Equity \$17,100

Problem 2-11B

David Segal

Statement of Owner's Equity

For Month Ended October 31, 20--

<i>David Segal, capital, October 1, 20--</i>		\$ —
<i>Investment during October</i>		15,000
<i>Total investment</i>		\$15,000
<i>Net income for October</i>	\$2,050	
<i>Less withdrawals for October</i>	150	
<i>Increase in capital</i>		1,900
<i>David Segal, capital, October 31, 20--</i>		\$16,900

Problem 2-12B

David Segal

Balance Sheet

October 31, 20--

<i>Assets</i>		<i>Liabilities</i>	
<i>Cash</i>	\$11,300	<i>Accounts payable</i>	\$ 200
<i>Accounts receivable</i>	1,000		
<i>Office supplies</i>	3,800	<i>Owner's Equity</i>	
<i>Prepaid insurance</i>	1,000	<i>David Segal, capital</i>	16,900
<i>Total assets</i>	\$17,100	<i>Total liab. & owner's equity</i>	\$17,100

MANAGING YOUR WRITING

The students should focus on the following differences:

1. An expense is an outflow of assets or increase in liabilities as a result of the efforts made to earn revenues. A withdrawal is an outflow of assets for the owner's personal use. The withdrawal is not related to the earning process.
2. A withdrawal that increases a liability would be unusual. Expenses often increase liabilities.

The student should focus on the following similarity:

1. Expenses and withdrawals reduce owner's equity.

Mastery Problem

1.

	Assets						=	Liabilities	+	Owner's Equity				Description
	(Items Owned)							(Amts. Owed)		(Owner's Investment)	(Earnings)			
	Cash	+ Accts. Rec.	+ Sup-plies	+ Prepaid Ins.	+ Tools	+ Van	= Accts. Payable	+ L. Vozniak, Capital	- L. Vozniak, Drawing	+ Rev.	- Exp.			
(a)	8,000							8,000						
(b)	(150)										150	Rent expense		
(c)	(5,000)					5,000								
(d)					600		600							
(e)	(200)		300				100							
(f)	(100)										100	Wages expense		
(g)	(75)										75	Adver. expense		
(h)	(480)			480										
(i)	800									800		Cleaning fees		
(j)		500								500		Cleaning fees		
(k)	(40)										40	Phone expense		
(l)	200	(200)												
(m)	(150)										150	Wages expense		
(n)	(200)						(200)							
(o)	600	200								800		Cleaning fees		
(p)	(100)								100					
2. Bal.	3,105	500	300	480	600	5,000	500	8,000	100	2,100	515			

Mastery Problem (Continued)

3.

We Do Windows
Income Statement
For Month Ended July 31, 20--

Revenues:		
<i>Cleaning fees</i>		\$2,100
Expenses:		
<i>Wages expense</i>	\$250	
<i>Rent expense</i>	150	
<i>Advertising expense</i>	75	
<i>Phone expense</i>	40	
Total expenses		515
Net income		\$1,585

4.

We Do Windows
Statement of Owner's Equity
For Month Ended July 31, 20--

<i>Lisa Vozniak, capital, July 1, 20--</i>		\$ —
<i>Investment in July</i>		8,000
Total investment		\$8,000
<i>Net income for July</i>	\$1,585	
<i>Less withdrawals for July</i>	100	
Increase in capital		1,485
<i>Lisa Vozniak, capital, July 31, 20--</i>		\$9,485

Mastery Problem (Concluded)

5.

We Do Windows

Balance Sheet

July 31, 20--

<i>Assets</i>		<i>Liabilities</i>	
<i>Cash</i>	<i>\$3,105</i>	<i>Accounts payable</i>	<i>\$ 500</i>
<i>Accounts receivable</i>	<i>500</i>		
<i>Supplies</i>	<i>300</i>		
<i>Prepaid insurance</i>	<i>480</i>		
<i>Tools</i>	<i>600</i>	<i>Owner's Equity</i>	
<i>Van</i>	<i>5,000</i>	<i>Lisa Vozniak, capital</i>	<i>9,485</i>
<i>Total assets</i>	<i>\$9,985</i>	<i>Total liab. & owner's equity</i>	<i>\$9,985</i>

Challenge Problem

Cash from customers		\$3,700
Cash paid for wages	\$450	
Cash paid for rent	300	
Cash paid for utilities	50	
Cash paid for insurance	600	
Cash paid for supplies	100	
Cash paid for phone	35	
Total cash paid for operating items		1,535
Difference between cash received from customers and cash paid for goods and services		\$2,165

Yes, there is a difference of \$2,000. Net income does a better job of measuring profits because it offers a better matching of revenues and expenses. However, cash flows are important. If you don't have enough cash to pay your bills, you will go out of business.

Comprehensive Problem 1: The Accounting Cycle

1.

GENERAL JOURNAL

DATE	DESCRIPTION	POST. REF.	DEBIT				CREDIT				
1 20-- Apr. 1	Cash	101	90	00	00	00					1
2	<i>Bob Night, Capital</i>	311					90	00	00	00	2
3	<i>Owner's original investment</i>										3
4											4
5	1 Prepaid Insurance	145	9	00	00	00					5
6	Cash	101					9	00	00	00	6
7	<i>Paid insurance premium for camping</i>										7
8	<i>season</i>										8
9											9
10	2 Rent Expense	521	40	00	00	00					10
11	Cash	101					40	00	00	00	11
12	<i>Paid rent for April</i>										12
13											13
14	2 Cash	101	35	00	00	00					14
15	Registration Fees	401					35	00	00	00	15
16	<i>Collected registration fees</i>										16
17											17
18	2 Fishing Boats	181	60	00	00	00					18
19	Accounts Payable	202					60	00	00	00	19
20	<i>Purchased fishing boats on account</i>										20
21											21
22	3 Food Supplies	144	7	00	00	00					22
23	Accounts Payable	202					7	00	00	00	23
24	<i>Purchased food supplies on account</i>										24
25	<i>from Acme Super Market</i>										25
26											26
27	5 Office Supplies	142	5	00	00	00					27
28	Accounts Payable	202					5	00	00	00	28
29	<i>Purchased office supplies on account</i>										29
30	<i>from Gordon Office Supplies</i>										30
31											31
32											32
33											33
34											34

Comprehensive Problem 1 (Continued)

GENERAL JOURNAL

DATE		DESCRIPTION	POST. REF.	DEBIT					CREDIT						
1	²⁰⁻⁻ Apr. 7	Cash	101	38	6	0	0	00							1
2		Registration Fees	401						38	6	0	0	00		2
3		<i>Collected registration fees</i>													3
4															4
5	10	Food Supplies	144	8	2	0	0	00							5
6		Accounts Payable	202						8	2	0	0	00		6
7		<i>Purchased food supplies on account from Acme Super Market</i>													7
8															8
9															9
10	10	Wages Expense	511	10	0	0	0	00							10
11		Cash	101						10	0	0	0	00		11
12		<i>Paid wages to guides</i>													12
13															13
14	14	Cash	101	30	5	0	0	00							14
15		Registration Fees	401						30	5	0	0	00		15
16		<i>Collected registration fees</i>													16
17															17
18	16	Food Supplies	144	9	0	0	0	00							18
19		Accounts Payable	202						9	0	0	0	00		19
20		<i>Purchased food supplies on account from Acme Super Market</i>													20
21															21
22															22
23	17	Wages Expense	511	10	0	0	0	00							23
24		Cash	101						10	0	0	0	00		24
25		<i>Paid wages to guides</i>													25
26															26
27	18	Postage Expense	536	1	5	0	00								27
28		Cash	101						1	5	0	00			28
29		<i>Paid postage</i>													29
30															30
31															31
32															32
33															33
34															34
35															35

Comprehensive Problem 1 (Continued)

GENERAL JOURNAL

DATE		DESCRIPTION	POST. REF.	DEBIT					CREDIT						
1	20-- Apr. 21	Cash	101	35	6	0	0	00							1
2		Registration Fees	401						35	6	0	0	00		2
3		Collected registration fees													3
4															4
5	24	Food Supplies	144	8	5	0	0	00							5
6		Accounts Payable	202						8	5	0	0	00		6
7		Purchased food supplies on account													7
8		from Acme Super Market													8
9															9
10	24	Wages Expense	511	10	0	0	0	00							10
11		Cash	101						10	0	0	0	00		11
12		Paid wages to guides													12
13															13
14	28	Cash	101	32	0	0	0	00							14
15		Registration Fees	401						32	0	0	0	00		15
16		Collected registration fees													16
17															17
18	29	Wages Expense	511	10	0	0	0	00							18
19		Cash	101						10	0	0	0	00		19
20		Paid wages to guides													20
21															21
22	30	Food Supplies	144	6	0	0	0	00							22
23		Accounts Payable	202						6	0	0	0	00		23
24		Purchased food supplies on account													24
25		from Acme Super Market													25
26															26
27	30	Accounts Payable	202	32	7	0	0	00							27
28		Cash	101						32	7	0	0	00		28
29		Made payment on account to													29
30		Acme Super Market													30
31															31
32															32
33															33
34															34
35															35

Comprehensive Problem 1 (Continued)

GENERAL JOURNAL

DATE		DESCRIPTION	POST. REF.	DEBIT				CREDIT				
1	20-Apr. 30	Utilities Expense	533	2	0	0	0					1
2		Cash	101					2	0	0	0	2
3		Paid utility bill										3
4												4
5	30	Phone Expense	525	1	2	0	0					5
6		Cash	101					1	2	0	0	6
7		Paid phone bill										7
8												8
9	30	Bob Night, Drawing	312	6	0	0	0					9
10		Cash	101					6	0	0	0	10
11		Owner's withdrawal										11

2., 6., and 11.

GENERAL LEDGER

ACCOUNT Cash ACCOUNT NO. 101

DATE	ITEM	POST. REF.	DEBIT	CREDIT	BALANCE			
					DEBIT		CREDIT	
20-Apr. 1		J1	90 0 0 0 00		90 0 0 0 00			
1		J1		9 0 0 0 00	81 0 0 0 00			
2		J1		40 0 0 0 00	41 0 0 0 00			
2		J1	35 0 0 0 00		76 0 0 0 00			
7		J2	38 6 0 0 00		114 6 0 0 00			
10		J2		10 0 0 0 00	104 6 0 0 00			
14		J2	30 5 0 0 00		135 1 0 0 00			
17		J2		10 0 0 0 00	125 1 0 0 00			
18		J2		1 5 0 0 00	124 9 5 0 00			
21		J3	35 6 0 0 00		160 5 5 0 00			
24		J3		10 0 0 0 00	150 5 5 0 00			
28		J3	32 0 0 0 00		182 5 5 0 00			
29		J3		10 0 0 0 00	172 5 5 0 00			
30		J3		32 7 0 0 00	139 8 5 0 00			
30		J4		2 0 0 0 00	137 8 5 0 00			
30		J4		1 2 0 0 00	136 6 5 0 00			
30		J4		6 0 0 0 00	130 6 5 0 00			

Comprehensive Problem 1 (Continued)

ACCOUNT Office Supplies

ACCOUNT NO. 142

DATE	ITEM	POST. REF.	DEBIT	CREDIT	BALANCE	
					DEBIT	CREDIT
20-- Apr. 5		J1	5 0 0 0 00			5 0 0 0 00
30	Adjusting	J5		4 0 0 0 00		1 0 0 0 00

ACCOUNT Food Supplies

ACCOUNT NO. 144

DATE	ITEM	POST. REF.	DEBIT	CREDIT	BALANCE	
					DEBIT	CREDIT
20-- Apr. 3		J1	7 0 0 0 0 00			7 0 0 0 0 00
10		J2	8 2 0 0 0 00			15 2 0 0 0 00
16		J2	9 0 0 0 0 00			24 2 0 0 0 00
24		J3	8 5 0 0 0 00			32 7 0 0 0 00
30		J3	6 0 0 0 0 00			38 7 0 0 0 00
30	Adjusting	J5		30 7 0 0 0 00		8 0 0 0 0 00

ACCOUNT Prepaid Insurance

ACCOUNT NO. 145

DATE	ITEM	POST. REF.	DEBIT	CREDIT	BALANCE	
					DEBIT	CREDIT
20-- Apr. 1		J1	9 0 0 0 0 00			9 0 0 0 0 00
30	Adjusting	J5		1 5 0 0 0 00		7 5 0 0 0 00

ACCOUNT Fishing Boats

ACCOUNT NO. 181

DATE	ITEM	POST. REF.	DEBIT	CREDIT	BALANCE	
					DEBIT	CREDIT
20-- Apr. 2		J1	60 0 0 0 0 00			60 0 0 0 0 00

Comprehensive Problem 1 (Continued)

ACCOUNT Accumulated Depreciation—Fishing Boats

ACCOUNT NO. 181.1

DATE	ITEM	POST. REF.	DEBIT	CREDIT	BALANCE	
					DEBIT	CREDIT
20-- Apr. 30	Adjusting	J5		1 0 0 0 00		1 0 0 0 00

ACCOUNT Accounts Payable

ACCOUNT NO. 202

DATE	ITEM	POST. REF.	DEBIT	CREDIT	BALANCE	
					DEBIT	CREDIT
20-- Apr. 2		J1		60 0 0 0 00		60 0 0 0 00
	3	J1		7 0 0 0 00		67 0 0 0 00
	5	J1		5 0 0 0 00		67 5 0 0 00
	10	J2		8 2 0 0 00		75 7 0 0 00
	16	J2		9 0 0 0 00		84 7 0 0 00
	24	J3		8 5 0 0 00		93 2 0 0 00
	30	J3		6 0 0 0 00		99 2 0 0 00
	30	J3	32 7 0 0 00			66 5 0 0 00

ACCOUNT Wages Payable

ACCOUNT NO. 219

DATE	ITEM	POST. REF.	DEBIT	CREDIT	BALANCE	
					DEBIT	CREDIT
20-- Apr. 30	Adjusting	J5		5 0 0 0 00		5 0 0 0 00

ACCOUNT Bob Night, Capital

ACCOUNT NO. 311

DATE	ITEM	POST. REF.	DEBIT	CREDIT	BALANCE	
					DEBIT	CREDIT
20-- Apr. 1		J1		90 0 0 0 00		90 0 0 0 00
	30 Closing	J6		54 2 5 0 00		144 2 5 0 00
	30 Closing	J6	6 0 0 0 00			138 2 5 0 00

Comprehensive Problem 1 (Continued)

ACCOUNT Bob Night, Drawing

ACCOUNT NO. 312

DATE	ITEM	POST. REF.	DEBIT	CREDIT	BALANCE	
					DEBIT	CREDIT
20-- Apr. 30		J4	6 0 0 0 00		6 0 0 0 00	
	30 Closing	J6		6 0 0 0 00		

ACCOUNT Income Summary

ACCOUNT NO. 313

DATE	ITEM	POST. REF.	DEBIT	CREDIT	BALANCE	
					DEBIT	CREDIT
20-- Apr. 30	Closing	J5		171 7 0 0 00		171 7 0 0 00
	30 Closing	J5	117 4 5 0 00			54 2 5 0 00
	30 Closing	J6	54 2 5 0 00			

ACCOUNT Registration Fees

ACCOUNT NO. 401

DATE	ITEM	POST. REF.	DEBIT	CREDIT	BALANCE	
					DEBIT	CREDIT
20-- Apr. 2		J1		35 0 0 0 00		35 0 0 0 00
	7	J2		38 6 0 0 00		73 6 0 0 00
	14	J2		30 5 0 0 00		104 1 0 0 00
	21	J3		35 6 0 0 00		139 7 0 0 00
	28	J3		32 0 0 0 00		171 7 0 0 00
	30 Closing	J5	171 7 0 0 00			

Comprehensive Problem 1 (Continued)

ACCOUNT Wages Expense

ACCOUNT NO. 511

DATE	ITEM	POST. REF.	DEBIT	CREDIT	BALANCE	
					DEBIT	CREDIT
20-- Apr. 10		J2	10 0 0 0 00			10 0 0 0 00
17		J2	10 0 0 0 00			20 0 0 0 00
24		J3	10 0 0 0 00			30 0 0 0 00
29		J3	10 0 0 0 00			40 0 0 0 00
30	Adjusting	J5	5 0 0 0 00			40 5 0 0 00
30	Closing	J5		40 5 0 0 00		

ACCOUNT Rent Expense

ACCOUNT NO. 521

DATE	ITEM	POST. REF.	DEBIT	CREDIT	BALANCE	
					DEBIT	CREDIT
20-- Apr. 2		J1	40 0 0 0 00			40 0 0 0 00
30	Closing	J5		40 0 0 0 00		

ACCOUNT Office Supplies Expense

ACCOUNT NO. 523

DATE	ITEM	POST. REF.	DEBIT	CREDIT	BALANCE	
					DEBIT	CREDIT
20-- Apr. 30	Adjusting	J5	4 0 0 0 00			4 0 0 0 00
30	Closing	J5		4 0 0 0 00		

ACCOUNT Food Supplies Expense

ACCOUNT NO. 524

DATE	ITEM	POST. REF.	DEBIT	CREDIT	BALANCE	
					DEBIT	CREDIT
20-- Apr. 30	Adjusting	J5	30 7 0 0 00			30 7 0 0 00
30	Closing	J5		30 7 0 0 00		

Comprehensive Problem 1 (Continued)

ACCOUNT Phone Expense

ACCOUNT NO. 525

DATE	ITEM	POST. REF.	DEBIT	CREDIT	BALANCE	
					DEBIT	CREDIT
20-- Apr. 30		J4	1 2 0 0 00		1 2 0 0 00	
	30 Closing	J5		1 2 0 0 00		

ACCOUNT Utilities Expense

ACCOUNT NO. 533

DATE	ITEM	POST. REF.	DEBIT	CREDIT	BALANCE	
					DEBIT	CREDIT
20-- Apr. 30		J4	2 0 0 0 00		2 0 0 0 00	
	30 Closing	J5		2 0 0 0 00		

ACCOUNT Insurance Expense

ACCOUNT NO. 535

DATE	ITEM	POST. REF.	DEBIT	CREDIT	BALANCE	
					DEBIT	CREDIT
20-- Apr. 30	Adjusting	J5	1 5 0 0 00		1 5 0 0 00	
	30 Closing	J5		1 5 0 0 00		

ACCOUNT Postage Expense

ACCOUNT NO. 536

DATE	ITEM	POST. REF.	DEBIT	CREDIT	BALANCE	
					DEBIT	CREDIT
20-- Apr. 18		J2	1 5 0 0 00		1 5 0 0 00	
	30 Closing	J5		1 5 0 0 00		

ACCOUNT Depreciation Expense—Fishing Boats

ACCOUNT NO. 542

DATE	ITEM	POST. REF.	DEBIT	CREDIT	BALANCE	
					DEBIT	CREDIT
20-- Apr. 30	Adjusting	J5	1 0 0 0 00		1 0 0 0 00	
	30 Closing	J5		1 0 0 0 00		

Comprehensive Problem 1 (Continued)
3. and 4.

The General's Favorite

Work

For the Month Ended

	ACCOUNT TITLE	TRIAL BALANCE				ADJUSTMENTS			
		DEBIT		CREDIT		DEBIT		CREDIT	
1	Cash	130	6 5 0 00						
2	Office Supplies		5 0 0 00					(a)	4 0 0 00
3	Food Supplies	38	7 0 0 00					(b)	30 7 0 0 00
4	Prepaid Insurance	9	0 0 0 00					(c)	1 5 0 0 00
5	Fishing Boats	60	0 0 0 00						
6	Accum. Depr.—Fishing Boats							(d)	1 0 0 0 00
7	Accounts Payable			66	5 0 0 00				
8	Wages Payable							(e)	5 0 0 0 00
9	Bob Night, Capital			90	0 0 0 00				
10	Bob Night, Drawing	6	0 0 0 00						
11	Registration Fees			171	7 0 0 00				
12	Wages Expense	40	0 0 0 00			(e)	5 0 0 00		
13	Rent Expense	40	0 0 0 00						
14	Office Supplies Expense					(a)	4 0 0 00		
15	Food Supplies Expense					(b)	30 7 0 0 00		
16	Phone Expense	1	2 0 0 00						
17	Utilities Expense	2	0 0 0 00						
18	Insurance Expense					(c)	1 5 0 0 00		
19	Postage Expense		1 5 0 00						
20	Depr. Exp.—Fishing Boats					(d)	1 0 0 0 00		
21		328	2 0 0 00	328	2 0 0 00	34	1 0 0 00	34	1 0 0 00
22	Net Income								
23									
24									
25									
26									
27									
28									
29									
30									
31									

Comprehensive Problem 1 (Continued)

Fishing Hole

Sheet

April 30, 20--

ADJUSTED TRIAL BALANCE					INCOME STATEMENT					BALANCE SHEET																				
DEBIT			CREDIT		DEBIT			CREDIT		DEBIT			CREDIT																	
130	6	5	0	00						130	6	5	0	00					1											
	1	0	0	00							1	0	0	00					2											
8	0	0	0	00						8	0	0	0	00					3											
7	5	0	0	00						7	5	0	0	00					4											
60	0	0	0	00						60	0	0	0	00					5											
															1	0	0	0	00	6										
															66	5	0	0	00	7										
															5	0	0	0	00	8										
															90	0	0	0	00	9										
6	0	0	0	00						6	0	0	0	00					10											
					171	7	0	0	00	171	7	0	0	00					11											
40	5	0	0	00						40	5	0	0	00					12											
40	0	0	0	00						40	0	0	0	00					13											
4	0	0	0	00						4	0	0	0	00					14											
30	7	0	0	00						30	7	0	0	00					15											
1	2	0	0	00						1	2	0	0	00					16											
2	0	0	0	00						2	0	0	0	00					17											
1	5	0	0	00						1	5	0	0	00					18											
1	5	0	0	00						1	5	0	0	00					19											
1	0	0	0	00						1	0	0	0	00					20											
329	7	0	0	00	329	7	0	0	00	117	4	5	0	00	171	7	0	0	00	212	2	5	0	00	158	0	0	0	00	21
										54	2	5	0	00						54	2	5	0	00	22					
										171	7	0	0	00	171	7	0	0	00	212	2	5	0	00	212	2	5	0	00	23
																									24					
																									25					
																									26					
																									27					
																									28					
																									29					
																									30					
																									31					

Comprehensive Problem 1 (Continued)

7.

*The General's Favorite Fishing Hole**Income Statement**For Month Ended April 30, 20--*

Revenues:		
Registration fees		\$171,700
Expenses:		
Wages expense	\$40,500	
Rent expense	40,000	
Office supplies expense	400	
Food supplies expense	30,700	
Phone expense	1,200	
Utilities expense	2,000	
Insurance expense	1,500	
Postage expense	150	
Depreciation expense—fishing boats	1,000	
Total expenses		117,450
Net income		\$ 54,250

8.

*The General's Favorite Fishing Hole**Statement of Owner's Equity**For Month Ended April 30, 20--*

Bob Night, capital, April 1, 20--		\$ —
Investments during April		90,000
Total investment		\$ 90,000
Net income for April	\$54,250	
Less withdrawals for April	6,000	
Increase in capital		48,250
Bob Night, capital, April 30, 20--		\$138,250

Comprehensive Problem 1 (Continued)

9.

The General's Favorite Fishing Hole

Balance Sheet

April 30, 20--

<i>Assets</i>		
Current assets:		
<i>Cash</i>	\$130,650	
<i>Office supplies</i>	100	
<i>Food supplies</i>	8,000	
<i>Prepaid insurance</i>	7,500	
Total current assets		\$146,250
Property, plant, and equipment:		
<i>Fishing boats</i>	\$ 60,000	
<i>Less accumulated depreciation</i>	1,000	59,000
Total assets		\$205,250
<i>Liabilities</i>		
Current liabilities:		
<i>Accounts payable</i>	\$ 66,500	
<i>Wages payable</i>	500	
Total current liabilities		\$ 67,000
<i>Owner's Equity</i>		
Bob Night, capital		138,250
Total liabilities and owner's equity		\$205,250

Comprehensive Problem 1 (Continued)
5. and 10.

GENERAL JOURNAL

DATE	DESCRIPTION	POST. REF.	DEBIT				CREDIT				
1	20-- Apr.		Adjusting Entries								1
2	30	Office Supplies Expense	523	4	0	0	00				2
3		Office Supplies	142					4	0	00	3
4											4
5	30	Food Supplies Expense	524	30	7	0	00				5
6		Food Supplies	144					30	7	00	6
7											7
8	30	Insurance Expense	535	1	5	0	00				8
9		Prepaid Insurance	145					1	5	00	9
10											10
11	30	Depreciation Expense—Fishing Boats	542	1	0	0	00				11
12		Accum. Depreciation—Fishing Boats	181.1					1	0	00	12
13											13
14	30	Wages Expense	511	5	0	0	00				14
15		Wages Payable	219					5	0	00	15
16											16
17		Closing Entries									17
18	30	Registration Fees	401	171	7	0	00				18
19		Income Summary	313					171	7	00	19
20											20
21	30	Income Summary	313	117	4	5	00				21
22		Wages Expense	511					40	5	00	22
23		Rent Expense	521					40	0	00	23
24		Office Supplies Expense	523					4	0	00	24
25		Food Supplies Expense	524					30	7	00	25
26		Phone Expense	525					1	2	00	26
27		Utilities Expense	533					2	0	00	27
28		Insurance Expense	535					1	5	00	28
29		Postage Expense	536					1	5	00	29
30		Depreciation Expense—Fishing Boats	542					1	0	00	30
31											31
32											32
33											33
34											34
35											35

Comprehensive Problem 1 (Concluded)

GENERAL JOURNAL

DATE		DESCRIPTION	POST. REF.	DEBIT					CREDIT				
1	20-- Apr. 30	Income Summary	313	54	25	00	00						1
2		Bob Night, Capital	311					54	25	00	00		2
3													3
4	30	Bob Night, Capital	311	6	00	00	00						4
5		Bob Night, Drawing	312					6	00	00	00		5
6													6
7													7
8													8
9													9

12.

The General's Favorite Fishing Hole

Post-Closing Trial Balance

April 30, 20--

ACCOUNT	ACCT. NO.	DEBIT BALANCE					CREDIT BALANCE				
Cash	101	130	65	00	00						
Office Supplies	142		1	00	00						
Food Supplies	144	8	00	00	00						
Prepaid Insurance	145	7	50	00	00						
Fishing Boats	181	60	00	00	00						
Accumulated Depreciation—Fishing Boats	181.1					1	00	00	00		
Accounts Payable	202					66	50	00	00		
Wages Payable	219						5	00	00		
Bob Night, Capital	311					138	25	00	00		
		206	25	00	00	206	25	00	00		

