Basic Accounting for Transactions

Learning Objectives

CONCEPTUAL
C1 Explain the steps in processing transactions and the role of source documents. (p. C-2)
C2 Describe an account and its use in recording transactions. (p. C-3)
C3 Describe a ledger and a chart of accounts. (p. C-6)
C4 Define debits and credits and explain double-entry accounting. (p. C-7)

ANALYTICAL
A1 Analyze the impact of transactions on accounts and financial statements. (p. C-11)
A2 Compute the debt ratio and describe its use in analyzing financial condition. (p. C-21)

PROCEDURAL
P1 Record transactions in a journal and post entries to a ledger. (p. C-8)
P2 Prepare and explain the use of a trial balance. (p. C-17)
P3 Prepare financial statements from business transactions. (p. C-18)
LOS ANGELES—“We call our customers Nomsters!” exclaims Misa. “There’s an entire Nom Nom movement.” Nom Nom Truck (NomNomTruck.com) is a mobile food business and the brainchild of Misa Chien and Jennifer Green. (Nom Nom is drawn from the sound “nom nom nom” when eating something “oh so tasty.”) Their specialty is the Vietnamese baguette sandwich, called banh mi, a sort of Vietnamese subsandwich. “It’s portable, it’s fast, and has a fresh taste that you can’t get from a burrito or hamburger,” states Jennifer.

To pursue their business ambitions, Misa and Jennifer took business courses. They learned about recordkeeping processes, transaction analysis, inventory accounting, and financial statement reporting. “We did lose a lot of money initially,” explains Misa. “We didn’t have the right pricing structure.” With careful analysis of their accounting reports, Misa and Jennifer solved the problem. Their business is now profitable and they have a reliable accounting system to help them make good business decisions.

“We had to account for product expenses, trucking expenses, supplier payments, and other expenses such as salaries, rent and insurance,” explains Misa. At the same time, the two have grown sales and expanded their food offerings. “Sales have definitely increased,” says Misa. “People totally embraced us!”

The two insist that it is crucial to track and account for all revenues and expenses, including what is invested in the business. They maintain that success requires proper accounting for and analysis of the financial side. “There was a point when we couldn’t keep up,” recounts Misa. Given the importance of accounting, “we [now] have a bookkeeper and an accountant!” The women emphasize the value of a great business model along with a sound accounting system. “It’s really easy to balance both now that we’ve been in the business for awhile,” explains Misa.

“The bigger message of our company,” says Jennifer, “is that each of us can succeed no matter what our starting point.” “You have to be responsible for yourself,” adds Misa. “We want to make people happy through our food!”

[Sources: Nom Nom Truck Website, January 2013; Inc., June 2011; Bundle.com, October 2010; VirgoBlue.net, September 2011; CNNMoney, October 2011.]
Analyzing and Recording Process

EXHIBIT C.1
The Analyzing and Recording Process

Business transactions and events are the starting points. Relying on source documents, the transactions and events are analyzed using the accounting equation to understand how they affect company performance and financial position. These effects are recorded in accounting records, informally referred to as the accounting books, or simply the books. Additional steps such as posting and then preparing a trial balance help summarize and classify the effects of transactions and events. Ultimately, the accounting process provides information in useful reports or financial statements to decision makers.

Source Documents

Source documents identify and describe transactions and events entering the accounting process. They are the sources of accounting information and can be in either hard copy or electronic form. Examples are sales tickets, checks, purchase orders, bills from suppliers, employee earnings
records, and bank statements. To illustrate, when an item is purchased on credit, the seller usually prepares at least two copies of a sales invoice. One copy is given to the buyer. Another copy, often sent electronically, results in an entry in the seller’s information system to record the sale. Sellers use invoices for recording sales and for control; buyers use them for recording purchases and for monitoring purchasing activity. Many cash registers record information for each sale on a tape or electronic file locked inside the register. This record can be used as a source document for recording sales in the accounting records. Source documents, especially if obtained from outside the organization, provide objective and reliable evidence about transactions and events and their amounts.

### Decision Ethics

**Cashier**  
Your manager requires that you, as cashier, immediately enter each sale. Recently, lunch-hour traffic has increased and the assistant manager asks you to avoid delays by taking customers’ cash and making change without entering sales. The assistant manager says she will add up cash and enter sales after lunch. She says that, in this way, the register will always match the cash amount when the manager arrives at three o’clock. What do you do?  

[Answer—p. C-26]

### The Account and Its Analysis

An **account** is a record of increases and decreases in a specific asset, liability, equity, revenue, or expense item. Information from an account is analyzed, summarized, and presented in reports and financial statements. The **general ledger**, or simply **ledger**, is a record containing all accounts used by a company. The ledger is often in electronic form. While most companies’ ledgers contain similar accounts, a company often uses one or more unique accounts because of its type of operations. As shown in Exhibit C.2, accounts are classified into three general categories based on the accounting equation: asset, liability, or equity.

#### Asset Accounts

Assets are resources owned or controlled by a company, and those resources have expected future benefits. Most accounting systems include (at a minimum) separate accounts for the assets described here.

- **Cash**  
A **cash account** reflects a company’s cash balance. All increases and decreases in cash are recorded in the Cash account. It includes money and any medium of exchange that a bank accepts for deposit (coins, checks, money orders, and checking account balances).

- **Accounts Receivable**  
**Accounts receivable** are held by a seller and refer to promises of payment from customers to sellers. These transactions are often called **credit sales or sales on account** (or **on credit**). Accounts receivable are increased by credit sales and are decreased by customer payments. A company needs a separate record for each customer, but for now, we use the simpler practice of recording all increases and decreases in receivables in a single account called Accounts Receivable.

- **Note Receivable**  
A **note receivable**, or promissory note, is a written promise of another entity to pay a definite sum of money on a specified future date to the holder of the note. A company holding a promissory note signed by another entity has an asset that is recorded in a Note (or Notes) Receivable account.

- **Prepaid Accounts**  
**Prepaid accounts** (also called **prepaid expenses**) are assets that represent pre-payments of future expenses (not current expenses). When the expenses are later incurred, the amounts in prepaid accounts are transferred to expense accounts. Common examples of prepaid accounts include prepaid insurance, prepaid rent, and prepaid services (such as club memberships). Prepaid accounts expire with the passage of time (such as with rent) or through use (such as with prepaid meal tickets). When financial statements are prepared, prepaid accounts are adjusted so that (1) all expired and used prepaid accounts are recorded as regular expenses and (2) all unexpired and unused prepaid accounts are recorded as assets (reflecting future use in future periods). To illustrate,

### EXHIBIT C.2

Accounts Organized by the Accounting Equation

#### Point
To ensure that all sales are rung up on the register, most sellers require customers to have their receipts to exchange or return purchased items.

#### C2 Describe an account and its use in recording transactions.

#### Point
Customers and others who owe a company are called its **debtors**.

#### Point
A college parking fee is a prepaid account from the student’s standpoint. At the beginning of the term, it represents an asset that entitles a student to park on or near campus. The benefits of the parking fee expire as the term progresses. At term-end, prepaid parking (asset) equals zero as it has been entirely recorded as parking expense.
Appendix C  Basic Accounting for Transactions

when an insurance fee, called a premium, is paid in advance, the cost is typically recorded in the asset account Prepaid Insurance. Over time, the expiring portion of the insurance cost is removed from this asset account and reported in expenses on the income statement. Any unexpired portion remains in Prepaid Insurance and is reported on the balance sheet as an asset. (An exception exists for prepaid accounts that will expire or be used before the end of the current accounting period when financial statements are prepared. In this case, the prepayments can be recorded immediately as expenses.)

Supplies Accounts  Supplies are assets until they are used. When they are used up, their costs are reported as expenses. The costs of unused supplies are recorded in a Supplies asset account. Supplies are often grouped by purpose—for example, office supplies and store supplies. Office supplies include stationery, paper, toner, and pens. Store supplies include packaging materials, plastic and paper bags, gift boxes and cartons, and cleaning materials. The costs of these unused supplies can be recorded in an Office Supplies or a Store Supplies asset account. When supplies are used, their costs are transferred from the asset accounts to expense accounts.

Equipment Accounts  Equipment is an asset. When equipment is used and gets worn down, its cost is gradually reported as an expense (called depreciation). Equipment is often grouped by its purpose—for example, office equipment and store equipment. Office equipment includes computers, printers, desks, chairs, and shelves. Costs incurred for these items are recorded in an Office Equipment asset account. The Store Equipment account includes the costs of assets used in a store, such as counters, showcases, ladders, hoists, and cash registers.

Buildings Accounts  Buildings such as stores, offices, warehouses, and factories are assets because they provide expected future benefits to those who control or own them. Their costs are recorded in a Buildings asset account. When several buildings are owned, separate accounts are sometimes kept for each of them.

Land  The cost of land owned by a business is recorded in a Land account. The cost of buildings located on the land is separately recorded in one or more building accounts.

Decision Insight

Women Entrepreneurs  The Center for Women’s Business Research reports that women-owned businesses, such as Nom Nom Truck, are growing and that they:

- Total approximately 11 million and employ nearly 20 million workers.
- Generate $2.5 trillion in annual sales and tend to embrace technology.
- Are philanthropic—70% of owners volunteer at least once per month.
- Are more likely funded by individual investors (73%) than venture firms (15%).

Liability Accounts  Liabilities are claims (by creditors) against assets, which means they are obligations to transfer assets or provide products or services to others. Creditors are individuals and organizations that have rights to receive payments from a company. If a company fails to pay its obligations, the law gives creditors a right to force the sale of that company’s assets to obtain the money to meet creditors’ claims. When assets are sold under these conditions, creditors are paid first, but only up to the amount of their claims. Any remaining money, the residual, goes to the owners of the company. Creditors often use a balance sheet to help decide whether to loan money to a company. A loan is less risky if the borrower’s liabilities are small in comparison to assets because this means there are more resources than claims on resources. Common liability accounts are described here.

Accounts Payable  Accounts payable refer to oral or implied promises to pay later, which usually arise from purchases of merchandise. Payables can also arise from purchases of supplies, equipment, and services. Accounting systems keep separate records about each creditor.

Note Payable  A note payable refers to a formal promise, usually denoted by the signing of a promissory note, to pay a future amount. It is recorded in either a short-term Note Payable account or a long-term Note Payable account, depending on when it must be repaid.
Unearned Revenue Accounts  Unearned revenue refers to a liability that is settled in the future when a company delivers its products or services. When customers pay in advance for products or services (before revenue is earned), the revenue recognition principle requires that the seller consider this payment as unearned revenue. Examples of unearned revenue include magazine subscriptions collected in advance by a publisher, sales of gift certificates by stores, and season ticket sales by sports teams. The seller would record these in liability accounts such as Unearned Subscriptions, Unearned Store Sales, and Unearned Ticket Revenue. When products and services are later delivered, the earned portion of the unearned revenue is transferred to revenue accounts such as Subscription Fees, Store Sales, and Ticket Sales.1

Accrued Liabilities  Accrued liabilities are amounts owed that are not yet paid. Examples are wages payable, taxes payable, and interest payable. These are often recorded in separate liability accounts by the same title. If they are not large in amount, one or more ledger accounts can be added and reported as a single amount on the balance sheet. (Financial statements often have amounts reported that are a summation of several ledger accounts.)

Decision Insight

Revenue Spread  The New York Giants have Unearned Revenues of about $100 million in advance ticket sales. When the team plays its home games, it settles this liability to its ticket holders and then transfers the amount earned to Ticket Revenues. ■

Equity Accounts  The owner’s claim on a company’s assets is called equity, or stockholders’ equity, or shareholders’ equity. Equity is the owners’ residual interest in the assets of a business after deducting liabilities. Equity is impacted by four types of accounts: common stock, dividends, revenues, and expenses. We show this visually in Exhibit C.3 by expanding the accounting equation. (The accounts for dividends, revenues, and expenses are reflected in the retained earnings account, and that account is reported in the balance sheet.)

Common Stock  When an owner invests in a company in exchange for common stock, the invested amount is recorded in an account titled Common Stock. Any further owner investments are recorded in this account.

Dividends  When the company pays any cash dividends, it decreases both the company’s assets and its total equity. Dividends are not expenses of the business. They are simply the opposite of owner investments. A Dividends account is used in recording asset distributions to stockholders (owners).

Revenue Accounts  Revenues and expenses also impact equity. Examples of revenue accounts are Sales, Commissions Earned, Professional Fees Earned, Rent Revenue, and Interest Revenue. Revenues increase equity and result from products and services provided to customers.

1 In practice, account titles vary. As one example, Subscription Fees is sometimes called Subscription Fees Revenue, Subscription Fees Earned, or Earned Subscription Fees. As another example, Rent Earned is sometimes called Rent Revenue, Rental Revenue, or Earned Rent Revenue. We must use good judgment when reading financial statements because titles can differ even within the same industry. For example, product sales are called sales at Polaris, net sales at Arctic Cat, and net revenues at Piaggio. Generally, the term revenues or fees is more commonly used with service businesses, and net sales or sales with product businesses.
Appendix C Basic Accounting for Transactions

Expense Accounts Examples of expense accounts are Advertising Expense, Store Supplies Expense, Office Salaries Expense, Office Supplies Expense, Rent Expense, Utilities Expense, and Insurance Expense. Expenses decrease equity and result from assets and services used in a company’s operations. The variety of revenues and expenses can be seen by looking at the chart of accounts that follows the index at the back of this book. (Different companies sometimes use different account titles than those in this book’s chart of accounts. For example, some might use Interest Revenue instead of Interest Earned, or Rental Expense instead of Rent Expense. It is important only that an account title describe the item it represents.)

Decision Insight

Sporting Accounts The Miami Heat, Los Angeles Lakers, and the other NBA teams have the following major revenue and expense accounts:

<table>
<thead>
<tr>
<th>Revenues</th>
<th>Expenses</th>
</tr>
</thead>
<tbody>
<tr>
<td>Basketball ticket sales</td>
<td>Team salaries</td>
</tr>
<tr>
<td>TV &amp; radio broadcast fees</td>
<td>Game costs</td>
</tr>
<tr>
<td>Advertising revenues</td>
<td>NBA franchise costs</td>
</tr>
<tr>
<td>Basketball playoff receipts</td>
<td>Promotional costs</td>
</tr>
</tbody>
</table>

ANALYZING AND PROCESSING TRANSACTIONS

This section explains several tools and processes that comprise an accounting system. These include a ledger, T-account, debits and credits, double-entry accounting, journalizing, and posting.

Ledger and Chart of Accounts

The collection of all accounts and their balances for an information system is called a ledger (or general ledger). If accounts are in files on a hard drive, the sum of those files is the ledger. If the accounts are pages in a file, that file is the ledger. A company’s size and diversity of operations affect the number of accounts needed. A small company can get by with as few as 20 or 30 accounts; a large company can require several thousand. The chart of accounts is a list of all ledger accounts and includes an identification number assigned to each account. A small business might use the following numbering system for its accounts:

<table>
<thead>
<tr>
<th>Chart of Accounts</th>
</tr>
</thead>
<tbody>
<tr>
<td>101–199 Asset accounts</td>
</tr>
<tr>
<td>201–299 Liability accounts</td>
</tr>
<tr>
<td>301–399 Equity accounts</td>
</tr>
<tr>
<td>401–499 Revenue accounts</td>
</tr>
<tr>
<td>501–699 Expense accounts</td>
</tr>
</tbody>
</table>

These numbers provide a three-digit code that is useful in recordkeeping. In this case, the first digit assigned to asset accounts is a 1, the first digit assigned to liability accounts is a 2, and so on. The second and third digits relate to the accounts’ subcategories. Exhibit C.4 shows a partial

EXHIBIT C.4 Partial Chart of Accounts for FastForward

<table>
<thead>
<tr>
<th>Acct. No.</th>
<th>Account Name</th>
<th>Acct. No.</th>
<th>Account Name</th>
<th>Acct. No.</th>
<th>Account Name</th>
</tr>
</thead>
<tbody>
<tr>
<td>101</td>
<td>Cash</td>
<td>236</td>
<td>Unearned consulting revenue</td>
<td>406</td>
<td>Rental revenue</td>
</tr>
<tr>
<td>106</td>
<td>Accounts receivable</td>
<td>307</td>
<td>Common stock</td>
<td>622</td>
<td>Salaries expense</td>
</tr>
<tr>
<td>126</td>
<td>Supplies</td>
<td>318</td>
<td>Retained earnings</td>
<td>637</td>
<td>Insurance expense</td>
</tr>
<tr>
<td>128</td>
<td>Prepaid insurance</td>
<td>319</td>
<td>Dividends</td>
<td>640</td>
<td>Rent expense</td>
</tr>
<tr>
<td>167</td>
<td>Equipment</td>
<td>403</td>
<td>Consulting revenue</td>
<td>652</td>
<td>Supplies expense</td>
</tr>
<tr>
<td>201</td>
<td>Accounts payable</td>
<td></td>
<td></td>
<td>690</td>
<td>Utilities expense</td>
</tr>
</tbody>
</table>

C-6
chart of accounts for FastForward. (Please review the more complete chart of accounts that follows the index at the back of this book.)

**Debits and Credits**

A **T-account** represents a ledger account and is a tool used to understand the effects of one or more transactions. Its name comes from its shape like the letter T. The layout of a T-account, shown in Exhibit C.5, is (1) the account title on top, (2) a left, or debit side, and (3) a right, or credit, side.

The left side of an account is called the **debit side**, often abbreviated Dr. The right side is called the **credit side**, abbreviated Cr.² To enter amounts on the left side of an account is to **debit** the account. To enter amounts on the right side is to **credit** the account. Do not make the error of thinking that the terms *debit* and *credit* mean increase or decrease. Whether a debit or a credit is an increase or decrease depends on the account. For an account where a debit is an increase, the credit is a decrease; for an account where a debit is a decrease, the credit is an increase. The difference between total debits and total credits for an account, including any beginning balance, is the **account balance**. When the sum of debits exceeds the sum of credits, the account has a **debit balance**. It has a **credit balance** when the sum of credits exceeds the sum of debits. When the sum of debits equals the sum of credits, the account has a **zero balance**.

**Double-Entry Accounting**

**Double-entry accounting** requires that for each transaction:

- At least two accounts are involved, with at least one debit and one credit.
- The total amount debited must equal the total amount credited.
- The accounting equation must not be violated.

This means the sum of the debits for all entries must equal the sum of the credits for all entries, and the sum of debit account balances in the ledger must equal the sum of credit account balances.

The system for recording debits and credits follows from the usual accounting equation—see Exhibit C.6. Two points are important here. First, like any simple mathematical relation, net increases or decreases on one side have equal net effects on the other side. For example, a net increase in assets must be accompanied by an identical net increase on the liabilities and equity side. Recall that some transactions affect only one side of the equation, meaning that two or more accounts on one side are affected, but their net effect on this one side is zero. Second, the left side is the **normal balance** side for assets, and the right side is the **normal balance** side for liabilities and equity. This matches their layout in the accounting equation where assets are on the left side of this equation, and liabilities and equity are on the right.

Recall that equity increases from revenues and stock issuances, and it decreases from expenses and dividends. These important equity relations are conveyed by expanding the accounting equation to include debits and credits in double-entry form as shown in Exhibit C.7.

Increases (credits) to common stock and revenues **increase** equity; increases (debts) to dividends and expenses **decrease** equity. The normal balance of each account (asset, liability, common stock, dividends, revenue, or expense) refers to the left or right (debit or credit) side.

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² These abbreviations are remnants of 18th-century English recordkeeping practices where the terms *debitor* and *creditor* were used instead of *debit* and *credit*. The abbreviations use the first and last letters of these terms, just as we still do for Saint (St.) and Doctor (Dr.).
EXHIBIT C.7
Debit and Credit Effects for Component Accounts

where increases are recorded. Understanding these diagrams and rules is required to prepare, analyze, and interpret financial statements.

The T-account for FastForward’s Cash account is shown in Exhibit C.8. The total increases in its Cash account are $36,100, the total decreases are $31,300, and the account’s debit balance is $4,800. (We illustrate use of T-accounts later in this appendix.)

EXHIBIT C.8
Computing the Balance for a T-Account

Point: The ending balance is on the side with the larger dollar amount. Also, a plus (+) and minus (−) are not used in a T-account.

Quick Check

1. Identify examples of accounting source documents.
2. Explain the importance of source documents.
3. Identify each of the following as either an asset, a liability, or equity: (a) Prepaid Rent, (b) Unearned Fees, (c) Building, (d) Wages Payable, and (e) Office Supplies.
4. What is an account? What is a ledger?
5. What determines the number and types of accounts a company uses?
6. Does debit always mean increase and credit always mean decrease?
7. Describe a chart of accounts.

Journalizing and Posting Transactions

Processing transactions is a crucial part of accounting. The four usual steps of this process are depicted in Exhibit C.9. Steps 1 and 2—involving transaction analysis and the accounting equation—were introduced in prior sections. This section extends that discussion and focuses on steps 3 and 4 of the accounting process. Step 3 is to record each transaction chronologically in a journal. A journal gives a complete record of each transaction in one place. It also shows debits and credits for each transaction. The process of recording transactions in a journal is called journalizing. Step 4 is to transfer (or post) entries from the journal to the ledger. The process of transferring journal entry information to the ledger is called posting.

Journalizing Transactions The process of journalizing transactions requires an understanding of a journal. While companies can use various journals, every company uses a general journal. It can be used to record any transaction and includes the following information about each transaction: (a) date of transaction, (b) titles of affected accounts, (c) dollar amount of each
debit and credit, and d) explanation of the transaction. Exhibit C.10 shows how the first two transactions of FastForward are recorded in a general journal. This process is similar for manual and computerized systems. Computerized journals are often designed to look like a manual journal page, and also include error-checking routines that ensure debits equal credits for each entry. Shortcuts allow recordkeepers to select account names and numbers from pull-down menus.

To record entries in a general journal, apply these steps; refer to the entries in Exhibit C.10 when reviewing these steps.

a. Date the transaction: Enter the year at the top of the first column and the month and day on the first line of each journal entry.

b. Enter titles of accounts debited and then enter amounts in the Debit column on the same line. Account titles are taken from the chart of accounts and are aligned with the left margin of the Account Titles and Explanation column.

c. Enter titles of accounts credited and then enter amounts in the Credit column on the same line. Account titles are from the chart of accounts and are indented from the left margin of the Account Titles and Explanation column to distinguish them from debited accounts.

d. Enter a brief explanation of the transaction on the line below the entry (it often references a source document). This explanation is indented about half as far as the credited account titles to avoid confusing it with accounts, and it is italicized.

EXHIBIT C.9
Steps in Processing Transactions
A blank line is left between each journal entry for clarity. When a transaction is first recorded, the posting reference (PR) column is left blank (in a manual system). Later, when posting entries to the ledger, the identification numbers of the individual ledger accounts are entered in the PR column.

**Point:** The fundamental concepts of a manual (pencil-and-paper) system are identical to those of a computerized information system.

**EXHIBIT C.11**  
Cash Account in Balance Column Format

<table>
<thead>
<tr>
<th>Date</th>
<th>Explanation</th>
<th>PR</th>
<th>Debit</th>
<th>Credit</th>
<th>Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>2013</td>
<td></td>
<td></td>
<td>30,000</td>
<td></td>
<td>30,000</td>
</tr>
<tr>
<td>Dec. 1</td>
<td></td>
<td>G1</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Dec. 2</td>
<td></td>
<td>G1</td>
<td>2,500</td>
<td>27,500</td>
<td></td>
</tr>
<tr>
<td>Dec. 3</td>
<td></td>
<td>G1</td>
<td>26,000</td>
<td>1,500</td>
<td></td>
</tr>
<tr>
<td>Dec. 10</td>
<td></td>
<td>G1</td>
<td>4,200</td>
<td></td>
<td>5,700</td>
</tr>
</tbody>
</table>

**EXHIBIT C.12**  
Posting an Entry to the Ledger

**Point:** Explanations are typically included in ledger accounts only for unusual transactions or events.

**Key:**  
1. Identify debit account in Ledger: enter date, journal page, amount, and balance.  
2. Enter the debit account number from the Ledger in the PR column of the journal.  
3. Identify credit account in Ledger: enter date, journal page, amount, and balance.  
4. Enter the credit account number from the Ledger in the PR column of the journal.
The heading of the Balance column does not show whether it is a debit or credit balance. Instead, an account is assumed to have a normal balance. Unusual events can sometimes temporarily give an account an abnormal balance. An abnormal balance refers to a balance on the side where decreases are recorded. For example, a customer might mistakenly overpay a bill. This gives that customer’s account receivable an abnormal (credit) balance. An abnormal balance is often identified by circling it or by entering it in red or some other unusual color. A zero balance for an account is usually shown by writing zeros or a dash in the Balance column to avoid confusion between a zero balance and one omitted in error.

**Posting Journal Entries**  Step 4 of processing transactions is to post journal entries to ledger accounts (see Exhibit C.9). To ensure that the ledger is up-to-date, entries are posted as soon as possible. This might be daily, weekly, or when time permits. All entries must be posted to the ledger before financial statements are prepared to ensure that account balances are up-to-date. When entries are posted to the ledger, the debits in journal entries are transferred into ledger accounts as debits, and credits are transferred into ledger accounts as credits. Exhibit C.12 shows the four steps to post a journal entry. First, identify the ledger account that is debited in the entry; then, in the ledger, enter the entry date, the journal and page in its PR column, the debit amount, and the new balance of the ledger account. (The letter G shows it came from the General Journal.) Second, enter the ledger account number in the PR column of the journal. Steps 3 and 4 repeat the first two steps for credit entries and amounts. The posting process creates a link between the ledger and the journal entry. This link is a useful cross-reference for tracing an amount from one record to another.

**Analyzing Transactions — An Illustration**

We return to the activities of FastForward to show how double-entry accounting is useful in analyzing and processing transactions. Analysis of each transaction follows the four steps of Exhibit C.9.

1. **Receive investment by Owner**
   - **Step 1** Identify the transaction and any source documents.
   - **Step 2** Analyze the transaction using the accounting equation.
   - **Step 3** Record the transaction in journal entry form applying double-entry accounting.
   - **Step 4** Post the entry (for simplicity, we use T-accounts to represent ledger accounts).

   **1. Receive investment by Owner**

   **Identify**
   FastForward receives $30,000 cash from Chas Taylor in exchange for common stock.

   **Analyze**
   - Assets = Liabilities + Equity
   - Cash + $30,000 = 0 + $30,000

   **Record**
   (1) Cash 101 30,000
   (1) Common Stock 307 30,000

   **Post**
   Cash 101
   (1) 30,000
   Common Stock 307
   (1) 30,000

2. **Purchase Supplies for Cash**
   - **Identify**
     FastForward pays $2,500 cash for supplies.
   - **Analyze**
     Changes the composition of assets but not the total.

   **Record**
   (2) Supplies 126 2,500
   (1) Cash 101 30,000
   (2) 2,500

   **Post**
   Supplies 126
   (2) 2,500
   Cash 101
   (1) 30,000
   (2) 2,500
Appendix C  Basic Accounting for Transactions

3. Purchase Equipment for Cash

1 IDENTIFY FastForward pays $26,000 cash for equipment.

2 ANALYZE

\[
\text{Assets} = \text{Liabilities} + \text{Equity}
\]

\[
\begin{align*}
\text{Cash} &\quad 101 = \text{Equipment} 167 + 26,000 \\
\end{align*}
\]

Changes the composition of assets but not the total.

3 RECORD

<table>
<thead>
<tr>
<th>Date</th>
<th>Account Titles and Explanation</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Equipment</td>
<td>167</td>
<td>26,000</td>
</tr>
<tr>
<td></td>
<td>Cash</td>
<td>101</td>
<td>26,000</td>
</tr>
</tbody>
</table>

4. Purchase Supplies on Credit

1 IDENTIFY FastForward purchases $7,100 of supplies on credit from a supplier.

2 ANALYZE

\[
\text{Assets} = \text{Liabilities} + \text{Equity}
\]

\[
\begin{align*}
\text{Supplies} 126 &\quad + 7,100 = \text{Accounts Payable} 201 + 7,100 \\
\end{align*}
\]

3 RECORD

<table>
<thead>
<tr>
<th>Date</th>
<th>Account Titles and Explanation</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Supplies</td>
<td>126</td>
<td>7,100</td>
</tr>
<tr>
<td></td>
<td>Accounts Payable</td>
<td>201</td>
<td>7,100</td>
</tr>
</tbody>
</table>

5. Provide Services for Cash

1 IDENTIFY FastForward provides consulting services and immediately collects $4,200 cash.

2 ANALYZE

\[
\text{Assets} = \text{Liabilities} + \text{Equity}
\]

\[
\begin{align*}
\text{Cash} 101 &\quad + 4,200 = \text{Consulting Revenue} 403 + 4,200 \\
\end{align*}
\]

3 RECORD

<table>
<thead>
<tr>
<th>Date</th>
<th>Account Titles and Explanation</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Cash</td>
<td>101</td>
<td>4,200</td>
</tr>
<tr>
<td></td>
<td>Consulting Revenue</td>
<td>403</td>
<td>4,200</td>
</tr>
</tbody>
</table>

6. Payment of Expense in Cash

1 IDENTIFY FastForward pays $1,000 cash for December rent.

2 ANALYZE

\[
\text{Assets} = \text{Liabilities} + \text{Equity}
\]

\[
\begin{align*}
\text{Cash} 101 &\quad - 1,000 = \text{Rent Expense} 640 - 1,000 \\
\end{align*}
\]

3 RECORD

<table>
<thead>
<tr>
<th>Date</th>
<th>Account Titles and Explanation</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Rent Expense</td>
<td>640</td>
<td>1,000</td>
</tr>
<tr>
<td></td>
<td>Cash</td>
<td>101</td>
<td>1,000</td>
</tr>
</tbody>
</table>

7. Payment of Expense in Cash

1 IDENTIFY FastForward pays $700 cash for employee salary.

2 ANALYZE

\[
\text{Assets} = \text{Liabilities} + \text{Equity}
\]

\[
\begin{align*}
\text{Cash} 101 &\quad - 700 = \text{Salaries Expense} 622 - 700 \\
\end{align*}
\]

3 RECORD

<table>
<thead>
<tr>
<th>Date</th>
<th>Account Titles and Explanation</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Salaries Expense</td>
<td>622</td>
<td>700</td>
</tr>
<tr>
<td></td>
<td>Cash</td>
<td>101</td>
<td>700</td>
</tr>
</tbody>
</table>

Point: Salary usually refers to compensation for an employee who receives a fixed amount for a given time period, whereas wages usually refers to compensation based on time worked.
Appendix C  Basic Accounting for Transactions

8. Provide Consulting and Rental Services on Credit

**IDENTIFY** FastForward provides consulting services of $1,600 and rents its test facilities for $300. The customer is billed $1,900 for these services.

**ANALYZE**

<table>
<thead>
<tr>
<th>Account</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounts Receivable</td>
<td>106</td>
<td>1,900</td>
</tr>
<tr>
<td>Consulting Revenue</td>
<td>403</td>
<td>1,600</td>
</tr>
<tr>
<td>Rental Revenue</td>
<td>406</td>
<td>300</td>
</tr>
</tbody>
</table>

**Post**

<table>
<thead>
<tr>
<th>Account</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounts Receivable</td>
<td>106</td>
<td>1,900</td>
</tr>
<tr>
<td>Consulting Revenue</td>
<td>403</td>
<td>1,600</td>
</tr>
<tr>
<td>Rental Revenue</td>
<td>406</td>
<td>300</td>
</tr>
</tbody>
</table>

**Point:** Transaction 8 is a compound journal entry, which affects three or more accounts.

9. Receipt of Cash on Account

**IDENTIFY** FastForward receives $1,900 cash from the client billed in transaction 8.

**ANALYZE**

<table>
<thead>
<tr>
<th>Account</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>101</td>
<td>1,900</td>
</tr>
<tr>
<td>Accounts Receivable</td>
<td>106</td>
<td>1,900</td>
</tr>
</tbody>
</table>

**Post**

<table>
<thead>
<tr>
<th>Account</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>101</td>
<td>1,900</td>
</tr>
<tr>
<td>Accounts Receivable</td>
<td>106</td>
<td>1,900</td>
</tr>
</tbody>
</table>

**Point:** The revenue recognition principle requires revenue to be recognized when earned, which is when the company provides products and services to a customer. This is not necessarily the same time that the customer pays. A customer can pay before or after products or services are provided.

10. Partial Payment of Accounts Payable

**IDENTIFY** FastForward pays CalTech Supply $900 cash toward the payable of transaction 4.

**ANALYZE**

<table>
<thead>
<tr>
<th>Account</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounts Payable</td>
<td>201</td>
<td>900</td>
</tr>
<tr>
<td>Cash</td>
<td>101</td>
<td>900</td>
</tr>
</tbody>
</table>

**Post**

<table>
<thead>
<tr>
<th>Account</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounts Payable</td>
<td>201</td>
<td>900</td>
</tr>
<tr>
<td>Cash</td>
<td>101</td>
<td>900</td>
</tr>
</tbody>
</table>

11. Payment of Cash Dividend

**IDENTIFY** FastForward pays $200 cash for dividends.

**ANALYZE**

<table>
<thead>
<tr>
<th>Account</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dividends</td>
<td>319</td>
<td>200</td>
</tr>
</tbody>
</table>

**Post**

<table>
<thead>
<tr>
<th>Account</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dividends</td>
<td>319</td>
<td>200</td>
</tr>
</tbody>
</table>

**Point:**
12. Receipt of Cash for Future Services

**Identify**
FastForward receives $3,000 cash in advance of providing consulting services to a customer.

**Analyze**
- **Assets** = **Liabilities** + **Equity**
- **Unearned Consulting Revenue**

<table>
<thead>
<tr>
<th>Date</th>
<th>Account Titles and Explanation</th>
<th>PR</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>(12)</td>
<td>Cash</td>
<td>101</td>
<td>3,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Unearned Consulting Revenue</td>
<td>236</td>
<td></td>
<td>3,000</td>
</tr>
</tbody>
</table>

Accepting $3,000 cash obligates FastForward to perform future services and is a liability. No revenue is earned until services are provided.

**Record**

**Post**

<table>
<thead>
<tr>
<th>Cash</th>
<th>101</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1)</td>
<td>30,000</td>
</tr>
<tr>
<td>(5)</td>
<td>4,200</td>
</tr>
<tr>
<td>(9)</td>
<td>1,900</td>
</tr>
<tr>
<td></td>
<td>(12) 3,000</td>
</tr>
<tr>
<td>(7)</td>
<td>700</td>
</tr>
<tr>
<td>(10)</td>
<td>900</td>
</tr>
<tr>
<td>(11)</td>
<td>200</td>
</tr>
</tbody>
</table>

**Unearned Consulting Revenue** 236

|        | (12) 3,000 |

**13. Pay Cash for Future Insurance Coverage**

**Identify**
FastForward pays $2,400 cash (insurance premium) for a 24-month insurance policy. Coverage begins on December 1.

**Analyze**
- **Assets** = **Liabilities** + **Equity**
- **Prepaid Insurance**

<table>
<thead>
<tr>
<th>Date</th>
<th>Account Titles and Explanation</th>
<th>PR</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>(13)</td>
<td>Prepaid Insurance</td>
<td>128</td>
<td>2,400</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Cash</td>
<td>101</td>
<td></td>
<td>2,400</td>
</tr>
</tbody>
</table>

Changes the composition of assets from cash to prepaid insurance. Expense is incurred as insurance coverage expires.

**Record**

**Post**

<table>
<thead>
<tr>
<th>Prepaid Insurance</th>
<th>128</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1)</td>
<td>30,000</td>
</tr>
<tr>
<td>(5)</td>
<td>4,200</td>
</tr>
<tr>
<td>(9)</td>
<td>1,900</td>
</tr>
<tr>
<td></td>
<td>(13) 2,400</td>
</tr>
<tr>
<td>(7)</td>
<td>700</td>
</tr>
<tr>
<td>(10)</td>
<td>900</td>
</tr>
<tr>
<td>(11)</td>
<td>200</td>
</tr>
</tbody>
</table>

**Cash** 101

|        | (13) 2,400 |

**14. Purchase Supplies for Cash**

**Identify**
FastForward pays $120 cash for supplies.

**Analyze**
- **Assets** = **Liabilities** + **Equity**
- **Supplies**

<table>
<thead>
<tr>
<th>Date</th>
<th>Account Titles and Explanation</th>
<th>PR</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>(14)</td>
<td>Supplies</td>
<td>126</td>
<td>120</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Cash</td>
<td>101</td>
<td></td>
<td>120</td>
</tr>
</tbody>
</table>

**Post**

<table>
<thead>
<tr>
<th>Supplies</th>
<th>126</th>
</tr>
</thead>
<tbody>
<tr>
<td>(2)</td>
<td>2,500</td>
</tr>
<tr>
<td>(4)</td>
<td>7,100</td>
</tr>
<tr>
<td>(14)</td>
<td>120</td>
</tr>
</tbody>
</table>

**Cash** 101

|        | (14) 120 |

---

**Point:** Luca Pacioli, a 15th-century monk, is considered a pioneer in accounting and the first to devise double-entry accounting.
Accounting Equation Analysis

Exhibit C.13 shows the ledger accounts (in T-account form) of FastForward after all 16 transactions are recorded and posted and the balances computed. The accounts are grouped into three major columns corresponding to the accounting equation: assets, liabilities, and equity. Note several important points. First, as with each transaction, the totals for the three columns must obey the accounting equation. Specifically, assets equal $42,470 ($4,350 + $0 + $9,720 + $2,400 + $26,000); liabilities equal $9,200 ($6,200 + $3,000); and equity equals $33,270 ($30,000 - $200 + $5,800 + $300 - $1,400 - $1,000 - $230). These numbers prove the accounting equation: Assets of $42,470 = Liabilities of $9,200 + Equity of $33,270. Second, the common stock, dividends, revenue, and expense accounts reflect the transactions that change equity. The latter three account categories underlie the statement of retained earnings. Third, the revenue and expense account balances will be summarized and reported in the income statement. Fourth, increases and decreases in the cash account make up the elements reported in the statement of cash flows.

Debit and Credit Rules

Point: Technology does not provide the judgment required to analyze most business transactions. Analysis requires the expertise of skilled and ethical professionals.
8. What types of transactions increase equity? What types decrease equity?
9. Why are accounting systems called double-entry?
10. For each transaction, double-entry accounting requires which of the following? (a) Debits to asset accounts must create credits to liability or equity accounts, (b) a debit to a liability account must create a credit to an asset account, or (c) total debits must equal total credits.
11. An owner invests $15,000 cash along with equipment having a market value of $23,000 in a company in exchange for common stock. Prepare the necessary journal entry.
12. Explain what a compound journal entry is.
13. Why are posting reference numbers entered in the journal when entries are posted to ledger accounts?
Double-entry accounting requires the sum of debit account balances to equal the sum of credit account balances. A trial balance is used to confirm this. A \textit{trial balance} is a list of accounts and their balances at a point in time. Account balances are reported in their appropriate debit or credit columns of a trial balance. A trial balance can be used to confirm this and to follow up on any abnormal or unusual balances. Exhibit C.14 shows the trial balance for FastForward after its 16 entries have been posted to the ledger. (This is an \textit{unadjusted} trial balance.)

### EXHIBIT C.14

\textbf{Trial Balance (Unadjusted)}

<table>
<thead>
<tr>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>$4,350</td>
</tr>
<tr>
<td>Accounts receivable</td>
<td>0</td>
</tr>
<tr>
<td>Supplies</td>
<td>$9,720</td>
</tr>
<tr>
<td>Prepaid insurance</td>
<td>$2,400</td>
</tr>
<tr>
<td>Equipment</td>
<td>$26,000</td>
</tr>
<tr>
<td>Accounts payable</td>
<td>$6,200</td>
</tr>
<tr>
<td>Unearned consulting revenue</td>
<td>$3,000</td>
</tr>
<tr>
<td>Common stock</td>
<td>$30,000</td>
</tr>
<tr>
<td>Dividends</td>
<td>200</td>
</tr>
<tr>
<td>Consulting revenue</td>
<td>$5,800</td>
</tr>
<tr>
<td>Rental revenue</td>
<td>$300</td>
</tr>
<tr>
<td>Salaries expense</td>
<td>$1,400</td>
</tr>
<tr>
<td>Rent expense</td>
<td>$1,000</td>
</tr>
<tr>
<td>Utilities expense</td>
<td>$230</td>
</tr>
<tr>
<td>Totals</td>
<td>$45,300</td>
</tr>
</tbody>
</table>

The total debit balances equals the total credit balances for the trial balance in Exhibit C.14. Equality of these two totals does not guarantee that no errors were made. For example, the column totals still will be equal when a debit or credit of a correct amount is made to a wrong account. Another error that does not cause unequal column totals occurs when equal debits and credits of an incorrect amount are entered.

#### Preparing a Trial Balance

Preparing a trial balance involves three steps:

1. List each account title and its amount (from ledger) in the trial balance. If an account has a zero balance, list it with a zero in its normal balance column (or omit it entirely).
2. Compute the total of debit balances and the total of credit balances.
3. Verify (\textit{prove}) total debit balances equal total credit balances.

#### Searching for and Correcting Errors

If the trial balance does not balance (when its columns are not equal), the error (or errors) must be found and corrected. An efficient way to search for an error is to check the journalizing, posting, and trial balance preparation.

\textbf{Point:} The ordering of accounts in a trial balance typically follows their identification number from the chart of accounts.

\textbf{P2} Prepare and explain the use of a trial balance.

\textbf{Point:} A trial balance is not a financial statement but a mechanism for checking equality of debits and credits in the ledger. Financial statements do not have debit and credit columns.
Appendix C  Basic Accounting for Transactions

Example: If a credit to Unearned Revenue was incorrectly posted from the journal as a credit to the Revenue ledger account, would the ledger still balance? Would the financial statements be correct? Answers: The ledger would balance, but liabilities would be understated, equity would be overstated, and income would be overstated (all because of overstated revenues).

Point: The IRS requires companies to keep records that can be audited.

Using a Trial Balance to Prepare Financial Statements

This section shows how to prepare financial statements from the trial balance in Exhibit C.14 and from information on the December transactions of FastForward. These statements are more precisely called unadjusted statements because we need to make some further accounting adjustments.

How financial statements are linked in time is illustrated in Exhibit C.15. A balance sheet reports on an organization’s financial position at a point in time. The income statement, statement of retained earnings, and statement of cash flows report on financial performance over a period of time. The three statements in the middle column of Exhibit C.15 link balance sheets from the beginning to the end of a reporting period. They explain how financial position changes from one point to another.

Preparers and users (including regulatory agencies) determine the length of the reporting period. A one-year, or annual, reporting period is common, as are semiannual, quarterly, and monthly periods. The one-year reporting period

Supplies ledger account balance is understated by $100, and the Equipment ledger account balance is overstated by $100. The correcting entry is: debit Supplies and credit Equipment (both for $100).

3 Transposition occurs when two digits are switched, or transposed, within a number. If transposition is the only error, it yields a difference between the two trial balance totals that is evenly divisible by 9. For example, assume that a $691 debit in an entry is incorrectly posted to the ledger as $619. Total credits in the trial balance are then larger than total debits by $72 ($691 - $619). The $72 error is evenly divisible by 9 (72/9 = 8). The first digit of the quotient (in our example it is 8) equals the difference between the digits of the two transposed numbers (the 9 and the 1). The number of digits in the quotient also tells the location of the transposition, starting from the right. The quotient in our example had only one digit (8), so it tells us the transposition is in the first digit. Consider another example where a transposition error involves posting $961 instead of the correct $691. The difference in these numbers is $270, and its quotient is 30 (270/9). The quotient has two digits, so it tells us to check the second digit from the right for a transposition of two numbers that have a difference of 3.
is known as the accounting, or fiscal, year. Businesses whose accounting year begins on January 1 and ends on December 31 are known as calendar-year companies. Polaris is a calendar-year company. Many companies choose a fiscal year ending on a date other than December 31. Arctic Cat is a noncalendar-year company as reflected in the headings of its March 31 year-end financial statements in Appendix A near the end of the book.

**Income Statement**  
An income statement reports the revenues earned less the expenses incurred by a business over a period of time. FastForward’s income statement for December is shown at the top of Exhibit C.16. Information about revenues and expenses is conveniently taken from the trial balance in Exhibit C.14. Net income of $3,470 is reported at the bottom of the statement. Owner investments and dividends are not part of income.

**Statement of Retained Earnings**  
The statement of retained earnings reports information about how retained earnings change over the reporting period. FastForward’s statement of retained earnings is the second report in Exhibit C.16. It shows the $3,470 of net income, the
Appendix C  Basic Accounting for Transactions

$200 dividend, and the $3,270 end-of-period balance. (The beginning balance in the statement of retained earnings is rarely zero; an exception is for the first period of operations. The beginning balance in January 2014 is $3,270, which is December’s ending balance.)

**Point:** An income statement is also called an earnings statement, a statement of operations, or a P&L (profit and loss) statement. A balance sheet is also called a statement of financial position.

**Point:** While revenues increase equity, and expenses decrease equity, the amounts are not reported in detail in the statement of retained earnings. Instead, their effects are reflected through net income.

**Balance Sheet** The balance sheet reports the financial position of a company at a point in time, usually at the end of a month, quarter, or year. FastForward’s balance sheet is the third report in Exhibit C.16. This statement refers to financial condition at the close of business on December 31. The left side of the balance sheet lists its assets: cash, supplies, prepaid insurance, and equipment. The upper right side of the balance sheet shows that it owes $6,200 to creditors and $3,000 in services to customers who paid in advance. The equity section shows an ending balance of $33,270. Note the link between the ending balance of the statement of retained earnings and the retained earnings balance. (Recall that this presentation of the balance sheet is called the account form: assets on the left and liabilities and equity on the right. Another presentation is the report form: assets on top, followed by liabilities and then equity. Either presentation is acceptable.)

**Decision Maker**

**Entrepreneur** You open a wholesale business selling entertainment equipment to retail outlets. You find that most of your customers demand to buy on credit. How can you use the balance sheets of these customers to decide which ones to extend credit to? [Answer—p. C-26]

**Presentation Issues** Dollar signs are not used in journals and ledgers. They do appear in financial statements and other reports such as trial balances. The usual practice is to put dollar signs beside only the first and last numbers in a column. *Polaris*’s financial statements in Appendix A show this. When amounts are entered in a journal, ledger, or trial balance, commas are optional to indicate thousands, millions, and so forth. However, commas are always used in financial statements. Companies also commonly round amounts in reports to the nearest dollar, or even to a higher level. *Polaris* is typical of many companies in that it rounds its financial statement amounts to the nearest thousand (or million). This decision is based on the perceived impact of rounding for users’ business decisions.

**Quick Check**

14. Where are dollar signs typically entered in financial statements?
15. If a $4,000 debit to Equipment in a journal entry is incorrectly posted to the ledger as a $4,000 credit, and the ledger account has a resulting debit balance of $20,000, what is the effect of this error on the Trial Balance column totals?
16. Describe the link between the income statement and the statement of retained earnings.
17. Explain the link between the balance sheet and the statement of retained earnings.
18. Define and describe revenues and expenses.
19. Define and describe assets, liabilities, and equity.

**GLOBAL VIEW**

Financial accounting according to U.S. GAAP is similar, but not identical, to IFRS. This section discusses differences in analyzing and recording transactions, and with the preparation of financial statements.

**Analyzing and Recording Transactions** Both U.S. GAAP and IFRS include broad and similar guidance for financial accounting. As the FASB and IASB work toward a common conceptual framework over the next few years, even those differences will fade. Further, both U.S. GAAP and IFRS apply transaction
Appendix C  Basic Accounting for Transactions

Analysis and recording as shown in this appendix—using the same debit and credit system and accrual accounting. Although some variations exist in revenue and expense recognition and other accounting principles, all of the transactions in this appendix are accounted for identically under these two systems.

Financial Statements  Both U.S. GAAP and IFRS prepare the same four basic financial statements. A few differences within each statement do exist and we will discuss those throughout the book. For example, both U.S. GAAP and IFRS require balance sheets to separate current items from noncurrent items. However, while U.S. GAAP balance sheets report current items first, IFRS balance sheets normally (but are not required to) present noncurrent items first, and equity before liabilities. To illustrate, a condensed version of Piaggio’s balance sheet follows (numbers using Euros in thousands).

<table>
<thead>
<tr>
<th>Assets</th>
<th>Equity and Liabilities</th>
</tr>
</thead>
<tbody>
<tr>
<td>Noncurrent assets</td>
<td>Total equity</td>
</tr>
<tr>
<td>1,010,476</td>
<td>446,218</td>
</tr>
<tr>
<td>Current assets</td>
<td>Noncurrent liabilities</td>
</tr>
<tr>
<td>509,708</td>
<td>429,689</td>
</tr>
<tr>
<td>Total assets</td>
<td>Current liabilities</td>
</tr>
<tr>
<td>1,520,184</td>
<td>644,277</td>
</tr>
<tr>
<td></td>
<td>Total equity and liabilities</td>
</tr>
<tr>
<td></td>
<td>1,520,184</td>
</tr>
</tbody>
</table>

Accounting Controls and Assurance  Accounting systems depend on control procedures that assure the proper principles were applied in processing accounting information. The passage of SOX legislation strengthened U.S. control procedures in recent years. However, global standards for control are diverse and so are enforcement activities. Consequently, while global accounting standards are converging, their application in different countries can yield different outcomes depending on the quality of their auditing standards and enforcement.

Decision Insight  Recording valid transactions, and not recording fraudulent transactions, enhances the quality of financial statements. The graph here shows the percentage of employees in information technology that report observing specific types of misconduct within the past year [Source: KPMG 2009].

Decision Analysis  An important business objective is gathering information to help assess a company’s risk of failing to pay its debts. Companies finance their assets with either liabilities or equity. A company that finances a relatively large portion of its assets with liabilities is said to have a high degree of financial leverage. Higher financial leverage involves greater risk because liabilities must be repaid and often require regular interest payments (equity financing does not). The risk that a company might not be able to meet such required payments is higher if it has more liabilities (is more highly leveraged). One way to assess the risk associated with a company’s use of liabilities is to compute the debt ratio as in Exhibit C.17.

Debt ratio = \[ \frac{\text{Total liabilities}}{\text{Total assets}} \]

EXHIBIT C.17  Debt Ratio
Appendix C  Basic Accounting for Transactions

To see how to apply the debt ratio, let’s look at Skechers’ liabilities and assets. The company designs, markets, and sells footwear for men, women, and children under the Skechers brand. Exhibit C.18 computes and reports its debt ratio at the end of each year from 2006 to 2011.

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Total liabilities</td>
<td>$389</td>
<td>$359</td>
<td>$246</td>
<td>$204</td>
<td>$201</td>
<td>$288</td>
</tr>
<tr>
<td>Total assets</td>
<td>$1,282</td>
<td>$1,305</td>
<td>$996</td>
<td>$876</td>
<td>$828</td>
<td>$737</td>
</tr>
<tr>
<td>Debt ratio</td>
<td>0.30</td>
<td>0.28</td>
<td>0.25</td>
<td>0.23</td>
<td>0.24</td>
<td>0.39</td>
</tr>
<tr>
<td>Industry debt ratio</td>
<td>0.47</td>
<td>0.49</td>
<td>0.51</td>
<td>0.50</td>
<td>0.46</td>
<td>0.48</td>
</tr>
</tbody>
</table>

Skechers’s debt ratio ranges from a low of 0.23 to a high of 0.39—also, see graph in margin. Its ratio is lower, compared with the industry ratio. This analysis implies a low risk from its financial leverage. Is financial leverage good or bad for Skechers? To answer that question we need to compare the company’s return on the borrowed money to the rate it is paying creditors. If the company’s return is higher, it is successfully borrowing money to make more money. A company’s success with making money from borrowed money can quickly turn unprofitable if its own return drops below the rate it is paying creditors.

**Decision Maker**

**Investor** You consider buying stock in Converse. As part of your analysis, you compute its debt ratio for 2011, 2012, and 2013 as: 0.35, 0.74, and 0.94, respectively. Based on the debt ratio, is Converse a low-risk investment? Has the risk of buying Converse stock changed over this period? (The industry debt ratio averages 0.40.)

**DEMONSTRATION PROBLEM**

After several months of planning, Jasmine Worthy started a haircutting business called Expressions. The following events occurred during its first month.

a. On August 1, Worthy invested $3,000 cash and $15,000 of equipment in Expressions in exchange for common stock.

b. On August 2, Expressions paid $600 cash for furniture for the shop.

c. On August 3, Expressions paid $500 cash to rent space in a strip mall for August.

d. On August 4, it purchased $1,200 of equipment on credit for the shop (using a long-term note payable).

e. On August 5, Expressions opened for business. Cash received from haircutting services in the first week and a half of business (ended August 15) was $825.

f. On August 15, it provided $100 of haircutting services on account.

g. On August 17, it received a $100 check for services previously rendered on account.

h. On August 17, it paid $125 to an assistant for hours worked during the grand opening.

i. Cash received from services provided during the second half of August was $930.

j. On August 31, it paid a $400 installment toward principal on the note payable entered into on August 4.

k. On August 31, it paid $900 cash in dividends to Worthy (sole shareholder).

**Required**

1. Open the following ledger accounts in balance column format (account numbers are in parentheses): Cash (101); Accounts Receivable (102); Furniture (161); Store Equipment (165); Note Payable (240); Common Stock (307); Dividends (319); Haircutting Services Revenue (403); Wages Expense (623); and Rent Expense (640). Prepare general journal entries for the transactions.

2. Post the journal entries from (1) to the ledger accounts.
3. Prepare a trial balance as of August 31.
4. Prepare an income statement for August.
5. Prepare a statement of retained earnings for August.
7. Determine the debt ratio as of August 31.

**Extended Analysis**

8. In the coming months, Expressions will experience a greater variety of business transactions. Identify which accounts are debited and which are credited for the following transactions. (*Hint*: We must use some accounts not opened in part 1.)
   a. Purchase supplies with cash.
   b. Pay cash for future insurance coverage.
   c. Receive cash for services to be provided in the future.
   d. Purchase supplies on account.

**PLANNING THE SOLUTION**

- Analyze each transaction and use the debit and credit rules to prepare a journal entry for each.
- Post each debit and each credit from journal entries to their ledger accounts and cross-reference each amount in the posting reference (PR) columns of the journal and ledger.
- Calculate each account balance and list the accounts with their balances on a trial balance.
- Verify that total debits in the trial balance equal total credits.
- To prepare the income statement, identify revenues and expenses. List those items on the statement, compute the difference, and label the result as *net income* or *net loss*.
- Use information in the ledger to prepare the statement of retained earnings.
- Use information in the ledger to prepare the balance sheet.
- Calculate the debt ratio by dividing total liabilities by total assets.
- Analyze the future transactions to identify the accounts affected and apply debit and credit rules.

**SOLUTION TO DEMONSTRATION PROBLEM**

1. General journal entries:

<table>
<thead>
<tr>
<th>Date</th>
<th>Account Titles and Explanation</th>
<th>PR</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Aug. 1</td>
<td>Cash ........................................</td>
<td>101</td>
<td>3,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Store Equipment ..................</td>
<td>165</td>
<td>15,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Common Stock ........................</td>
<td>307</td>
<td>18,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Owner’s investment for stock.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>Furniture ..........................</td>
<td>161</td>
<td>600</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Cash ..................................</td>
<td>101</td>
<td>600</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Purchased furniture for cash.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3</td>
<td>Rent Expense ......................</td>
<td>640</td>
<td>500</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Cash ..................................</td>
<td>101</td>
<td>500</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Paid rent for August.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4</td>
<td>Store Equipment ..................</td>
<td>165</td>
<td>1,200</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Note Payable .....................</td>
<td>240</td>
<td>1,200</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Purchased additional equipment on credit.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>15</td>
<td>Cash ..................................</td>
<td>101</td>
<td>825</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Haircutting Services Revenue ....</td>
<td>403</td>
<td>825</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Cash receipts from first half of August.</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

[continued on next page]
[continued from previous page]

15 Accounts Receivable ......................................... 102 100
   Haircutting Services Revenue .......................... 403  100
   To record revenue for services provided on account.
17 Cash ................................................................. 101 100
   Accounts Receivable ........................................ 102  100
   To record cash received as payment on account.
17 Wages Expense ............................................... 623  125
   Paid wages to assistant.
31 Cash ................................................................. 101  930
   Haircutting Services Revenue ......................... 403  930
   Cash receipts from second half of August.
31 Note Payable ................................................... 240 400
   Cash ................................................................. 101 400
   Paid an installment on the note payable.
31 Dividends ....................................................... 319 900
   Cash ................................................................. 101 900
   Paid cash dividend.

2. Post journal entries from part 1 to the ledger accounts:

<table>
<thead>
<tr>
<th>Date</th>
<th>PR</th>
<th>Debit</th>
<th>Credit</th>
<th>Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Aug.</td>
<td>G1</td>
<td>3,000</td>
<td>3,000</td>
<td></td>
</tr>
<tr>
<td>Aug.</td>
<td>G1</td>
<td>600</td>
<td>2,400</td>
<td></td>
</tr>
<tr>
<td>Aug.</td>
<td>G1</td>
<td>500</td>
<td>1,900</td>
<td></td>
</tr>
<tr>
<td>Aug.</td>
<td>G1</td>
<td>825</td>
<td>2,725</td>
<td></td>
</tr>
<tr>
<td>Aug.</td>
<td>G1</td>
<td>100</td>
<td>2,825</td>
<td></td>
</tr>
<tr>
<td>Aug.</td>
<td>G1</td>
<td>125</td>
<td>2,700</td>
<td></td>
</tr>
<tr>
<td>Aug.</td>
<td>G1</td>
<td>930</td>
<td>3,630</td>
<td></td>
</tr>
<tr>
<td>Aug.</td>
<td>G1</td>
<td>400</td>
<td>3,230</td>
<td></td>
</tr>
<tr>
<td>Aug.</td>
<td>G1</td>
<td>900</td>
<td>2,330</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Date</th>
<th>PR</th>
<th>Debit</th>
<th>Credit</th>
<th>Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Aug.</td>
<td>G1</td>
<td>100</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>Aug.</td>
<td>G1</td>
<td>100</td>
<td>100</td>
<td>0</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Date</th>
<th>PR</th>
<th>Debit</th>
<th>Credit</th>
<th>Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Aug.</td>
<td>G1</td>
<td>600</td>
<td>600</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Date</th>
<th>PR</th>
<th>Debit</th>
<th>Credit</th>
<th>Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Aug.</td>
<td>G1</td>
<td>15,000</td>
<td>15,000</td>
<td></td>
</tr>
<tr>
<td>Aug.</td>
<td>G1</td>
<td>1,200</td>
<td>16,200</td>
<td></td>
</tr>
<tr>
<td>Aug.</td>
<td>G1</td>
<td>500</td>
<td>500</td>
<td></td>
</tr>
</tbody>
</table>
3. Prepare a trial balance from the ledger:

<table>
<thead>
<tr>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>$ 2,330</td>
</tr>
<tr>
<td>Accounts receivable</td>
<td>0</td>
</tr>
<tr>
<td>Furniture</td>
<td>600</td>
</tr>
<tr>
<td>Store equipment</td>
<td>16,200</td>
</tr>
<tr>
<td>Note payable</td>
<td>$ 800</td>
</tr>
<tr>
<td>Common stock</td>
<td>18,000</td>
</tr>
<tr>
<td>Dividends</td>
<td>900</td>
</tr>
<tr>
<td>Haircutting services revenue</td>
<td>1,855</td>
</tr>
<tr>
<td>Wages expense</td>
<td>125</td>
</tr>
<tr>
<td>Rent expense</td>
<td>500</td>
</tr>
<tr>
<td><strong>Totals</strong></td>
<td><strong>$20,655</strong></td>
</tr>
<tr>
<td><strong>Debit</strong></td>
<td><strong>Credit</strong></td>
</tr>
<tr>
<td><strong>Credit</strong></td>
<td><strong>Debit</strong></td>
</tr>
</tbody>
</table>

4. Income Statement:

<table>
<thead>
<tr>
<th>Revenues</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Haircutting services revenue</td>
<td>$1,855</td>
</tr>
<tr>
<td>Operating expenses</td>
<td></td>
</tr>
<tr>
<td>Rent expense</td>
<td>$500</td>
</tr>
<tr>
<td>Wages expense</td>
<td>125</td>
</tr>
<tr>
<td><strong>Total operating expenses</strong></td>
<td><strong>625</strong></td>
</tr>
<tr>
<td><strong>Net income</strong></td>
<td><strong>$1,230</strong></td>
</tr>
</tbody>
</table>

5. Statement of Retained Earnings:

| Retained earnings, August 1                    | $ 0      |
| Plus: Net income                              | $1,230   |
| Less: Cash dividends                           | $ 900    |
| Retained earnings, August 31                  | $ 330    |

6. Balance Sheet:

<table>
<thead>
<tr>
<th>Assets</th>
<th>Liabilities</th>
<th>Equity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>$ 2,330</td>
<td>Note payable</td>
</tr>
<tr>
<td>Furniture</td>
<td>600</td>
<td>$ 800</td>
</tr>
<tr>
<td>Store equipment</td>
<td>16,200</td>
<td>Common stock</td>
</tr>
<tr>
<td></td>
<td></td>
<td>18,000</td>
</tr>
<tr>
<td><strong>Total assets</strong></td>
<td><strong>$19,130</strong></td>
<td>Retained earnings</td>
</tr>
<tr>
<td></td>
<td></td>
<td>330</td>
</tr>
<tr>
<td><strong>Total liabilities and equity</strong></td>
<td><strong>$19,130</strong></td>
<td><strong>Total equity</strong></td>
</tr>
<tr>
<td></td>
<td></td>
<td><strong>18,330</strong></td>
</tr>
</tbody>
</table>
Appendix C  Basic Accounting for Transactions

7. Debt ratio = \( \frac{\text{Total liabilities}}{\text{Total assets}} \) = \( \frac{\$800}{\$19,130} \) = 4.18%

8a. Supplies debited
Cash credited

8b. Prepaid Insurance debited
Cash credited

8c. Cash debited
Unearned Services Revenue credited

8d. Supplies debited
Accounts Payable credited

Summary

C1  Explain the steps in processing transactions and the role of source documents. The accounting process identifies business transactions and events, analyzes and records their effects, and summarizes and prepares information useful in making decisions. Transactions and events are the starting points in the accounting process. Source documents identify and describe transactions and events. Examples are sales tickets, checks, purchase orders, bills, and bank statements. Source documents provide objective and reliable evidence, making information more useful. The effects of transactions and events are recorded in journals. Posting along with a trial balance helps summarize and classify these effects.

C2  Describe an account and its use in recording transactions. An account is a detailed record of increases and decreases in a specific asset, liability, equity, revenue, or expense. Information from accounts is analyzed, summarized, and presented in reports and financial statements for decision makers.

C3  Describe a ledger and a chart of accounts. The ledger (or general ledger) is a record containing all accounts used by a company and their balances. It is referred to as the books. The chart of accounts is a list of all accounts and usually includes an identification number assigned to each account.

C4  Define debits and credits and explain double-entry accounting. Debit refers to left, and credit refers to right. Debits increase assets, expenses, and dividends while credits decrease them. Credits increase liabilities, common stock, and revenues; debits decrease them. Double-entry accounting means each transaction affects at least two accounts and has at least one debit and one credit. The system for recording debits and credits follows from the accounting equation. The left side of an account is the normal balance for assets, dividends, and expenses, and the right side is the normal balance for liabilities, common stock, and revenues.

A1  Analyze the impact of transactions on accounts and financial statements. We analyze transactions using concepts of double-entry accounting. This analysis is performed by determining a transaction’s effects on accounts. These effects are recorded in journals and posted to ledgers.

A2  Compute the debt ratio and describe its use in analyzing financial condition. A company’s debt ratio is computed as total liabilities divided by total assets. It reveals how much of the assets are financed by creditor (nonowner) financing. The higher this ratio, the more risk a company faces because liabilities must be repaid at specific dates.

P1  Record transactions in a journal and post entries to a ledger. Transactions are recorded in a journal. Each entry in a journal is posted to the accounts in the ledger. This provides information that is used to produce financial statements. Balance column accounts are widely used and include columns for debits, credits, and the account balance.

P2  Prepare and explain the use of a trial balance. A trial balance is a list of accounts from the ledger showing their debit or credit balances in separate columns. The trial balance is a summary of the ledger’s contents and is useful in preparing financial statements and in revealing recordkeeping errors.

P3  Prepare financial statements from business transactions. The balance sheet, the statement of retained earnings, the income statement, and the statement of cash flows use data from the trial balance (and other financial statements) for their preparation.

Guidance Answers to Decision Maker and Decision Ethics

Cashier  The advantages to the process proposed by the assistant manager include improved customer service, fewer delays, and less work for you. However, you should have serious concerns about internal control and the potential for fraud. In particular, the assistant manager could steal cash and simply enter fewer sales to match the remaining cash. You should reject her suggestion without the manager’s approval. Moreover, you should have an ethical concern about the assistant manager’s suggestion to ignore store policy.

Entrepreneur  We can use the accounting equation (Assets = Liabilities + Equity) to help us identify risky customers to whom we would likely not want to extend credit. A balance sheet provides amounts for each of these key components. The lower a customer’s equity is relative to liabilities, the less likely you would extend credit. A low equity means the business has little value that does not already have creditor claims to it.

Investor  The debt ratio suggests the stock of Converse is of higher risk than normal and that this risk is rising. The average industry ratio of 0.40 further supports this conclusion. The 2013 debt ratio for Converse is twice the industry norm. Also, a debt ratio approaching 1.0 indicates little to no equity.
Appendix C  Basic Accounting for Transactions

Guidance Answers to Quick Checks

1. Examples of source documents are sales tickets, checks, purchase orders, charges to customers, bills from suppliers, employee earnings records, and bank statements.

2. Source documents serve many purposes, including record-keeping and internal control. Source documents, especially if obtained from outside the organization, provide objective and reliable evidence about transactions and their amounts.

3. Assets  Liabilities  Equity  
   a,c,e       b,d

4. An account is a record in an accounting system that records and stores the increases and decreases in a specific asset, liability, equity, revenue, or expense. The ledger is a collection of all the accounts of a company.

5. A company’s size and diversity affect the number of accounts in its accounting system. The types of accounts depend on information the company needs to both effectively operate and report its activities in financial statements.

6. No. Debit and credit both can mean increase or decrease. The particular meaning in a circumstance depends on the type of account. For example, a debit increases the balance of asset, dividends, and expense accounts, but it decreases the balance of liability, common stock, and revenue accounts.

7. A chart of accounts is a list of all of a company’s accounts and their identification numbers.

8. Equity is increased by revenues and by owner investments. Equity is decreased by expenses and dividends.

9. The name double-entry is used because all transactions affect at least two accounts. There must be at least one debit in one account and at least one credit in another account.

10. The answer is (c).

11. | Account          | Amount  |
     |-----------------|---------|
     | Cash           | 15,000  |
     | Equipment      | 23,000  |
     | Common Stock   | 38,000  |

   Investment by owner of cash and equipment.

12. A compound journal entry affects three or more accounts.

13. Posting reference numbers are entered in the journal when posting to the ledger as a cross-reference that allows the record-keeper or auditor to trace debits and credits from one record to another.

14. At a minimum, dollar signs are placed beside the first and last numbers in a column. It is also common to place dollar signs beside any amount that appears after a ruled line to indicate that an addition or subtraction has occurred.

15. The Equipment account balance is incorrectly reported at $20,000—it should be $28,000. The effect of this error understates the trial balance’s Debit column total by $8,000. This results in an $8,000 difference between the column totals.

16. An income statement reports a company’s revenues and expenses along with the resulting net income or loss. A statement of retained earnings reports changes in retained earnings, including that from net income or loss. Both statements report transactions occurring over a period of time.

17. The balance sheet describes a company’s financial position (assets, liabilities, and equity) at a point in time. The retained earnings amount in the balance sheet is obtained from the statement of retained earnings.

18. Revenues are inflows of assets in exchange for products or services provided to customers as part of the main operations of a business. Expenses are outflows or the using up of assets that result from providing products or services to customers.

19. Assets are the resources a business owns or controls that carry expected future benefits. Liabilities are the obligations of a business, representing the claims of others against the assets of a business. Equity reflects the owner’s claims on the assets of the business after deducting liabilities.

Key Terms

<table>
<thead>
<tr>
<th>Account (p. C-3)</th>
<th>Debit (p. C-7)</th>
<th>Journalizing (p. C-8)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Account balance, or Balance (p. C-7)</td>
<td>Debt ratio (p. C-21)</td>
<td>Posting (p. C-8)</td>
</tr>
<tr>
<td>Balance column account (p. C-10)</td>
<td>Dividends (p. C-5)</td>
<td>Posting reference (PR) column (p. C-10)</td>
</tr>
<tr>
<td>Chart of accounts (p. C-6)</td>
<td>Double-entry accounting (p. C-7)</td>
<td>Source documents (p. C-2)</td>
</tr>
<tr>
<td>Compound journal entry (p. C-13)</td>
<td>General journal (p. C-8)</td>
<td>T-accounts (p. C-7)</td>
</tr>
<tr>
<td>Credit (p. C-7)</td>
<td>General ledger (p. C-3)</td>
<td>Trial balance (p. C-17)</td>
</tr>
<tr>
<td>Creditors (p. C-4)</td>
<td>Journal (p. C-8)</td>
<td>Unearned revenue (p. C-5)</td>
</tr>
</tbody>
</table>
Appendix C  Basic Accounting for Transactions

Multiple Choice Quiz  Answers on p. C-45

Additional Quiz Questions are available at the book’s Website.

1. Amalia Company received its utility bill for the current period of $700 and immediately paid it. Its journal entry to record this transaction includes a
   a. Credit to Utility Expense for $700.
   b. Debit to Utility Expense for $700.
   c. Debit to Accounts Payable for $700.
   d. Debit to Cash for $700.
   e. Credit to Common Stock for $700.

2. On May 1, Mattingly Lawn Service collected $2,500 cash from a customer in advance of five months of lawn service. Mattingly’s journal entry to record this transaction includes a
   a. Credit to Unearned Lawn Service Fees for $2,500.
   b. Debit to Lawn Service Fees Earned for $2,500.
   c. Credit to Cash for $2,500.
   d. Debit to Unearned Lawn Service Fees for $2,500.
   e. Credit to Common Stock for $2,500.

3. Liang Shue contributed $250,000 cash and land worth $500,000 to open his new business, Shue Consulting Corporation. Which of the following journal entries does Shue Consulting make to record this transaction?
   a. Cash Assets ............ 750,000
      Common Stock .......... 750,000
   b. Common Stock .......... 750,000
      Assets ............... 750,000
   c. Cash ............... 250,000
      Land .............. 500,000
      Common Stock ....... 750,000

d. Common Stock .......... 750,000
   Cash ............... 250,000
   Land .............. 500,000

4. A trial balance prepared at year-end shows total credits exceed total debits by $765. This discrepancy could have been caused by
   a. An error in the general journal where a $765 increase in Accounts Payable was recorded as a $765 decrease in Accounts Payable.
   b. The ledger balance for Accounts Payable of $7,650 being entered in the trial balance as $765.
   c. A general journal error where a $765 increase in Accounts Receivable was recorded as a $765 increase in Cash.
   d. The ledger balance of $850 in Accounts Receivable was entered in the trial balance as $85.
   e. An error in recording a $765 increase in Cash as a credit.

5. Bonaventure Company has total assets of $1,000,000, liabilities of $400,000, and equity of $600,000. What is its debt ratio (rounded to a whole percent)?
   a. 250%
   b. 167%
   c. 67%
   d. 150%
   e. 40%

Discussion Questions

1. Provide the names of two (a) asset accounts, (b) liability accounts, and (c) equity accounts.

2. What is the difference between a note payable and an account payable?

3. Discuss the steps in processing business transactions.

4. What kinds of transactions can be recorded in a general journal?

5. Are debits or credits typically listed first in general journal entries? Are the debits or the credits indented?

6. Should a transaction be recorded first in a journal or the ledger? Why?

7. If assets are valuable resources and asset accounts have debit balances, why do expense accounts also have debit balances?

8. Why does the recordkeeper prepare a trial balance?

9. If an incorrect amount is journalized and posted to the accounts, how should the error be corrected?

10. Identify the four financial statements of a business.

11. What information is reported in a balance sheet?

12. What information is reported in an income statement?

13. Why does the user of an income statement need to know the time period that it covers?

14. Define (a) assets, (b) liabilities, (c) equity, and (d) net assets.

15. Which financial statement is sometimes called the statement of financial position?

16. Review the Polaris balance sheet in Appendix A. Identify three accounts on its balance sheet that carry debit balances and three accounts on its balance sheet that carry credit balances.

17. Review the Arctic Cat balance sheet in Appendix A. Identify an asset with the word receivable in its account title and a liability with the word payable in its account title.

18. Locate KTM’s income statement in Appendix A. What is the title of its revenue account?

19. Refer to Piaggio’s balance sheet in Appendix A. What does Piaggio title its current asset referring to merchandise available for sale?
Identify the items from the following list that are likely to serve as source documents.

<table>
<thead>
<tr>
<th>a. Sales ticket</th>
<th>d. Telephone bill</th>
<th>g. Balance sheet</th>
</tr>
</thead>
<tbody>
<tr>
<td>b. Income statement</td>
<td>e. Invoice from supplier</td>
<td>h. Prepaid insurance</td>
</tr>
<tr>
<td>c. Trial balance</td>
<td>f. Company revenue account</td>
<td>i. Bank statement</td>
</tr>
</tbody>
</table>

Identify the financial statement(s) where each of the following items appears. Use I for income statement, E for statement of retained earnings, and B for balance sheet.

<table>
<thead>
<tr>
<th>a. Office equipment</th>
<th>d. Prepaid insurance</th>
<th>g. Cash</th>
</tr>
</thead>
<tbody>
<tr>
<td>b. Cash dividends</td>
<td>e. Office supplies</td>
<td>h. Unearned rent revenue</td>
</tr>
<tr>
<td>c. Revenue</td>
<td>f. Rent expense</td>
<td>i. Accounts payable</td>
</tr>
</tbody>
</table>

Identify the normal balance (debit or credit) for each of the following accounts.

<table>
<thead>
<tr>
<th>a. Office Supplies</th>
<th>d. Wages Expense</th>
<th>g. Wages Payable</th>
</tr>
</thead>
<tbody>
<tr>
<td>b. Dividends</td>
<td>e. Accounts Receivable</td>
<td>h. Building</td>
</tr>
<tr>
<td>c. Fees Earned</td>
<td>f. Prepaid Rent</td>
<td>i. Common Stock</td>
</tr>
</tbody>
</table>

Indicate whether a debit or credit decreases the normal balance of each of the following accounts.

<table>
<thead>
<tr>
<th>a. Service Revenue</th>
<th>e. Common Stock</th>
<th>i. Dividends</th>
</tr>
</thead>
<tbody>
<tr>
<td>b. Interest Payable</td>
<td>f. Prepaid Insurance</td>
<td>j. Unearned Revenue</td>
</tr>
<tr>
<td>c. Accounts Receivable</td>
<td>g. Buildings</td>
<td>k. Accounts Payable</td>
</tr>
<tr>
<td>d. Salaries Expense</td>
<td>h. Interest Revenue</td>
<td>l. Land</td>
</tr>
</tbody>
</table>

Identify whether a debit or credit yields the indicated change for each of the following accounts.

<table>
<thead>
<tr>
<th>a. To increase Land</th>
<th>f. To decrease Prepaid Rent</th>
</tr>
</thead>
<tbody>
<tr>
<td>b. To decrease Cash</td>
<td>g. To increase Notes Payable</td>
</tr>
<tr>
<td>c. To increase Office Expense</td>
<td>h. To decrease Accounts Receivable</td>
</tr>
<tr>
<td>d. To increase Fees Earned</td>
<td>i. To increase Common Stock</td>
</tr>
<tr>
<td>e. To decrease Unearned Revenue</td>
<td>j. To increase Store Equipment</td>
</tr>
</tbody>
</table>

Prepare journal entries for each of the following selected transactions.

| a. On May 15, DeShawn Tyler opens a landscaping company called Elegant Lawns by investing $70,000 cash along with equipment having a $30,000 value in exchange for common stock. |
| b. On May 21, Elegant Lawns purchases office supplies on credit for $280. |
| c. On May 25, Elegant Lawns receives $7,800 cash for performing landscaping services. |
| d. On May 30, Elegant Lawns receives $1,000 cash in advance of providing landscaping services to a customer. |

A trial balance has total debits of $20,000 and total credits of $24,500. Which one of the following errors would create this imbalance? Explain.

| a. A $2,250 debit to Utilities Expense in a journal entry is incorrectly posted to the ledger as a $2,250 credit, leaving the Utilities Expense account with a $3,000 debit balance. |
| b. A $4,500 debit to Salaries Expense in a journal entry is incorrectly posted to the ledger as a $4,500 credit, leaving the Salaries Expense account with a $750 debit balance. |
| c. A $2,250 credit to Consulting Fees Earned in a journal entry is incorrectly posted to the ledger as a $2,250 debit, leaving the Consulting Fees Earned account with a $6,300 credit balance. |
| d. A $2,250 debit posting to Accounts Receivable was posted mistakenly to Land. |
| e. A $4,500 debit posting to Equipment was posted mistakenly to Cash. |
| f. An entry debiting Cash and crediting Accounts Payable for $4,500 was mistakenly not posted. |
Appendix C  Basic Accounting for Transactions

QS C-8  Classifying accounts in financial statements
P3
Indicate the financial statement on which each of the following items appears. Use I for income statement, E for statement of retained earnings, and B for balance sheet.

a. Services Revenue  e. Equipment  i. Dividends
b. Interest Payable  f. Prepaid Insurance  j. Office Supplies
c. Accounts Receivable  g. Buildings  k. Interest Expense
d. Salaries Expense  h. Rental Revenue  l. Insurance Expense

QS C-9  International accounting standards
C4
Answer each of the following questions related to international accounting standards.

a. What type of entry system is applied when accounting follows IFRS?
b. Identify the number and usual titles of the financial statements prepared under IFRS.
c. How do differences in accounting controls and enforcement impact accounting reports prepared across different countries?

EXERCISES

Exercise C-1  Steps in analyzing and recording transactions
C1
Order the following steps in the accounting process that focus on analyzing and recording transactions.

______ a. Analyze each transaction from source documents.
______ b. Prepare and analyze the trial balance.
______ c. Record relevant transactions in a journal.
______ d. Post journal information to ledger accounts.

Exercise C-2  Identifying and classifying accounts
C2
Enter the number for the item that best completes each of the descriptions below.

1. Asset  3. Account  5. Three
2. Equity  4. Liability
   a. An ______ is a record of increases and decreases in a specific asset, liability, equity, revenue, or expense item.
   b. Accounts payable, unearned revenue, and note payable are examples of ______ accounts.
   c. Accounts receivable, prepaid accounts, supplies, and land are examples of ______ accounts.
   d. Accounts are arranged into ______ general categories.
   e. Common stock and dividends are examples of ______ accounts.

Exercise C-3  Identifying a ledger and chart of accounts
C3
Enter the number for the item that best completes each of the descriptions below.

1. Chart  2. General ledger
   a. The ______ is a record containing all accounts used by a company.
   b. A ______ of accounts is a list of all accounts a company uses.

Exercise C-4  Identifying type and normal balances of accounts
C4
For each of the following (1) identify the type of account as an asset, liability, equity, revenue, or expense, (2) identify the normal balance of the account, and (3) enter debit (Dr.) or credit (Cr.) to identify the kind of entry that would increase the account balance.

a. Cash  e. Accounts Receivable  i. Fees Earned
b. Legal Expense  f. Dividends  j. Equipment
c. Prepaid Insurance  g. License Fee Revenue  k. Notes Payable
d. Land  h. Unearned Revenue  l. Common Stock

Exercise C-5  Analyzing account entries and balances
A1
Use the information in each of the following separate cases to calculate the unknown amount.

a. Corentine Co. had $152,000 of accounts payable on September 30 and $132,500 on October 31. Total purchases on account during October were $281,000. Determine how much cash was paid on accounts payable during October.

b. On September 30, Valerian Co. had a $102,500 balance in Accounts Receivable. During October, the company collected $102,890 from its credit customers. The October 31 balance in Accounts Receivable was $89,000. Determine the amount of sales on account that occurred in October.

c. During October, Alameda Company had $102,500 of cash receipts and $103,150 of cash disbursements. The October 31 Cash balance was $18,600. Determine how much cash the company had at the close of business on September 30.
Appendix C  Basic Accounting for Transactions  C-31

Groro Co. bills a client $62,000 for services provided and agrees to accept the following three items in full payment: (1) $10,000 cash, (2) computer equipment worth $80,000, and (3) to assume responsibility for a $28,000 note payable related to the computer equipment. The entry Groro makes to record this transaction includes which one or more of the following?

- $28,000 increase in a liability account
- $10,000 increase in the Cash account
- $10,000 increase in a revenue account
- $62,000 increase in an asset account
- $62,000 increase in a revenue account
- $62,000 increase in an equity account

Prepare general journal entries for the following transactions of a new company called Pose-for-Pics.

Aug. 1 Madison Harris, the owner, invested $6,500 cash and $33,500 of photography equipment in the company in exchange for common stock.
2 The company paid $2,100 cash for an insurance policy covering the next 24 months.
5 The company purchased office supplies for $880 cash.
20 The company received $3,331 cash in photography fees earned.
31 The company paid $675 cash for August utilities.

Use the information in Exercise C-7 to prepare an August 31 trial balance for Pose-for-Pics. Begin by opening these T-accounts: Cash; Accounts Receivable; Office Supplies; Office Equipment; Accounts Payable; Common Stock; Photography Fees Earned; and Utilities Expense. Then, post the general journal entries to these T-accounts (which will serve as the ledger), and prepare the trial balance.

Prepare general journal entries to record the transactions below for Spade Company by using the following accounts: Cash; Accounts Receivable; Office Supplies; Office Equipment; Accounts Payable; Common Stock; Photography Fees Earned; and Utilities Expense. Use the letters beside each transaction to identify entries. After recording the transactions, post them to T-accounts, which serves as the general ledger for this assignment. Determine the ending balance of each T-account.

- a. Kacy Spade, owner, invested $100,750 cash in the company in exchange for common stock.
- b. The company purchased office supplies for $1,250 cash.
- c. The company purchased $10,050 of office equipment on credit.
- d. The company received $15,500 cash as fees for services provided to a customer.
- e. The company paid $10,050 cash to settle the payable for the office equipment purchased in transaction c.
- f. The company billed a customer $2,700 as fees for services provided.
- g. The company paid $1,225 cash for the monthly rent.
- h. The company collected $1,125 cash as partial payment for the account receivable created in transaction f.
- i. The company paid $10,000 cash in dividends to Spade (sole shareholder).

After recording the transactions of Exercise C-9 in T-accounts and calculating the balance of each account, prepare a trial balance. Use May 31, 2013, as its report date.

Examine the following transactions and identify those that create revenues for Valdez Services, a company owned by Brina Valdez. Prepare general journal entries to record those revenue transactions and explain why the other transactions did not create revenues.

- b. The company provided $2,300 of services on credit.
- c. The company provided services to a client and immediately received $875 cash.
- d. The company received $10,200 cash from a client in payment for services to be provided next year.
- e. The company received $3,500 cash from a client in partial payment of an account receivable.
- f. The company borrowed $120,000 cash from the bank by signing a promissory note.

Exercise C-6  Analyzing effects of transactions on accounts  A1
Exercise C-7  Preparing general journal entries  P1
Exercise C-8  Preparing T-accounts (ledger) and a trial balance  P2
Exercise C-9  Recording effects of transactions in T-accounts  A1
Exercise C-10 Preparing a trial balance  P2
Exercise C-11 Analyzing and journalizing revenue transactions  A1 P1
Appendix C  Basic Accounting for Transactions

**Exercise C-12**
Analyzing and journalizing expense transactions

Examine the following transactions and identify those that create expenses for Valdez Services. Prepare general journal entries to record those expense transactions and explain why the other transactions did not create expenses.

- **a.** The company paid $12,200 cash for payment on a 16-month old liability for office supplies.
- **b.** The company paid $1,233 cash for the just completed two-week salary of the receptionist.
- **c.** The company paid $39,200 cash for equipment purchased.
- **d.** The company paid $870 cash for this month’s utilities.
- **e.** The company paid $4,500 cash in dividends.

---

**Exercise C-13**
Preparing an income statement

Carmen Camry operates a consulting firm called Help Today, which began operations on August 1. On August 31, the company’s records show the following accounts and amounts for the month of August. Use this information to prepare an August income statement for the business.

<table>
<thead>
<tr>
<th>Account</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>$25,360</td>
</tr>
<tr>
<td>Dividends</td>
<td>$6,000</td>
</tr>
<tr>
<td>Accounts receivable</td>
<td>$22,360</td>
</tr>
<tr>
<td>Consulting fees earned</td>
<td>$27,000</td>
</tr>
<tr>
<td>Office supplies</td>
<td>$5,250</td>
</tr>
<tr>
<td>Rent expense</td>
<td>$9,550</td>
</tr>
<tr>
<td>Land</td>
<td>$44,000</td>
</tr>
<tr>
<td>Salaries expense</td>
<td>$5,600</td>
</tr>
<tr>
<td>Office equipment</td>
<td>$20,000</td>
</tr>
<tr>
<td>Telephone expense</td>
<td>$860</td>
</tr>
<tr>
<td>Accounts payable</td>
<td>$10,500</td>
</tr>
<tr>
<td>Miscellaneous expenses</td>
<td>$520</td>
</tr>
<tr>
<td>Common stock</td>
<td>$102,000</td>
</tr>
</tbody>
</table>

**Check**  Net income, $10,470

---

**Exercise C-14**
Preparing a statement of retained earnings

Use the information in Exercise C-13 to prepare an August statement of retained earnings for Help Today. (The owner invested a total of $102,000 in the company in exchange for common stock on August 1.)

---

**Exercise C-15**
Preparing a balance sheet

Use the information in Exercise C-13 (if completed, you can also use your solution to Exercise C-14) to prepare an August 31 balance sheet for Help Today.

---

**Exercise C-16**
Computing net income

A corporation had the following assets and liabilities at the beginning and end of this year.

<table>
<thead>
<tr>
<th></th>
<th>Assets</th>
<th>Liabilities</th>
</tr>
</thead>
<tbody>
<tr>
<td>Beginning of the year</td>
<td>$60,000</td>
<td>$20,000</td>
</tr>
<tr>
<td>End of the year</td>
<td>105,000</td>
<td>36,000</td>
</tr>
</tbody>
</table>

Determine the net income earned or net loss incurred by the business during the year for each of the following separate cases:

- **a.** Owner made no investments in the business and no dividends were paid during the year.
- **b.** Owner made no investments in the business but dividends were $1,250 cash per month.
- **c.** No dividends were paid during the year but the owner did invest an additional $55,000 cash in exchange for common stock.
- **d.** Dividends were $1,250 cash per month and the owner invested an additional $35,000 cash in exchange for common stock.

---

**Exercise C-17**
Analyzing changes in a company’s equity

Compute the missing amount for each of the following separate companies a through d.
Appendix C  Basic Accounting for Transactions

Exercise C-18  Interpreting and describing transactions from T-accounts

Use information from the T-accounts in Exercise C-18 to prepare general journal entries for each of the seven transactions a through g.

<table>
<thead>
<tr>
<th>Cash</th>
<th>Automobiles</th>
<th>Accounts Payable</th>
<th>Common Stock</th>
<th>Delivery Services Revenue</th>
<th>Equipment</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a) 6,000</td>
<td>(a) 12,000</td>
<td>(f) 1,600</td>
<td>(a) 25,600</td>
<td>(e) 4,500</td>
<td>(g) 820</td>
</tr>
<tr>
<td>(e) 4,500</td>
<td></td>
<td>(d) 10,000</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Office Supplies</td>
<td>Accounts Payable</td>
<td>Prepaid Insurance</td>
<td>Delivery Services Revenue</td>
<td>Gas and Oil Expense</td>
<td></td>
</tr>
<tr>
<td>(c) 900</td>
<td>(c) 900</td>
<td>(d) 300</td>
<td>(c) 900</td>
<td>(g) 820</td>
<td></td>
</tr>
<tr>
<td>(d) 300</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Exercise C-19  Preparing general journal entries

Posting errors are identified in the following table. In column (1), enter the amount of the difference between the two trial balance columns (debit and credit) due to the error. In column (2), identify the trial balance column (debit or credit) with the larger amount if they are not equal. In column (3), identify the account(s) affected by the error. In column (4), indicate the amount by which the account(s) in column (3) is understated or overstated. Item (a) is completed as an example.

<table>
<thead>
<tr>
<th>Description of Posting Error</th>
<th>(1) Difference between Debit and Credit Columns</th>
<th>(2) Column with the Larger Total</th>
<th>(3) Identify Account(s) Incorrectly Stated</th>
<th>(4) Amount that Account(s) is Over- or Understated</th>
</tr>
</thead>
<tbody>
<tr>
<td>a. $3,600 debit to Rent Expense is posted as a $1,340 debit.</td>
<td>$2,260</td>
<td>Credit</td>
<td>Rent Expense</td>
<td>Rent Expense understated $2,260</td>
</tr>
<tr>
<td>b. $6,500 credit to Cash is posted twice as two credits to Cash.</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>c. $10,900 debit to the Dividends account is debited to Common Stock.</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>d. $2,050 debit to Prepaid Insurance is posted as a debit to Insurance Expense.</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>e. $38,000 debit to Machinery is posted as a debit to Accounts Payable.</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>f. $5,850 credit to Services Revenue is posted as a $585 credit.</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>g. $1,390 debit to Store Supplies is not posted.</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Exercise C-20  Identifying effects of posting errors on the trial balance

Exercise C-21  Analyzing a trial balance error

You are told the column totals in a trial balance are not equal. After careful analysis, you discover only one error. Specifically, a correctly journalized credit purchase of an automobile for $18,950 is posted from the journal to the ledger with a $18,950 debit to Automobiles and another $18,950 debit to Accounts Payable. The Automobiles account has a debit balance of $37,100 on the trial balance. Answer each of the following questions and compute the dollar amount of any misstatement.
The company purchased $20,000 of additional drafting equipment by paying $9,500 cash and signing a long-term note payable for $10,500.

The company paid $1,200 cash for wages to a drafting assistant.

The company received a bill for rent of equipment that was used on a recently completed job. The total of the rent cost must be paid within 30 days.

The company completed engineering services for $22,000 on credit.

The company completed and delivered a set of plans for a client and collected $6,200 cash.

The company purchased a portable building with $55,000 cash and moved it onto the land acquired in transaction b.

To launch the company, Jenna Aracel, the owner, invested $100,000 cash, office equipment with a value of $5,000, and $60,000 of drafting equipment in exchange for common stock.

Aracel Engineering completed the following transactions in the month of June.

a. Is the debit column total of the trial balance overstated, understated, or correctly stated?

b. Is the credit column total of the trial balance overstated, understated, or correctly stated?

c. Is the Automobiles account balance overstated, understated, or correctly stated in the trial balance?

d. Is the Accounts Payable account balance overstated, understated, or correctly stated in the trial balance?

e. If the debit column total of the trial balance is $200,000 before correcting the error, what is the total of the credit column before correction?

f. The company paid $9,480 cash in dividends.

g. The company paid $925 cash for minor maintenance of its drafting equipment.

h. The company paid $1,150 cash to settle the account payable created in transaction a.

i. The company collected $7,900 cash in partial payment from the client described in transaction e.

j. The company purchased $1,150 of additional office equipment on credit.

k. The company completed engineering services for a client. This amount is to be received in 30 days.

l. The company purchased $1,200 cash for wages to a drafting assistant.

m. The company paid $1,150 cash to settle the account payable created in transaction h.

n. The company paid $925 cash for minor maintenance of its drafting equipment.

o. The company paid $9,480 cash in dividends.
Appendix C  Basic Accounting for Transactions

p.  The company paid $1,200 cash for wages to a drafting assistant.

q.  The company paid $2,500 cash for advertisements on the Web during June.

Required

1.  Prepare general journal entries to record these transactions (use the account titles listed in part 2).
2.  Open the following ledger accounts—their account numbers are in parentheses (use the balance column format): Cash (101); Accounts Receivable (106); Prepaid Insurance (108); Office Equipment (163); Drafting Equipment (164); Building (170); Land (172); Accounts Payable (201); Notes Payable (250); Common Stock (307); Dividends (319); Engineering Fees Earned (402); Wages Expense (601); Equipment Rental Expense (602); Advertising Expense (603); and Repairs Expense (604). Post the journal entries from part 1 to the accounts and enter the balance after each posting.
3.  Prepare a trial balance as of the end of June.

Denzel Brooks opens a Web consulting business called Venture Consultants and completes the following transactions in March.

March 1  Brooks invested $150,000 cash along with $22,000 in office equipment in the company in exchange for common stock.
2  The company prepaid $6,000 cash for six months’ rent for an office.  (Hint: Debit Prepaid Rent for $6,000.)
3  The company made credit purchases of office equipment for $3,000 and office supplies for $1,200.  Payment is due within 10 days.
6  The company completed services for a client and immediately received $4,000 cash.
9  The company completed a $7,500 project for a client, who must pay within 30 days.
12  The company paid $4,200 cash to settle the account payable created on March 3.
19  The company paid $5,000 cash for the premium on a 12-month insurance policy.  (Hint: Debit Prepaid Insurance for $5,000.)
22  The company received $3,500 cash as partial payment for the work completed on March 9.
25  The company completed work for another client for $3,820 on credit.
29  The company paid $5,100 cash in dividends.
30  The company paid $5,000 cash for this month’s utility bill.

Required

1.  Prepare general journal entries to record these transactions (use the account titles listed in part 2).
2.  Open the following ledger accounts—their account numbers are in parentheses (use the balance column format): Cash (101); Accounts Receivable (106); Prepaid Insurance (108); Office Equipment (163); Drafting Equipment (164); Building (170); Land (172); Accounts Payable (201); Common Stock (307); Dividends (319); Engineering Fees Earned (402); Wages Expense (601); Equipment Rental Expense (602); Advertising Expense (603); and Repairs Expense (604). Post the journal entries from part 1 to the accounts and enter the balance after each posting.
3.  Prepare a trial balance as of the end of March.

Karla Tanner opens a Web consulting business called Linkworks and completes the following transactions in its first month of operations.

April 1  Tanner invests $80,000 cash along with office equipment valued at $26,000 in the company in exchange for common stock.
2  The company prepaid $9,000 cash for 12 months’ rent for office space.  (Hint: Debit Prepaid Rent for $9,000.)
3  The company made credit purchases for $8,000 in office equipment and $3,600 in office supplies.  Payment is due within 10 days.
6  The company completed services for a client and immediately received $4,000 cash.
9  The company completed a $6,000 project for a client, who must pay within 30 days.
13  The company paid $11,600 cash to settle the account payable created on April 3.
19  The company paid $2,400 cash for the premium on a 12-month insurance policy.  (Hint: Debit Prepaid Insurance for $2,400.)
22  The company received $4,400 cash as partial payment for the work completed on April 9.
25  The company completed work for another client for $2,890 on credit.
28  The company paid $5,500 cash in dividends.
29  The company purchased $600 of additional office supplies on credit.
30  The company paid $435 cash for this month’s utility bill.

Check  (2) Ending balances: Cash, $22,945; Accounts Receivable, $29,000; Accounts Payable, $1,333
      (3) Trial balance totals, $261,733

Problem C-2A
Preparing and posting journal entries; preparing a trial balance

Check  (2) Ending balances: Cash, $136,700; Accounts Receivable, $7820; Accounts Payable, $600
      (3) Total debits, $187,920

Problem C-3A
Preparing and posting journal entries; preparing a trial balance
Appendix C  Basic Accounting for Transactions

**Required**

1. Prepare general journal entries to record these transactions (use account titles listed in part 2).

2. Open the following ledger accounts—their account numbers are in parentheses (use the balance column format): Cash (101); Accounts Receivable (106); Office Supplies (124); Prepaid Insurance (128); Prepaid Rent (131); Office Equipment (163); Accounts Payable (201); Common Stock (307); Dividends (319); Services Revenue (403); and Utilities Expense (690). Post journal entries from part 1 to the ledger accounts and enter the balance after each posting.

3. Prepare a trial balance as of April 30.

---

**Problem C-4A**

Computing net income from equity analysis, preparing a balance sheet, and computing the debt ratio

Check  (2) Ending balances: Cash, $64,465; Accounts Receivable, $4,490; Accounts Payable, $600

(3) Total debits, $119,490

---

The accounting records of Nettle Distribution show the following assets and liabilities as of December 31, 2012 and 2013.

```
<table>
<thead>
<tr>
<th>December 31</th>
<th>2012</th>
<th>2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>$64,300</td>
<td>$15,640</td>
</tr>
<tr>
<td>Accounts receivable</td>
<td>26,240</td>
<td>19,390</td>
</tr>
<tr>
<td>Office supplies</td>
<td>3,160</td>
<td>1,960</td>
</tr>
<tr>
<td>Office equipment</td>
<td>44,000</td>
<td>44,000</td>
</tr>
<tr>
<td>Trucks</td>
<td>148,000</td>
<td>157,000</td>
</tr>
<tr>
<td>Building</td>
<td>0</td>
<td>80,000</td>
</tr>
<tr>
<td>Land</td>
<td>0</td>
<td>60,000</td>
</tr>
<tr>
<td>Accounts payable</td>
<td>3,500</td>
<td>33,500</td>
</tr>
<tr>
<td>Note payable</td>
<td>0</td>
<td>40,000</td>
</tr>
<tr>
<td>Note payable</td>
<td>0</td>
<td>40,000</td>
</tr>
</tbody>
</table>
```

Late in December 2013, the business purchased a small office building and land for $140,000. It paid $100,000 cash toward the purchase and a $40,000 note payable was signed for the balance. Mr. Nettle had to invest $35,000 cash in the business (in exchange for common stock) to enable it to pay the $100,000 cash. The business also pays $3,000 cash per month for dividends.

**Required**

1. Prepare balance sheets for the business as of December 31, 2012 and 2013. (Hint: Report only total equity on the balance sheet and remember that total equity equals the difference between assets and liabilities.)

2. By comparing equity amounts from the balance sheets and using the additional information presented in this problem, prepare a calculation to show how much net income was earned by the business during 2013.

3. Compute the 2013 year-end debt ratio (in percent and rounded to one decimal).

---

**Problem C-5A**

Analyzing account balances and reconstructing transactions

Check  (2) Net income, $23,290

(3) Debt ratio, 19.4%

---

Yi Min started an engineering firm called Min Engineering. He began operations and completed seven transactions in May, which included his initial investment of $18,000 cash. After those seven transactions, the ledger included the following accounts with normal balances.

```
<table>
<thead>
<tr>
<th>Account Title</th>
<th>Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>$37,641</td>
</tr>
<tr>
<td>Office supplies</td>
<td>890</td>
</tr>
<tr>
<td>Prepaid insurance</td>
<td>4,600</td>
</tr>
<tr>
<td>Office equipment</td>
<td>12,900</td>
</tr>
<tr>
<td>Accounts payable</td>
<td>12,900</td>
</tr>
<tr>
<td>Common stock</td>
<td>18,000</td>
</tr>
<tr>
<td>Dividends</td>
<td>3,329</td>
</tr>
<tr>
<td>Engineering fees earned</td>
<td>36,000</td>
</tr>
<tr>
<td>Rent expense</td>
<td>7,540</td>
</tr>
</tbody>
</table>
```

**Required**

1. Prepare a trial balance for this business as of the end of May.

**Analysis Components**

2. Analyze the accounts and their balances and prepare a list that describes each of the seven most likely transactions and their amounts.

3. Prepare a report of cash received and cash paid showing how the seven transactions in part 2 yield the $37,641 ending Cash balance.
Business transactions completed by Hannah Venedict during the month of September are as follows.

a. Venedict invested $60,000 cash along with office equipment valued at $25,000 in exchange for common stock of a new company named HV Consulting.

b. The company purchased land worth $40,000 and a building valued at $160,000. The purchase is paid with $30,000 cash and a long-term note payable for $170,000.

c. The company purchased $2,000 of office supplies on credit.

d. Venedict invested her personal automobile in the company in exchange for more common stock. The automobile has a value of $16,500 and is to be used exclusively in the business.

e. The company purchased $5,600 of additional office equipment on credit.

f. The company paid $1,800 cash salary to an assistant.

g. The company provided services to a client and collected $8,000 cash.

h. The company paid $635 cash for this month’s utilities.

i. The company paid $2,000 cash to settle the account payable created in transaction e.

j. The company purchased $20,300 of new office equipment by paying $20,300 cash.

k. The company completed $6,250 of services for a client, who must pay within 30 days.

l. The company paid $1,800 cash salary to an assistant.

m. The company received $4,000 cash in partial payment on the receivable created in transaction k.

n. The company paid $2,800 cash in dividends.

Required

1. Prepare general journal entries to record these transactions (use account titles listed in part 2).

2. Open the following ledger accounts—their account numbers are in parentheses (use the balance column format): Cash (101); Accounts Receivable (106); Office Supplies (108); Office Equipment (163); Automobiles (164); Building (170); Land (172); Accounts Payable (201); Notes Payable (250); Common Stock (307); Dividends (319); Fees Earned (402); Salaries Expense (601); and Utilities Expense (602). Post the journal entries from part 1 to the ledger accounts and enter the balance after each posting.

3. Prepare a trial balance as of the end of September.

At the beginning of April, Bernadette Grechus launched a custom computer solutions company called Softworks. The company had the following transactions during April.

a. Bernadette Grechus invested $65,000 cash, office equipment with a value of $5,750, and $30,000 of computer equipment in exchange for common stock.

b. The company purchased land worth $22,000 for an office by paying $5,000 cash and signing a long-term note payable for $17,000.

c. The company purchased a portable building with $34,500 cash and moved it onto the land acquired in b.

d. The company paid $5,000 cash for the premium on a two-year insurance policy.

e. The company provided services to a client and immediately collected $4,600 cash.

f. The company purchased $4,500 of additional computer equipment by paying $800 cash and signing a long-term note payable for $3,700.

g. The company completed $4,250 of services for a client. This amount is to be received within 30 days.

h. The company purchased $950 of additional office equipment on credit.

i. The company completed client services for $10,200 on credit.

j. The company received a bill for rent of a computer testing device that was used on a recently completed job. The $580 rent cost must be paid within 30 days.

k. The company collected $5,100 cash in partial payment from the client described in transaction i.

l. The company paid $1,800 cash for wages to an assistant.

m. The company paid $950 cash to settle the payable created in transaction h.

n. The company paid $608 cash for minor maintenance of the company’s computer equipment.

o. The company paid $6,230 cash in dividends.

p. The company paid $1,800 cash for wages to an assistant.

q. The company paid $750 cash for advertisements on the Web during April.
Appendix C  Basic Accounting for Transactions

Required

1. Prepare general journal entries to record these transactions (use account titles listed in part 2).

2. Open the following ledger accounts—their account numbers are in parentheses (use the balance column format): Cash (101); Accounts Receivable (106); Prepaid Insurance (108); Office Equipment (163); Computer Equipment (164); Building (170); Land (172); Accounts Payable (201); Notes Payable (250); Common Stock (307); Dividends (319); Fees Earned (402); Wages Expense (601); Computer Rental Expense (602); Advertising Expense (603); and Repairs Expense (604). Post the journal entries from part 1 to the ledger accounts and enter the balance after each posting.

3. Prepare a trial balance as of the end of April.

Problem C-2B
Preparing and posting journal entries; preparing a trial balance

Zucker Management Services opens for business and completes these transactions in November.

Nov.  1  Matt Zucker, the owner, invested $30,000 cash along with $15,000 of office equipment in the company in exchange for common stock.
2  The company prepaid $4,500 cash for six months’ rent for an office. (Hint: Debit Prepaid Rent for $4,500.)
4  The company made credit purchases of office equipment for $2,500 and of office supplies for $600. Payment is due within 10 days.
8  The company completed work for a client and immediately received $3,400 cash.
12  The company completed a $10,200 project for a client, who must pay within 30 days.
13  The company paid $3,100 cash to settle the payable created on November 4.
19  The company paid $1,800 cash for the premium on a 24-month insurance policy.
22  The company received $5,200 cash as partial payment for the work completed on November 12.
24  The company completed work for another client for $1,750 on credit.
28  The company paid $5,300 cash in dividends.
29  The company purchased $249 of additional office supplies on credit.
30  The company paid $831 cash for this month’s utility bill.

Required

1. Prepare general journal entries to record these transactions (use account titles listed in part 2).

2. Open the following ledger accounts—their account numbers are in parentheses (use the balance column format): Cash (101); Accounts Receivable (106); Office Supplies (124); Prepaid Insurance (128); Prepaid Rent (131); Office Equipment (163); Accounts Payable (201); Common Stock (307); Dividends (319); Services Revenue (403); and Utilities Expense (690). Post the journal entries from part 1 to the ledger accounts and enter the balance after each posting.

3. Prepare a trial balance as of the end of November.

Problem C-3B
Preparing and posting journal entries; preparing a trial balance

Humble Management Services opens for business and completes these transactions in September.

Sept.  1  Henry Humble, the owner, invests $38,000 cash along with office equipment valued at $15,000 in the company in exchange for common stock.
2  The company prepaid $9,000 cash for 12 months’ rent for office space. (Hint: Debit Prepaid Rent for $9,000.)
4  The company made credit purchases for $8,000 in office equipment and $2,400 in office supplies. Payment is due within 10 days.
8  The company completed work for a client and immediately received $3,280 cash.
12  The company completed a $15,400 project for a client, who must pay within 30 days.
13  The company paid $3,100 cash to settle the payable created on September 4.
19  The company paid $1,900 cash for the premium on an 18-month insurance policy. (Hint: Debit Prepaid Insurance for $1,900.)
22. The company received $7,700 cash as partial payment for the work completed on September 12.
24. The company completed work for another client for $2,100 on credit.
28. The company paid $5,300 cash in dividends.
29. The company purchased $550 of additional office supplies on credit.
30. The company paid $860 cash for this month’s utility bill.

**Required**

1. Prepare general journal entries to record these transactions (use account titles listed in part 2).

2. Open the following ledger accounts—their account numbers are in parentheses (use the balance column format): Cash (101); Accounts Receivable (106); Office Supplies (124); Prepaid Insurance (128); Prepaid Rent (131); Office Equipment (163); Accounts Payable (201); Common Stock (307); Dividends (319); Service Fees Earned (401); and Utilities Expense (690). Post journal entries from part 1 to the ledger accounts and enter the balance after each posting.

3. Prepare a trial balance as of the end of September.

The accounting records of Tama Co. show the following assets and liabilities as of December 31, 2012 and 2013.

<table>
<thead>
<tr>
<th>December 31</th>
<th>2012</th>
<th>2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>$20,000</td>
<td>$5,000</td>
</tr>
<tr>
<td>Accounts receivable</td>
<td>35,000</td>
<td>25,000</td>
</tr>
<tr>
<td>Office supplies</td>
<td>8,000</td>
<td>13,500</td>
</tr>
<tr>
<td>Office equipment</td>
<td>40,000</td>
<td>40,000</td>
</tr>
<tr>
<td>Machinery</td>
<td>28,500</td>
<td>28,500</td>
</tr>
<tr>
<td>Building</td>
<td>0</td>
<td>250,000</td>
</tr>
<tr>
<td>Land</td>
<td>0</td>
<td>50,000</td>
</tr>
<tr>
<td>Accounts payable</td>
<td>4,000</td>
<td>12,000</td>
</tr>
<tr>
<td>Note payable</td>
<td>0</td>
<td>250,000</td>
</tr>
</tbody>
</table>

Late in December 2013, the business purchased a small office building and land for $300,000. It paid $50,000 cash toward the purchase and a $250,000 note payable was signed for the balance. Joe Tama, the owner, had to invest an additional $15,000 cash (in exchange for common stock) to enable it to pay the $50,000 cash toward the purchase. The business also pays $250 cash per month for dividends.

**Required**

1. Prepare balance sheets for the business as of December 31, 2012 and 2013. (*Hint: Report only total equity on the balance sheet and remember that total equity equals the difference between assets and liabilities.*)

2. By comparing equity amounts from the balance sheets and using the additional information presented in the problem, prepare a calculation to show how much net income was earned by the business during 2013.

3. Calculate the December 31, 2013, debt ratio (in percent and rounded to one decimal).

Roshaun Gould started a Web consulting firm called Gould Solutions. He began operations and completed seven transactions in April that resulted in the following accounts, which all have normal balances.

**Problem C-4B**

Computing net income from equity analysis, preparing a balance sheet, and computing the debt ratio

- (2) Ending balances: Cash, $21,520; Accounts Receivable, $9,800; Accounts Payable, $550
- (3) Total debits, $74,330

**Problem C-5B**

Analyzing account balances and reconstructing transactions
Appendix C  Basic Accounting for Transactions

Nuncio Consulting completed the following transactions during June.

a. Armand Nuncio, the owner, invested $35,000 cash along with office equipment valued at $11,000 in the new company in exchange for common stock.

b. The company purchased land valued at $7,500 and a building valued at $40,000. The purchase is paid with $15,000 cash and a long-term note payable for $32,500.

c. The company purchased $500 of office supplies on credit.

d. A. Nuncio invested his personal automobile in the company in exchange for more common stock. The automobile has a value of $8,000 and is to be used exclusively in the business.

e. The company purchased $1,200 of additional office equipment on credit.

f. The company paid $1,000 cash salary to an assistant.

g. The company provided services to a client and collected $3,200 cash.

h. The company paid $540 cash for this month’s utilities.

i. The company paid $500 cash to settle the payable created in transaction c.

j. The company purchased $3,400 of new office equipment by paying $3,400 cash.

k. The company completed $4,200 of services for a client, who must pay within 30 days.

l. The company paid $1,000 cash salary to an assistant.

m. The company received $2,200 cash in partial payment on the receivable created in transaction k.

n. The company paid $1,100 cash in dividends.

Required

1. Prepare general journal entries to record these transactions (use account titles listed in part 2).

2. Open the following ledger accounts—their account numbers are in parentheses (use the balance column format): Cash (101); Accounts Receivable (106); Office Supplies (108); Office Equipment (163); Automobiles (164); Building (170); Land (172); Accounts Payable (201); Notes Payable (250); Common Stock (307); Dividends (319); Fees Earned (402); Salaries Expense (601); and Utilities Expense (602). Post the journal entries from part 1 to the ledger accounts and enter the balance after each posting.

3. Prepare a trial balance as of the end of June.

Check  (1) Trial balance total, $47,650

(3) Cash paid, $15,418

Problem C-6B

Recording transactions; posting to ledger; preparing a trial balance

Nuncio Consulting completed the following transactions during June.

a. Armand Nuncio, the owner, invested $35,000 cash along with office equipment valued at $11,000 in the new company in exchange for common stock.

b. The company purchased land valued at $7,500 and a building valued at $40,000. The purchase is paid with $15,000 cash and a long-term note payable for $32,500.

c. The company purchased $500 of office supplies on credit.

d. A. Nuncio invested his personal automobile in the company in exchange for more common stock. The automobile has a value of $8,000 and is to be used exclusively in the business.

e. The company purchased $1,200 of additional office equipment on credit.

f. The company paid $1,000 cash salary to an assistant.

g. The company provided services to a client and collected $3,200 cash.

h. The company paid $540 cash for this month’s utilities.

i. The company paid $500 cash to settle the payable created in transaction c.

j. The company purchased $3,400 of new office equipment by paying $3,400 cash.

k. The company completed $4,200 of services for a client, who must pay within 30 days.

l. The company paid $1,000 cash salary to an assistant.

m. The company received $2,200 cash in partial payment on the receivable created in transaction k.

n. The company paid $1,100 cash in dividends.

Required

1. Prepare general journal entries to record these transactions (use account titles listed in part 2).

2. Open the following ledger accounts—their account numbers are in parentheses (use the balance column format): Cash (101); Accounts Receivable (106); Office Supplies (108); Office Equipment (163); Automobiles (164); Building (170); Land (172); Accounts Payable (201); Notes Payable (250); Common Stock (307); Dividends (319); Fees Earned (402); Salaries Expense (601); and Utilities Expense (602). Post the journal entries from part 1 to the ledger accounts and enter the balance after each posting.

3. Prepare a trial balance as of the end of June.
Appendix C  Basic Accounting for Transactions

**SERIAL PROBLEM**

**Success Systems**

**A1  P1  P2**

**SP C** On October 1, 2013, Adria Lopez launched a computer services company called Success Systems, which provides consulting services, computer system installations, and custom program development. Adria adopts the calendar year for reporting purposes and expects to prepare the company’s first set of financial statements on December 31, 2013. The company’s initial chart of accounts follows.

<table>
<thead>
<tr>
<th>Account</th>
<th>No.</th>
<th>Account</th>
<th>No.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>101</td>
<td>Common Stock</td>
<td>307</td>
</tr>
<tr>
<td>Accounts Receivable</td>
<td>106</td>
<td>Dividends</td>
<td>319</td>
</tr>
<tr>
<td>Computer Supplies</td>
<td>126</td>
<td>Computer Services Revenue</td>
<td>403</td>
</tr>
<tr>
<td>Prepaid Insurance</td>
<td>128</td>
<td>Wages Expense</td>
<td>623</td>
</tr>
<tr>
<td>Prepaid Rent</td>
<td>131</td>
<td>Advertising Expense</td>
<td>655</td>
</tr>
<tr>
<td>Office Equipment</td>
<td>163</td>
<td>Mileage Expense</td>
<td>676</td>
</tr>
<tr>
<td>Computer Equipment</td>
<td>167</td>
<td>Miscellaneous Expenses</td>
<td>677</td>
</tr>
<tr>
<td>Accounts Payable</td>
<td>201</td>
<td>Repairs Expense—Computer</td>
<td>684</td>
</tr>
</tbody>
</table>

**Required**

1. Prepare journal entries to record each of the following transactions for Success Systems.
   
   Oct.
   1  Adria Lopez invested $55,000 cash, a $20,000 computer system, and $8,000 of office equipment in the company in exchange for its common stock.
   2  The company paid $3,300 cash for four months’ rent. *(Hint: Debit Prepaid Rent for $3,300.)*
   3  The company purchased $1,420 of computer supplies on credit from Harris Office Products.
   5  The company paid $2,220 cash for one year’s premium on a property and liability insurance policy. *(Hint: Debit Prepaid Insurance for $2,220.)*
   6  The company billed Easy Leasing $4,800 for services performed in installing a new Web server.
   8  The company paid $1,420 cash for the computer supplies purchased from Harris Office Products on October 3.
   10 The company hired Lyn Addie as a part-time assistant for $125 per day, as needed.
   12 The company billed Easy Leasing another $1,400 for services performed.
   15 The company received $4,800 cash from Easy Leasing as partial payment on its account.
   17 The company paid $805 cash to repair computer equipment that was damaged when moving it.
   20 The company paid $1,940 cash for advertisements published in the local newspaper.
   22 The company received $1,400 cash from Easy Leasing on its account.
   28 The company billed IFM Company $5,208 for services performed.
   31 The company paid $875 cash for Lyn Addie’s wages for seven days’ work.
   31 The company paid $3,600 cash in dividends.

   Nov.
   1  The company reimbursed Adria Lopez in cash for business automobile mileage allowance (Lopez logged 1,000 miles at $0.32 per mile).
   2  The company received $4,633 cash from Liu Corporation for computer services performed.
   5  The company purchased computer supplies for $1,125 cash from Harris Office Products.
   8  The company billed Gomez Co. $5,668 for services performed.
   13 The company received notification from Alex’s Engineering Co. that Success Systems’ bid of $3,950 for an upcoming project is accepted.
   18 The company received $2,208 cash from IFM Company as partial payment of the October 28 bill.
   22 The company donated $250 cash to the United Way in the company’s name.
   24 The company completed work for Alex’s Engineering Co. and sent it a bill for $3,950.
   25 The company sent another bill to IFM Company for the past-due amount of $3,000.
   28 The company reimbursed Adria Lopez in cash for business automobile mileage (1,200 miles at $0.32 per mile).
   30 The company paid $1,750 cash for Lyn Addie’s wages for 14 days’ work.
   30 The company paid $2,000 cash in dividends.

2. Open ledger accounts (in balance column format) and post the journal entries from part 1 to them.

3. Prepare a trial balance as of the end of November.

---

**Check**

- (2) Cash, Nov. 30 bal., $48,052
- (3) Trial bal. totals, $108,659
Appendix C  Basic Accounting for Transactions

Beyond the Numbers

BTN C-1  Refer to Polaris’s financial statements in Appendix A for the following questions.

Required

1. What amount of total liabilities does it report for each of the fiscal years ended December 31, 2011 and 2010?
2. What amount of total assets does it report for each of the fiscal years ended December 31, 2011 and 2010?
3. Compute its debt ratio for each of the fiscal years ended December 31, 2011 and 2010. (Report ratio in percent and round it to one decimal.)
4. In which fiscal year did it employ more financial leverage (December 31, 2011 or 2010)? Explain.

Fast Forward

5. Access its financial statements (10-K report) for a fiscal year ending after December 31, 2011, from its Website (Polaris.com) or the SEC’s EDGAR database (www.sec.gov). Recompute its debt ratio for any subsequent year’s data and compare it with the debt ratio for 2010 and 2011.

COMPARATIVE ANALYSIS

BTN C-2  Key comparative figures for Polaris and Arctic Cat follow.

<table>
<thead>
<tr>
<th></th>
<th>Polaris</th>
<th>Arctic Cat</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Current Year</td>
<td>Prior Year</td>
</tr>
<tr>
<td>Total liabilities</td>
<td>$727,968</td>
<td>$690,656</td>
</tr>
<tr>
<td>Total assets</td>
<td>$1,228,024</td>
<td>$1,061,647</td>
</tr>
</tbody>
</table>

1. What is the debt ratio for Polaris in the current year and for the prior year?
2. What is the debt ratio for Arctic Cat in the current year and for the prior year?
3. Which of the two companies has the higher degree of financial leverage? What does this imply?

ETHICS CHALLENGE

BTN C-3  Review the Decision Ethics case from the first part of this appendix involving the cashier. The guidance answer suggests that you should not comply with the assistant manager’s request.

Required

Propose and evaluate two other courses of action you might consider, and explain why.

COMMUNICATING IN PRACTICE

BTN C-4  Lila Corentine is an aspiring entrepreneur and your friend. She is having difficulty understanding the purposes of financial statements and how they fit together across time.

Required

Write a one-page memorandum to Corentine explaining the purposes of the four financial statements and how they are linked across time.
BTN C-5 Access EDGAR online (www.sec.gov) and locate the 2011 year 10-K report of Amazon.com (ticker AMZN) filed on February 1, 2012. Review its financial statements reported for years ended 2011, 2010, and 2009 to answer the following questions.

Required
1. What are the amounts of its net income or net loss reported for each of these three years?
2. Does Amazon’s operating activities provide cash or use cash for each of these three years?
3. If Amazon has a 2011 net income of more than $600 million and 2011 operating cash flows of nearly $4,000 million, how is it possible that its cash balance at December 31, 2011, increases by less than $1,500 million relative to its balance at December 31, 2010?

BTN C-6 The expanded accounting equation consists of assets, liabilities, common stock, dividends, revenues, and expenses. It can be used to reveal insights into changes in a company’s financial position.

Required
1. Form learning teams of six (or more) members. Each team member must select one of the six components and each team must have at least one expert on each component: (a) assets, (b) liabilities, (c) common stock, (d) dividends, (e) revenues, and (f) expenses.
2. Form expert teams of individuals who selected the same component in part 1. Expert teams are to draft a report that each expert will present to his or her learning team addressing the following:
   a. Identify for its component the (i) increase and decrease side of the account and (ii) normal balance side of the account.
   b. Describe a transaction, with amounts, that increases its component.
   c. Using the transaction and amounts in (b), verify the equality of the accounting equation and then explain any effects on the income statement and statement of cash flows.
   d. Describe a transaction, with amounts, that decreases its component.
   e. Using the transaction and amounts in (d), verify the equality of the accounting equation and then explain any effects on the income statement and statement of cash flows.
3. Each expert should return to his/her learning team. In rotation, each member presents his/her expert team’s report to the learning team. Team discussion is encouraged.

BTN C-7 Assume Misa Chien and Jennifer Green of Nom Nom Truck plan on expanding their business to accommodate more product lines. They are considering financing their expansion in one of two ways: (1) contributing more of their own funds to the business or (2) borrowing the funds from a bank.

Required
Identify at least two issues that Misa and Jennifer should consider when trying to decide on the method for financing their expansion.
Appendix C  Basic Accounting for Transactions

ENTREPRENEURIAL DECISION

BTN C-8  Angel Martin is a young entrepreneur who operates Martin Music Services, offering singing lessons and instruction on musical instruments. Martin wishes to expand but needs a $30,000 loan. The bank requests Martin to prepare a balance sheet and key financial ratios. Martin has not kept formal records but is able to provide the following accounts and their amounts as of December 31, 2013.

<table>
<thead>
<tr>
<th>Account</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>$3,600</td>
</tr>
<tr>
<td>Prepaid Rent</td>
<td>$9,400</td>
</tr>
<tr>
<td>Accounts Payable</td>
<td>$2,200</td>
</tr>
<tr>
<td>Prepaid Insurance</td>
<td>$1,500</td>
</tr>
<tr>
<td>Accounts Receivable</td>
<td>$9,600</td>
</tr>
<tr>
<td>Store Supplies</td>
<td>$6,600</td>
</tr>
<tr>
<td>Equipment</td>
<td>$50,000</td>
</tr>
<tr>
<td>Unearned Lesson Fees</td>
<td>$15,600</td>
</tr>
<tr>
<td>Annual net income</td>
<td>$40,000</td>
</tr>
<tr>
<td>Total Equity*</td>
<td>$62,900</td>
</tr>
</tbody>
</table>

* The total equity amount reflects all owner investments, dividends, revenues, and expenses as of December 31, 2013.

Required
1. Prepare a balance sheet as of December 31, 2013, for Martin Music Services. (Report only the total equity amount on the balance sheet.)
2. Compute Martin’s debt ratio and its return on assets. Assume average assets equal its ending balance.
3. Do you believe the prospects of a $30,000 bank loan are good? Why or why not?

HITTING THE ROAD

BTN C-9  Obtain a recent copy of the most prominent newspaper distributed in your area. Research the classified section and prepare a report answering the following questions (attach relevant classified clippings to your report). Alternatively, you may want to search the Web for the required information. One suitable Website is CareerOneStop (www.CareerOneStop.org). For documentation, you should print copies of Websites accessed.

1. Identify the number of listings for accounting positions and the various accounting job titles.
2. Identify the number of listings for other job titles, with examples, that require or prefer accounting knowledge/experience but are not specifically accounting positions.
3. Specify the salary range for the accounting and accounting-related positions if provided.
4. Indicate the job that appeals to you, the reason for its appeal, and its requirements.

GLOBAL DECISION

BTN C-10  KTM (www.KTM.com) is a leading manufacturer of offroad and street motorcycles, and it competes to some extent with both Polaris and Arctic Cat. Key financial ratios for the current fiscal year follow.

<table>
<thead>
<tr>
<th>Key Figure</th>
<th>KTM</th>
<th>Polaris</th>
<th>Arctic Cat</th>
</tr>
</thead>
<tbody>
<tr>
<td>Return on assets</td>
<td>4.3%</td>
<td>18.5%</td>
<td>4.8%</td>
</tr>
<tr>
<td>Debt ratio</td>
<td>54.8%</td>
<td>59.3%</td>
<td>32.9%</td>
</tr>
</tbody>
</table>

Required
1. Which company is most profitable according to its return on assets?
2. Which company is most risky according to the debt ratio?
3. Which company deserves increased investment based on a joint analysis of return on assets and the debt ratio? Explain.
ANSWERS TO MULTIPLE CHOICE QUIZ

1. b; debit Utility Expense for $700, and credit Cash for $700.
2. a; debit Cash for $2,500, and credit Unearned Lawn Service Fees for $2,500.
3. c; debit Cash for $250,000, debit Land for $500,000, and credit Common Stock for $750,000.
4. d
5. e; Debt ratio = $400,000/$1,000,000 = 40%