

Basic Accounting for Transactions



A Look at This Appendix

This appendix focuses on the accounting process. We describe transactions and source documents, and we explain the analysis and recording of transactions. The accounting equation, T-account, general ledger, trial balance, and debits and credits are key tools in the accounting process.

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)



Decision Insight



Some Like It Hot

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

"You can still excel if you work really hard and follow your dreams!"

—MISA CHIEN (ON LEFT)

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.

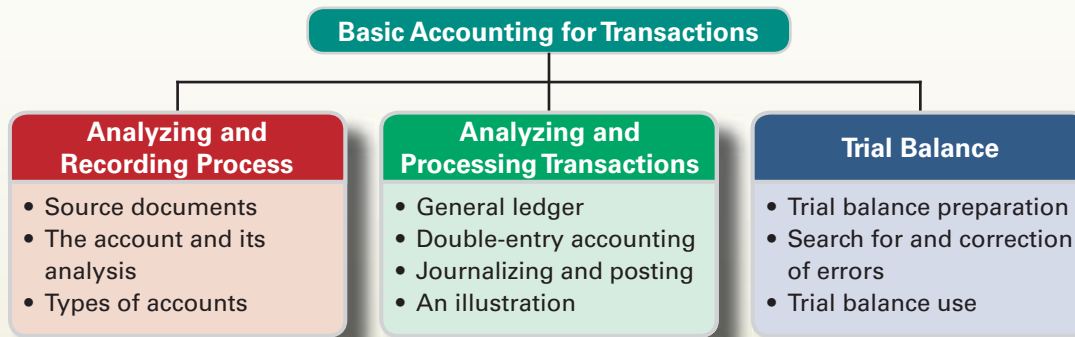
"The bigger message of our company," says Jennifer, "is that each of us can succeed no matter what our starting point." "You have to be responsible for yourself," adds Misa. "We want to make people happy through our food!"

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

Appendix Preview

Financial statements report on the financial performance and condition of an organization. Knowledge of their preparation, organization, and analysis is important. A main goal of this appendix is to illustrate how transactions are recorded, how

they are reflected in financial statements, and how they impact analysis of financial statements. Debits and credits are introduced and identified as a tool in helping analyze and process transactions.

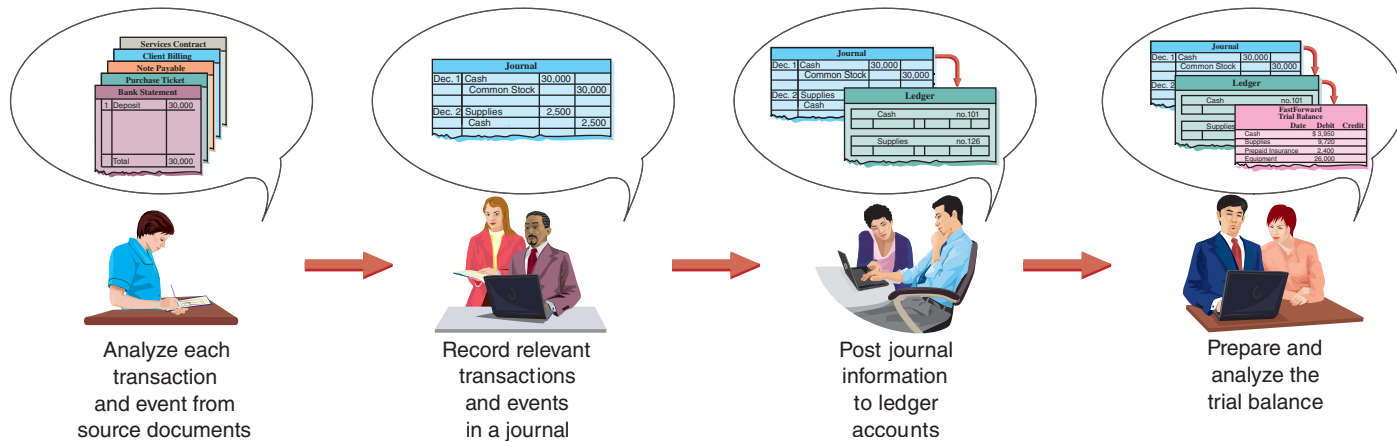


ANALYZING AND RECORDING PROCESS

The accounting process identifies business transactions and events, analyzes and records their effects, and summarizes and presents information in reports and financial statements. These reports and statements are used for making investing, lending, and other business decisions. The steps in the accounting process that focus on *analyzing and recording* transactions and events are shown in Exhibit C.1.

EXHIBIT C.1

The Analyzing and Recording Process



C1 Explain the steps in processing transactions and the role of source documents.

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.

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.

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.

C2 Describe an account and its use in recording transactions.

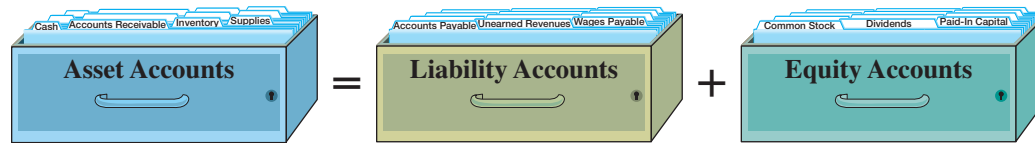


EXHIBIT C.2

Accounts Organized by the Accounting Equation

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 prepayments 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,

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.

Point: Prepaid accounts that apply to current and future periods are assets. These assets are adjusted at the end of each period to reflect only those amounts that have not yet expired, and to record as expenses those amounts that have expired.

Point: Some assets are described as *intangible* because they do not have physical existence or their benefits are highly uncertain. A recent balance sheet for **Coca-Cola Company** shows nearly \$1 billion in intangible assets.

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.

Point: Accounts payable are also called *trade payables*.

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

Point: If a subscription is canceled, the publisher is expected to refund the unused portion to the subscriber.

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.)

Point: Equity is also called *net assets*.

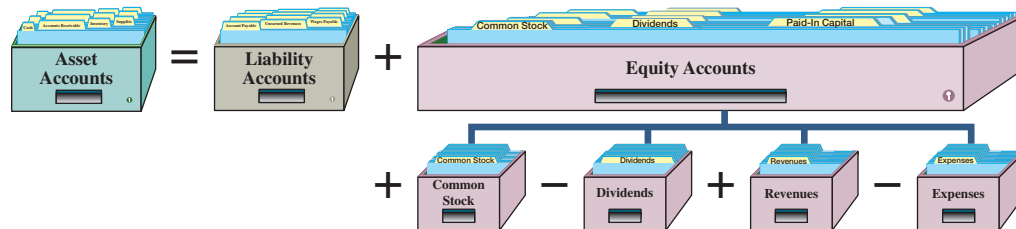


EXHIBIT C.3

Expanded Accounting Equation

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.

Point: The Dividends account is sometimes referred to as a *contra equity* account because it reduces the normal balance of equity.

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).

Point: The withdrawal of assets by the owners of a corporation is called a *dividend*.

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.

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:

Revenues

- Basketball ticket sales
- TV & radio broadcast fees
- Advertising revenues
- Basketball playoff receipts

Expenses

- Team salaries
- Game costs
- NBA franchise costs
- Promotional costs ■



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

C3 Describe a ledger and a 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:

Chart of Accounts	
101-199	Asset accounts
201-299	Liability accounts
301-399	Equity accounts
401-499	Revenue accounts
501-699	Expense accounts



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

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

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*.

Account Title	
(Left side) Debit	(Right side) Credit

C4 Define *debits* and *credits* and explain double-entry accounting.

EXHIBIT C.5

The T-Account

Point: Think of *debit* and *credit* as accounting directions for left and right.

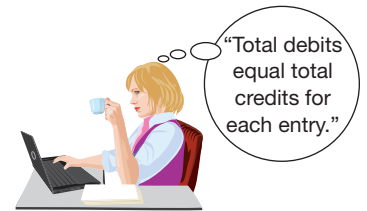
Double-Entry Accounting

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



Assets		=	Liabilities		+	Equity	
Debit for increases + Normal	Credit for decreases -		Debit for decreases -	Credit for increases + Normal		Debit for decreases -	Credit for increases + Normal

EXHIBIT C.6

Debits and Credits in the Accounting Equation

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.

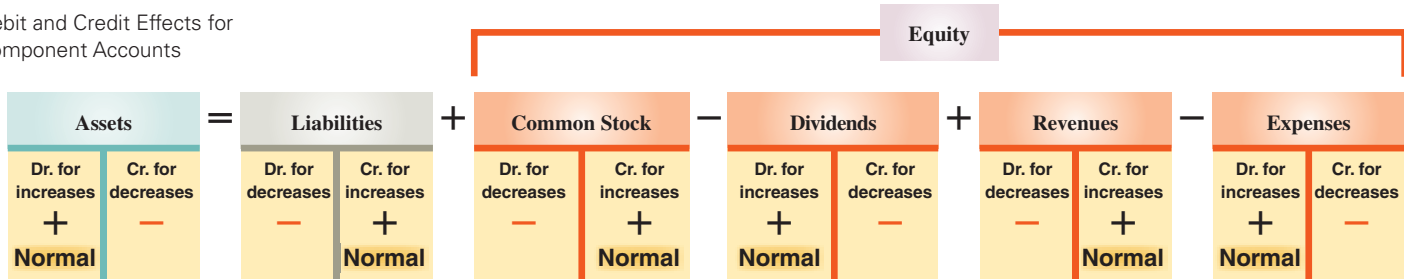
Increases (credits) to common stock and revenues *increase* equity; increases (debits) to dividends and expenses *decrease* equity. The normal balance of each account (asset, liability, common stock, dividends, revenue, or expense) refers to the left or right (debit or credit) side

Point: Debits and credits do not mean favorable or unfavorable. A debit to an asset increases it, as does a debit to an expense. A credit to a liability increases it, as does a credit to a revenue.

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.

Cash			
Receive investment by owner for stock	30,000	Purchase of supplies	2,500
Consulting services revenue earned	4,200	Purchase of equipment	26,000
Collection of account receivable	1,900	Payment of rent	1,000
		Payment of salary	700
		Payment of account payable	900
		Payment of cash dividend	200
Balance	4,800		

Quick Check

Answers — p. C-27



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.

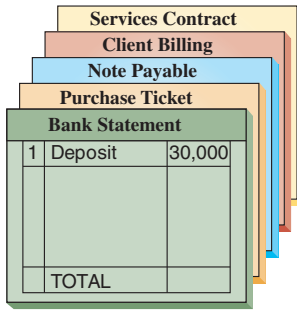
Journalizing and Posting Transactions

P1 Record transactions in a journal and post entries to a ledger.

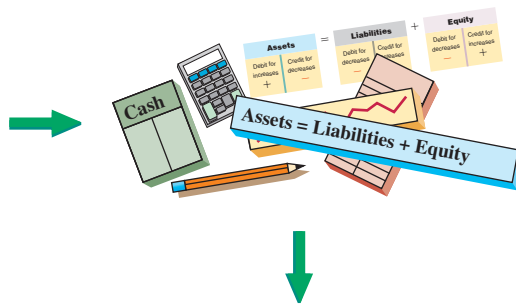
Processing transactions is a crucial part of accounting. The four usual steps of this process are depicted in Exhibit C.9. Steps 1 and 2—involving transaction analysis and the accounting equation—were introduced in prior sections. This section extends that discussion and focuses on steps 3 and 4 of the 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

Step 1: Identify transactions and source documents.



Step 2: Analyze transactions using the accounting equation.



Step 3: Record journal entry.

General Journal			
Dec. 1	Cash	30,000	
	Common Stock		30,000
Dec. 2	Supplies	2,500	
	Cash		2,500

Step 4: Post entry to ledger.

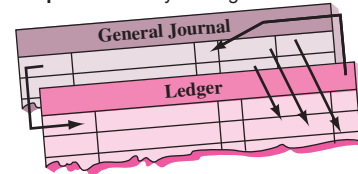


EXHIBIT C.9

Steps in Processing Transactions

debit and credit, and ④ 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.

Date	Account Titles and Explanation	PR	Debit	Credit
2013 ① Dec. 1	② Cash		30,000	
	Common Stock			30,000 ④
	<i>Receive investment by owner. ④</i>			
Dec. 2	Supplies		2,500	
	Cash			2,500
	<i>Purchase supplies for cash.</i>			

EXHIBIT C.10

Partial General Journal for FastForward

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

- 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.
- 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.
- 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.
- 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.

Point: There are no exact rules for writing journal entry explanations. An explanation should be short yet describe why an entry is made.

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.

IFRS

IFRS requires that companies report the following four basic financial statements with explanatory notes:

- Balance sheet
- Statement of changes in equity (or statement of recognized revenue and expense)
- Income statement
- Statement of cash flows

IFRS does not prescribe specific formats; and comparative information is required for the preceding period only. ■

Balance Column Account T-accounts are simple and direct means to show how the accounting process works. However, actual accounting systems need more structure and therefore use **balance column accounts**, such as that in Exhibit C.11.

EXHIBIT C.11

Cash Account in Balance Column Format

General Ledger					
Cash					
Account No. 101					
Date	Explanation	PR	Debit	Credit	Balance
2013					
Dec. 1		G1	30,000		30,000
Dec. 2		G1		2,500	27,500
Dec. 3		G1		26,000	1,500
Dec. 10		G1	4,200		5,700

The balance column account format is similar to a T-account in having columns for debits and credits. It is different in including transaction date and explanation columns. It also has a column with the balance of the account after each entry is recorded. To illustrate, FastForward’s Cash account in Exhibit C.11 is debited on December 1 for the \$30,000 owner investment, yielding a \$30,000 debit balance. The account is credited on December 2 for \$2,500, yielding a \$27,500 debit balance. On December 3, it is credited again, this time for \$26,000, and its debit balance is reduced to \$1,500. The Cash account is debited for \$4,200 on December 10, and its debit balance increases to \$5,700; and so on.

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

EXHIBIT C.12

Posting an Entry to the Ledger

The screenshot displays two windows: 'General Journal' and 'General Ledger'. The 'General Journal' window shows an entry for Dec 1, 2013, with a debit to Cash (Account 101) for 30,000 and a credit to Common Stock (Account 307) for 30,000. The 'General Ledger' window shows the 'Cash' account (Account no. 101) and the 'Common Stock' account (Account no. 307). Red arrows and numbers 1-4 indicate the posting process: 1 points to the date and amount in the journal; 2 points to the debit account number (101) in the PR column; 3 points to the credit account number (307) in the PR column; 4 points to the amount in the journal being posted to the ledger.

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

- 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.

Point: Computerized systems often provide a code beside a balance such as *dr.* or *cr.* to identify its balance. Posting is automatic and immediate with accounting software.

Point: A journal is often referred to as the *book of original entry*. The ledger is referred to as the *book of final entry* because financial statements are prepared from it.

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.

- 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).

A1 Analyze the impact of transactions on accounts and financial statements.

Study each transaction thoroughly before proceeding to the next. The first 16 transactions of FastForward are the focus of this section.

Point: In the Demonstration Problem at the appendix end we show how to use “balance column accounts” for the ledger.

1. Receive investment by Owner

1 IDENTIFY FastForward receives \$30,000 cash from Chas Taylor in exchange for common stock

2 ANALYZE

Assets		=	Liabilities	+	Equity
Cash		=			Common Stock
+30,000		=	0		+30,000

3 RECORD

Date	Account Titles and Explanation	PR	Debit	Credit
(1)	Cash	101	30,000	
	Common Stock	307		30,000

4 POST

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



2. Purchase Supplies for Cash

1 IDENTIFY FastForward pays \$2,500 cash for supplies.

2 ANALYZE

Assets		=	Liabilities	+	Equity
Cash	Supplies	=			
-2,500	+2,500	=	0		+ 0

3 RECORD

Date	Account Titles and Explanation	PR	Debit	Credit
(2)	Supplies	126	2,500	
	Cash	101		2,500

4 POST

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

3. Purchase Equipment for Cash

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

2 ANALYZE

Assets		=	Liabilities	+	Equity
Cash	Equipment				
-26,000	+26,000	=	0	+	0

Changes the composition of assets but not the total.

3 RECORD

Date	Account Titles and Explanation	PR	Debit	Credit
(3)	Equipment	167	26,000	
	Cash	101		26,000

4 POST

Equipment		167
(3)	26,000	

Cash		101
(1)	30,000	(2) 2,500
		(3) 26,000

4. Purchase Supplies on Credit

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

2 ANALYZE

Assets		=	Liabilities	+	Equity
Supplies			Accounts Payable		
+7,100		=	+7,100	+	0

3 RECORD

Date	Account Titles and Explanation	PR	Debit	Credit
(4)	Supplies	126	7,100	
	Accounts Payable	201		7,100

4 POST

Supplies		126
(2)	2,500	
(4)	7,100	

Accounts Payable		201
		(4) 7,100

5. Provide Services for Cash

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

2 ANALYZE

Assets		=	Liabilities	+	Equity
Cash					Consulting Revenue
+4,200		=	0	+	+4,200

3 RECORD

Date	Account Titles and Explanation	PR	Debit	Credit
(5)	Cash	101	4,200	
	Consulting Revenue	403		4,200

4 POST

Cash		101
(1)	30,000	(2) 2,500
(5)	4,200	(3) 26,000

Consulting Revenue		403
		(5) 4,200

6. Payment of Expense in Cash

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

2 ANALYZE

Assets		=	Liabilities	+	Equity
Cash					Rent Expense
-1,000		=	0		-1,000

3 RECORD

Date	Account Titles and Explanation	PR	Debit	Credit
(6)	Rent Expense	640	1,000	
	Cash	101		1,000

4 POST

Rent Expense		640
(6)	1,000	

Cash		101
(1)	30,000	(2) 2,500
(5)	4,200	(3) 26,000
		(6) 1,000

7. Payment of Expense in Cash

1 IDENTIFY FastForward pays \$700 cash for employee salary.

2 ANALYZE

Assets		=	Liabilities	+	Equity
Cash					Salaries Expense
-700		=	0		-700

3 RECORD

Date	Account Titles and Explanation	PR	Debit	Credit
(7)	Salaries Expense	622	700	
	Cash	101		700

4 POST

Salaries Expense		622
(7)	700	

Cash		101
(1)	30,000	(2) 2,500
(5)	4,200	(3) 26,000
		(6) 1,000
		(7) 700

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.

8. Provide Consulting and Rental Services on Credit

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

2 ANALYZE

Assets		=	Liabilities	+	Equity	
Accounts Receivable					Consulting Revenue	Rental Revenue
+1,900		=	0		+1,600	+300

3 RECORD

Date	Account Titles and Explanation	PR	Debit	Credit
(8)	Accounts Receivable	106	1,900	
	Consulting Revenue	403		1,600
	Rental Revenue	406		300

4 POST

Accounts Receivable		106
(8)	1,900	
Consulting Revenue		403
(5)	4,200	
(8)	1,600	
Rental Revenue		406
(8)	300	

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

9. Receipt of Cash on Account

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

2 ANALYZE

Assets		=	Liabilities	+	Equity	
Cash	Accounts Receivable					
+1,900	-1,900	=	0		+	0

3 RECORD

Date	Account Titles and Explanation	PR	Debit	Credit
(9)	Cash	101	1,900	
	Accounts Receivable	106		1,900

4 POST

Cash		101
(1)	30,000	
(5)	4,200	
(9)	1,900	
(2)	2,500	
(3)	26,000	
(6)	1,000	
(7)	700	
Accounts Receivable		106
(8)	1,900	(9) 1,900

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

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

2 ANALYZE

Assets		=	Liabilities	+	Equity	
Cash	Accounts Payable					
-900		=	-900		+	0

3 RECORD

Date	Account Titles and Explanation	PR	Debit	Credit
(10)	Accounts Payable	201	900	
	Cash	101		900

4 POST

Accounts Payable		201
(10)	900	(4) 7,100
Cash		101
(1)	30,000	(2) 2,500
(5)	4,200	(3) 26,000
(9)	1,900	(6) 1,000
		(7) 700
		(10) 900
		(11) 200

11. Payment of Cash Dividend

1 IDENTIFY FastForward pays \$200 cash for dividends.

2 ANALYZE

Assets		=	Liabilities	+	Equity	
Cash	Dividends					
-200		=	0			-200

3 RECORD

Date	Account Titles and Explanation	PR	Debit	Credit
(11)	Dividends	319	200	
	Cash	101		200

4 POST

Dividends		319
(11)	200	
Cash		101
(1)	30,000	(2) 2,500
(5)	4,200	(3) 26,000
(9)	1,900	(6) 1,000
		(7) 700
		(10) 900
		(11) 200

12. Receipt of Cash for Future Services

1 IDENTIFY FastForward receives \$3,000 cash in advance of providing consulting services to a customer.

2 ANALYZE

Assets		=	Liabilities		+	Equity	
Cash	+3,000	=	Unearned Consulting Revenue	+3,000	+		0

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

3 RECORD

Date	Account Titles and Explanation	PR	Debit	Credit
(12)	Cash	101	3,000	
	Unearned Consulting Revenue	236		3,000

4 POST

Cash		101	
(1)	30,000	(2)	2,500
(5)	4,200	(3)	26,000
(9)	1,900	(6)	1,000
(12)	3,000	(7)	700
		(10)	900
		(11)	200

Unearned Consulting Revenue		236
	(12)	3,000

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

13. Pay Cash for Future Insurance Coverage

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

2 ANALYZE

Assets		=	Liabilities		+	Equity	
Cash	-2,400	=	Prepaid Insurance	+2,400	=	0	+ 0

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

3 RECORD

Date	Account Titles and Explanation	PR	Debit	Credit
(13)	Prepaid Insurance	128	2,400	
	Cash	101		2,400

4 POST

Prepaid Insurance		128
(13)	2,400	

Cash		101	
(1)	30,000	(2)	2,500
(5)	4,200	(3)	26,000
(9)	1,900	(6)	1,000
(12)	3,000	(7)	700
		(10)	900
		(11)	200
		(13)	2,400

14. Purchase Supplies for Cash

1 IDENTIFY FastForward pays \$120 cash for supplies.

2 ANALYZE

Assets		=	Liabilities		+	Equity	
Cash	-120	=	Supplies	+120	=	0	+ 0

3 RECORD

Date	Account Titles and Explanation	PR	Debit	Credit
(14)	Supplies	126	120	
	Cash	101		120

4 POST

Supplies		126
(2)	2,500	
(4)	7,100	
(14)	120	

Cash		101	
(1)	30,000	(2)	2,500
(5)	4,200	(3)	26,000
(9)	1,900	(6)	1,000
(12)	3,000	(7)	700
		(10)	900
		(11)	200
		(13)	2,400
		(14)	120

15. Payment of Expense in Cash

1 IDENTIFY FastForward pays \$230 cash for December utilities expense.

2 ANALYZE

Assets	=	Liabilities	+	Equity
Cash				Utilities Expense
-230	=	0		-230

3 RECORD

Date	Account Titles and Explanation	PR	Debit	Credit
(15)	Utilities Expense	690	230	
	Cash	101		230

4 POST

Utilities Expense		690
(15)	230	

Cash		101
(1)	30,000	(2) 2,500
(5)	4,200	(3) 26,000
(9)	1,900	(6) 1,000
(12)	3,000	(7) 700
		(10) 900
		(11) 200
		(13) 2,400
		(14) 120
		(15) 230

16. Payment of Expense in Cash

1 IDENTIFY FastForward pays \$700 cash in employee salary for work performed in the latter part of December.

2 ANALYZE

Assets	=	Liabilities	+	Equity
Cash				Salaries Expense
-700	=	0		-700

3 RECORD

Date	Account Titles and Explanation	PR	Debit	Credit
(16)	Salaries Expense	622	700	
	Cash	101		700

4 POST

Salaries Expense		622
(7)	700	
(16)	700	

Cash		101
(1)	30,000	(2) 2,500
(5)	4,200	(3) 26,000
(9)	1,900	(6) 1,000
(12)	3,000	(7) 700
		(10) 900
		(11) 200
		(13) 2,400
		(14) 120
		(15) 230
		(16) 700

Point: We could merge transactions 15 and 16 into one compound entry.

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

Accounts	Increase (normal bal.)	Decrease
Asset	Debit	Credit
Liability	Credit	Debit
Common Stock	Credit	Debit
Dividends	Debit	Credit
Revenue	Credit	Debit
Expense	Debit	Credit

Point: Technology does not provide the judgment required to analyze most business transactions. Analysis requires the expertise of skilled and ethical professionals.

EXHIBIT C.13

Ledger for FastForward (in T-Account Form)

General Ledger											
Assets		=	Liabilities				+	Equity			
Cash 101			Accounts Payable 201					Common Stock 307			
(1)	30,000	(2)	2,500	(10)	900	(4)	7,100	(1)	30,000		
(5)	4,200	(3)	26,000				Balance	6,200			
(9)	1,900	(6)	1,000	Unearned Consulting Revenue 236				Dividends 319			
(12)	3,000	(7)	700			(12)	3,000	(11)	200		
		(10)	900					Consulting Revenue 403			
		(11)	200						(5)	4,200	
		(13)	2,400						(8)	1,600	
		(14)	120						Balance	5,800	
		(15)	230					Rental Revenue 406			
		(16)	700						(8)	300	
Balance	4,350							Salaries Expense 622			
Accounts Receivable 106							(7)	700			
(8)	1,900	(9)	1,900					(16)	700		
Balance	0							Balance	1,400		
Supplies 126							Rent Expense 640				
(2)	2,500							(6)	1,000		
(4)	7,100							Utilities Expense 690			
(14)	120							(15)	230		
Balance	9,720										
Prepaid Insurance 128											
(13)	2,400										
Equipment 167											
(3)	26,000										
\$42,470		=	\$9,200				+	\$33,270			

Accounts in this white area reflect those reported on the income statement.

Quick Check

Answers — p. C-27



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?

TRIAL BALANCE

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 **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 *unadjusted* trial balance.)

FASTFORWARD Trial Balance December 31, 2013		
	Debit	Credit
Cash	\$ 4,350	
Accounts receivable	0	
Supplies	9,720	
Prepaid insurance	2,400	
Equipment	26,000	
Accounts payable		\$ 6,200
Unearned consulting revenue		3,000
Common stock		30,000
Dividends	200	
Consulting revenue		5,800
Rental revenue		300
Salaries expense	1,400	
Rent expense	1,000	
Utilities expense	230	
Totals	\$ 45,300	\$ 45,300

EXHIBIT C.14

Trial Balance (Unadjusted)

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

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 (*prove*) total debit balances equal total credit balances.

The total of debit balances equals the total of 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.

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

P2 Prepare and explain the use of a trial balance.

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.

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.

in *reverse order*. Step 1 is to verify that the trial balance columns are correctly added. If step 1 fails to find the error, step 2 is to verify that account balances are accurately entered from the ledger. Step 3 is to see whether a debit (or credit) balance is mistakenly listed in the trial balance as a credit (or debit). A clue to this error is when the difference between total debits and total credits equals twice the amount of the incorrect account balance. If the error is still undiscovered, Step 4 is to recompute each account balance in the ledger. Step 5 is to verify that each journal entry is properly posted. Step 6 is to verify that the original journal entry has equal debits and credits. At this point, the errors should be uncovered.³

If an error in a journal entry is discovered before the error is posted, it can be corrected in a manual system by drawing a line through the incorrect information. The correct information is written above it to create a record of change for the auditor. Many computerized systems allow the operator to replace the incorrect information directly.

If an error in a journal entry is not discovered until after it is posted, we do not strike through both erroneous entries in the journal and ledger. Instead, we correct this error by creating a *correcting entry* that removes the amount from the wrong account and records it to the correct account. As an example, suppose a \$100 purchase of supplies is journalized with an incorrect debit to Equipment, and then this incorrect entry is posted to the ledger. The 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).

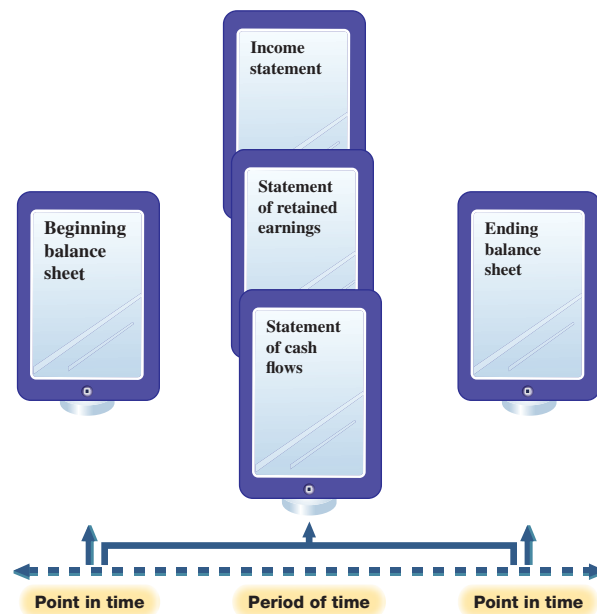
Using a Trial Balance to Prepare Financial Statements

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.

P3 Prepare financial statements from business transactions.

EXHIBIT C.15

Links between Financial Statements across Time



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

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

Point: A statement’s heading lists the 3 V’s: **Who**—name of organization, **What**—name of statement, **When**—statement’s point in time or period of time.

FASTFORWARD Income Statement For Month Ended December 31, 2013		
Revenues		
Consulting revenue (\$4,200 + \$1,600)	\$ 5,800	
Rental revenue	300	
Total revenues		\$ 6,100
Expenses		
Rent expense	1,000	
Salaries expense	1,400	
Utilities expense	230	
Total expenses		2,630
Net income		<u>\$ 3,470</u>

EXHIBIT C.16

Financial Statements and Their Links

FASTFORWARD Statement of Retained Earnings For Month Ended December 31, 2013		
Retained earnings, December 1, 2013	\$ 0	
Plus: Net income	3,470	
		3,470
Less: Cash dividends	200	
Retained earnings, December 31, 2013		<u>\$ 3,270</u>

Point: Arrow lines show how the statements are linked.

FASTFORWARD Balance Sheet December 31, 2013			
Assets		Liabilities	
Cash	\$ 4,350	Accounts payable	\$ 6,200
Supplies	9,720	Unearned revenue	3,000
Prepaid insurance	2,400	Total liabilities	9,200
Equipment	26,000	Equity	
		Common stock	30,000
		Retained earnings	3,270
		Total equity	33,270
Total assets	<u>\$42,470</u>	Total liabilities and equity	<u>\$42,470</u>

Point: To foot a column of numbers is to add them.

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.

Point: Knowing how financial statements are prepared improves our analysis of them.



\$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.)

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

Answers — p. C-27



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

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).

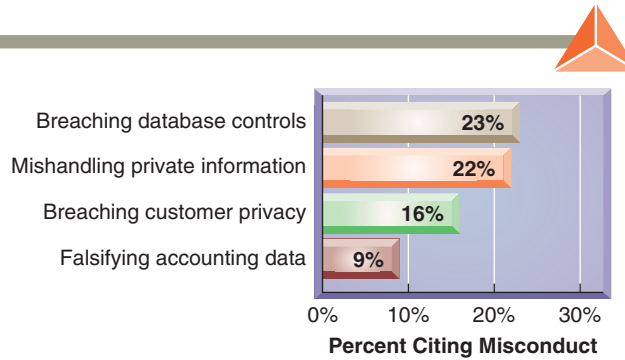
PIAGGIO

PIAGGIO Balance Sheet (in thousands of Euros) December 31, 2011			
Assets		Equity and Liabilities	
Noncurrent assets	1,010,476	Total equity	446,218
Current assets	509,708	Noncurrent liabilities	429,689
		Current liabilities	644,277
Total assets	<u>1,520,184</u>	Total equity and liabilities	<u>1,520,184</u>

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

Accounting Control 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]. ■



Debt Ratio



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.

A2 Compute the debt ratio and describe its use in analyzing financial condition.

$$\text{Debt ratio} = \frac{\text{Total liabilities}}{\text{Total assets}}$$

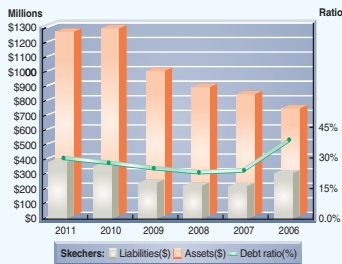
EXHIBIT C.17
Debt Ratio

Point: Compare the equity amount to the liability amount to assess the extent of owner versus nonowner financing.

EXHIBIT C.18

Computation and Analysis of Debt Ratio

\$ in millions	2011	2010	2009	2008	2007	2006
Total liabilities	\$ 389	\$ 359	\$246	\$204	\$201	\$288
Total assets	\$1,282	\$1,305	\$996	\$876	\$828	\$737
Debt ratio	0.30	0.28	0.25	0.23	0.24	0.39
Industry debt ratio	0.47	0.49	0.51	0.50	0.46	0.48



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.) ■ [Answer—p. C-26]

DEMONSTRATION PROBLEM

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

- On August 1, Worthy invested \$3,000 cash and \$15,000 of equipment in Expressions in exchange for common stock.
- On August 2, Expressions paid \$600 cash for furniture for the shop.
- On August 3, Expressions paid \$500 cash to rent space in a strip mall for August.
- On August 4, it purchased \$1,200 of equipment on credit for the shop (using a long-term note payable).
- 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.
- On August 15, it provided \$100 of haircutting services on account.
- On August 17, it received a \$100 check for services previously rendered on account.
- On August 17, it paid \$125 to an assistant for hours worked during the grand opening.
- Cash received from services provided during the second half of August was \$930.
- On August 31, it paid a \$400 installment toward principal on the note payable entered into on August 4.
- On August 31, it paid \$900 cash in dividends to Worthy (sole shareholder).

Required

- 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.
- 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.
6. Prepare a balance sheet as of August 31.
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:

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

[continued on next page]

[continued from previous page]

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

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

General Ledger									
Cash					Account No. 101				
Date	PR	Debit	Credit	Balance					
Aug. 1	GI	3,000		3,000					
2	GI		600	2,400					
3	GI		500	1,900					
15	GI	825		2,725					
17	GI	100		2,825					
17	GI		125	2,700					
31	GI	930		3,630					
31	GI		400	3,230					
31	GI		900	2,330					
Accounts Receivable					Account No. 102				
Date	PR	Debit	Credit	Balance					
Aug. 15	GI	100		100					
17	GI		100	0					
Furniture					Account No. 161				
Date	PR	Debit	Credit	Balance					
Aug. 2	GI	600		600					
Store Equipment					Account No. 165				
Date	PR	Debit	Credit	Balance					
Aug. 1	GI	15,000		15,000					
4	GI	1,200		16,200					
Note Payable					Account No. 240				
Date	PR	Debit	Credit	Balance					
Aug. 4	GI		1,200	1,200					
31	GI	400		800					
Common Stock					Account No. 307				
Date	PR	Debit	Credit	Balance					
Aug. 1	GI		18,000	18,000					
Dividends					Account No. 319				
Date	PR	Debit	Credit	Balance					
Aug. 31	GI	900		900					
Haircutting Services Revenue					Account No. 403				
Date	PR	Debit	Credit	Balance					
Aug. 15	GI		825	825					
15	GI		100	925					
31	GI		930	1,855					
Wages Expense					Account No. 623				
Date	PR	Debit	Credit	Balance					
Aug. 17	GI	125		125					
Rent Expense					Account No. 640				
Date	PR	Debit	Credit	Balance					
Aug. 3	GI	500		500					

3. Prepare a trial balance from the ledger:

EXPRESSIONS Trial Balance August 31		
	<u>Debit</u>	<u>Credit</u>
Cash	\$ 2,330	
Accounts receivable	0	
Furniture	600	
Store equipment	16,200	
Note payable		\$ 800
Common stock		18,000
Dividends	900	
Haircutting services revenue		1,855
Wages expense	125	
Rent expense	500	
Totals	<u>\$20,655</u>	<u>\$20,655</u>

4.

EXPRESSIONS Income Statement For Month Ended August 31		
Revenues		
Haircutting services revenue		\$1,855
Operating expenses		
Rent expense	\$500	
Wages expense	125	
Total operating expenses		625
Net income		<u>\$1,230</u>

5.

EXPRESSIONS Statement of Retained Earnings For Month Ended August 31		
Retained earnings, August 1	\$ 0	
Plus: Net income	1,230	
	1,230	
Less: Cash dividends	900	
Retained earnings, August 31	<u>\$ 330</u>	

6.

EXPRESSIONS Balance Sheet August 31			
Assets		Liabilities	
Cash	\$ 2,330	Note payable	\$ 800
Furniture	600	Equity	
Store equipment	16,200	Common stock	18,000
		Retained earnings	330
		Total equity	18,330
Total assets	<u>\$19,130</u>	Total liabilities and equity	<u>\$19,130</u>

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

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.



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.

Cash	15,000	
Equipment	23,000	
Common Stock		38,000
<i>Investment by owner of cash and equipment.</i>		

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

<p>Account (p. C-3)</p> <p>Account balance, or Balance (p. C-7)</p> <p>Balance column account (p. C-10)</p> <p>Chart of accounts (p. C-6)</p> <p>Compound journal entry (p. C-13)</p> <p>Credit (p. C-7)</p> <p>Creditors (p. C-4)</p>	<p>Debit (p. C-7)</p> <p>Debt ratio (p. C-21)</p> <p>Dividends (p. C-5)</p> <p>Double-entry accounting (p. C-7)</p> <p>General journal (p. C-8)</p> <p>General ledger (p. C-3)</p> <p>Journal (p. C-8)</p>	<p>Journalizing (p. C-8)</p> <p>Posting (p. C-8)</p> <p>Posting reference (PR) column (p. C-10)</p> <p>Source documents (p. C-2)</p> <p>T-accounts (p. C-7)</p> <p>Trial balance (p. C-17)</p> <p>Unearned revenue (p. C-5)</p>
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Multiple Choice Quiz

Answers on p. C-45

mhhe.com/wildMA4e

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

- 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
 - Credit to Utility Expense for \$700.
 - Debit to Utility Expense for \$700.
 - Debit to Accounts Payable for \$700.
 - Debit to Cash for \$700.
 - Credit to Common Stock for \$700.
- 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
 - Credit to Unearned Lawn Service Fees for \$2,500.
 - Debit to Lawn Service Fees Earned for \$2,500.
 - Credit to Cash for \$2,500.
 - Debit to Unearned Lawn Service Fees for \$2,500.
 - Credit to Common Stock for \$2,500.
- 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
- Common Stock 750,000
Cash 250,000
Land 500,000
- A trial balance prepared at year-end shows total credits exceeded total debits by \$765. This discrepancy could have been caused by
 - An error in the general journal where a \$765 increase in Accounts Payable was recorded as a \$765 decrease in Accounts Payable.
 - The ledger balance for Accounts Payable of \$7,650 being entered in the trial balance as \$765.
 - A general journal error where a \$765 increase in Accounts Receivable was recorded as a \$765 increase in Cash.
 - The ledger balance of \$850 in Accounts Receivable was entered in the trial balance as \$85.
 - An error in recording a \$765 increase in Cash as a credit.
- 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)?
 - 250%
 - 167%
 - 67%
 - 150%
 - 40%



Icon denotes assignments that involve decision making.

Discussion Questions

- Provide the names of two (a) asset accounts, (b) liability accounts, and (c) equity accounts.
- What is the difference between a note payable and an account payable?
- Discuss the steps in processing business transactions.
- What kinds of transactions can be recorded in a general journal?
- Are debits or credits typically listed first in general journal entries? Are the debits or the credits indented?
- Should a transaction be recorded first in a journal or the ledger? Why?
- If assets are valuable resources and asset accounts have debit balances, why do expense accounts also have debit balances?
- Why does the recordkeeper prepare a trial balance?
- If an incorrect amount is journalized and posted to the accounts, how should the error be corrected?
- Identify the four financial statements of a business.
- What information is reported in a balance sheet?
- What information is reported in an income statement?
- Why does the user of an income statement need to know the time period that it covers?
- Define (a) assets, (b) liabilities, (c) equity, and (d) net assets.
- Which financial statement is sometimes called the *statement of financial position*?
- 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.
- 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.
- Locate **KTM**'s income statement in Appendix A. **KTM** What is the title of its revenue account?
- Refer to **Piaggio**'s balance sheet in Appendix A. **PIAGGIO** 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.

- | | | |
|----------------------------|-----------------------------------|-----------------------------|
| a. Sales ticket | d. Telephone bill | g. Balance sheet |
| b. Income statement | e. Invoice from supplier | h. Prepaid insurance |
| c. Trial balance | f. Company revenue account | i. Bank statement |

QUICK STUDY

QS C-1

Identifying source documents

C1

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.

- | | | |
|----------------------------|-----------------------------|---------------------------------|
| a. Office equipment | d. Prepaid insurance | g. Cash |
| b. Cash dividends | e. Office supplies | h. Unearned rent revenue |
| c. Revenue | f. Rent expense | i. Accounts payable |

QS C-2

Identifying financial statement items

C2 P3

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

- | | | |
|---------------------------|-------------------------------|-------------------------|
| a. Office Supplies | d. Wages Expense | g. Wages Payable |
| b. Dividends | e. Accounts Receivable | h. Building |
| c. Fees Earned | f. Prepaid Rent | i. Common Stock |

QS C-3

Identifying normal balance

C4

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

- | | | |
|-------------------------------|-----------------------------|----------------------------|
| a. Service Revenue | e. Common Stock | i. Dividends |
| b. Interest Payable | f. Prepaid Insurance | j. Unearned Revenue |
| c. Accounts Receivable | g. Buildings | k. Accounts Payable |
| d. Salaries Expense | h. Interest Revenue | l. Land |

QS C-4

Linking debit or credit with normal balance

C4

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

- | | |
|--|---|
| a. To increase Land | f. To decrease Prepaid Rent |
| b. To decrease Cash | g. To increase Notes Payable |
| c. To increase Office Expense | h. To decrease Accounts Receivable |
| d. To increase Fees Earned | i. To increase Common Stock |
| e. To decrease Unearned Revenue | j. To increase Store Equipment |

QS C-5

Analyzing debit or credit by account

A1



Prepare journal entries for each of the following selected transactions.

- 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.
- On May 21, Elegant Lawns purchases office supplies on credit for \$280.
- On May 25, Elegant Lawns receives \$7,800 cash for performing landscaping services.
- On May 30, Elegant Lawns receives \$1,000 cash in advance of providing landscaping services to a customer.

QS C-6

Preparing journal entries

P1

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 \$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.
- 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.
- 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.
- A \$2,250 debit posting to Accounts Receivable was posted mistakenly to Land.
- A \$4,500 debit posting to Equipment was posted mistakenly to Cash.
- An entry debiting Cash and crediting Accounts Payable for \$4,500 was mistakenly not posted.

QS C-7

Identifying a posting error

P2



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.

- What type of entry system is applied when accounting follows IFRS?
- Identify the number and usual titles of the financial statements prepared under IFRS.
- 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 | |
- An _____ is a record of increases and decreases in a specific asset, liability, equity, revenue, or expense item.
 - Accounts payable, unearned revenue, and note payable are examples of _____ accounts.
 - Accounts receivable, prepaid accounts, supplies, and land are examples of _____ accounts.
 - Accounts are arranged into _____ general categories.
 - 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 |
|----------|-------------------|
- The _____ is a record containing all accounts used by a company.
 - 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.

- 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.
- 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.
- 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.

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?

- a. \$28,000 increase in a liability account
- b. \$10,000 increase in the Cash account
- c. \$10,000 increase in a revenue account
- d. \$62,000 increase in an asset account
- e. \$62,000 increase in a revenue account
- f. \$62,000 increase in an equity account

Exercise C-6

Analyzing effects of transactions on accounts

A1



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.

Exercise C-7

Preparing general journal entries

P1

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; Office Supplies; Prepaid Insurance; Photography Equipment; 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.

Exercise C-8

Preparing T-accounts (ledger) and a trial balance

P2

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; Dividends; Fees Earned; and Rent 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).

Exercise C-9

Recording effects of transactions in T-accounts

A1

Check Cash ending balance, \$94,850

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.

Exercise C-10

Preparing a trial balance

P2

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.

- a. Brina Valdez invests \$39,350 cash in the company in exchange for common stock.
- 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-11

Analyzing and journalizing revenue transactions

A1 P1



Exercise C-12

Analyzing and journalizing expense transactions

A1 P1 

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

C3 P3

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.

Cash	\$ 25,360	Dividends	\$ 6,000
Accounts receivable	22,360	Consulting fees earned	27,000
Office supplies	5,250	Rent expense	9,550
Land	44,000	Salaries expense	5,600
Office equipment	20,000	Telephone expense	860
Accounts payable	10,500	Miscellaneous expenses	520
Common stock	102,000		

Check Net income, \$10,470

Exercise C-14

Preparing a statement of retained earnings P3

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 P3

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

A1 

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

	Assets	Liabilities
Beginning of the year	\$ 60,000	\$20,000
End of the year	105,000	36,000

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

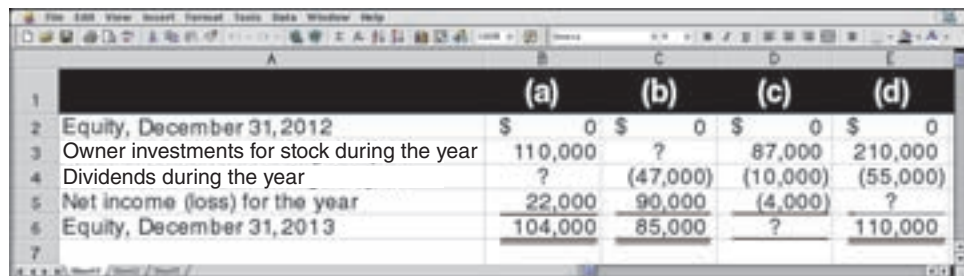
- a. Owner made no investments in the business and no dividends were paid during the year.
- b. Owner made no investments in the business but dividends were \$1,250 cash per month.
- c. No dividends were paid during the year but the owner did invest an additional \$55,000 cash in exchange for common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

P3 

Compute the missing amount for each of the following separate companies *a* through *d*.



	(a)	(b)	(c)	(d)
Equity, December 31, 2012	\$ 0	\$ 0	\$ 0	\$ 0
Owner investments for stock during the year	110,000	?	87,000	210,000
Dividends during the year	?	(47,000)	(10,000)	(55,000)
Net income (loss) for the year	22,000	90,000	(4,000)	?
Equity, December 31, 2013	104,000	85,000	?	110,000

Assume the following T-accounts reflect Belle Co.'s general ledger and that seven transactions *a* through *g* are posted to them. Provide a short description of each transaction. Include the amounts in your descriptions.

Cash			
(a)	6,000	(b)	4,800
(e)	4,500	(c)	900
		(f)	1,600
		(g)	820

Office Supplies	
(c)	900
(d)	300

Prepaid Insurance	
(b)	4,800

Equipment	
(a)	7,600
(d)	9,700

Automobiles	
(a)	12,000

Accounts Payable	
(f)	1,600
(d)	10,000

Common Stock	
(a)	25,600

Delivery Services Revenue	
(e)	4,500

Gas and Oil Expense	
(g)	820

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*.

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 under- or overstated. Item (a) is completed as an example.

Exercise C-20

Identifying effects of posting errors on the trial balance



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

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.

Exercise C-21

Analyzing a trial balance error



- Is the debit column total of the trial balance overstated, understated, or correctly stated?
- Is the credit column total of the trial balance overstated, understated, or correctly stated?
- Is the Automobiles account balance overstated, understated, or correctly stated in the trial balance?
- Is the Accounts Payable account balance overstated, understated, or correctly stated in the trial balance?
- 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?

Exercise C-22

Interpreting the debt ratio and return on assets



- Calculate the debt ratio and the return on assets using the year-end information for each of the following six separate companies (\$ thousands).

Case	Assets	Liabilities	Average Assets	Net Income
Company 1	\$90,500	\$11,765	\$100,000	\$20,000
Company 2	64,000	46,720	40,000	3,800
Company 3	32,500	26,650	50,000	650
Company 4	147,000	55,860	200,000	21,000
Company 5	92,000	31,280	40,000	7,520
Company 6	104,500	52,250	80,000	12,000

- Of the six companies, which business relies most heavily on creditor financing?
- Of the six companies, which business relies most heavily on equity financing?
- Which two companies indicate the greatest risk?
- Which two companies earn the highest return on assets?
- Which one company would investors likely prefer based on the risk–return relation?

Exercise C-23

Preparing a balance sheet following IFRS



BMW reports the following balance sheet accounts for the year ended December 31, 2011 (euro in millions). Prepare the balance sheet for this company as of December 31, 2011, following the usual IFRS formats.

Current liabilities	€11,519	Noncurrent liabilities	€7,767
Current assets	17,682	Noncurrent assets	9,826
Total equity	8,222		

**PROBLEM SET A****Problem C-1A**

Preparing and posting journal entries; preparing a trial balance

C3 C4 A1 P1 P2

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

- 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.
- The company purchased land worth \$49,000 for an office by paying \$6,300 cash and signing a long-term note payable for \$42,700.
- The company purchased a portable building with \$55,000 cash and moved it onto the land acquired in *b*.
- The company paid \$3,000 cash for the premium on an 18-month insurance policy.
- The company completed and delivered a set of plans for a client and collected \$6,200 cash.
- 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 completed \$14,000 of engineering services for a client. This amount is to be received in 30 days.
- The company purchased \$1,150 of additional office equipment on credit.
- The company completed engineering services for \$22,000 on credit.
- The company received a bill for rent of equipment that was used on a recently completed job. The \$1,333 rent cost must be paid within 30 days.
- The company collected \$7,000 cash in partial payment from the client described in transaction *g*.
- The company paid \$1,200 cash for wages to a drafting assistant.
- The company paid \$1,150 cash to settle the account payable created in transaction *h*.
- The company paid \$925 cash for minor maintenance of its drafting equipment.
- The company paid \$9,480 cash in dividends.

- 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.

Check (2) Ending balances: Cash, \$22,945; Accounts Receivable, \$29,000; Accounts Payable, \$1,333

(3) Trial balance totals, \$261,733

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 purchased \$600 of additional office supplies on credit.
 - 31 The company paid \$500 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); 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 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.

Problem C-2A

Preparing and posting journal entries; preparing a trial balance

C3 C4 A1 P1 P2



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Check (2) Ending balances: Cash, \$136,700; Accounts Receivable, \$7,820; Accounts Payable, \$600

(3) Total debits, \$187,920

Problem C-3A

Preparing and posting journal entries; preparing a trial balance

C3 C4 A1 P1 P2

Check (2) Ending balances: Cash, \$59,465; Accounts Receivable, \$4,490; Accounts Payable, \$600

(3) Total debits, \$119,490

Problem C-4A

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

C2 A1 A2 P3 



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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.

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

December 31	2012	2013
Cash	\$ 64,300	\$ 15,640
Accounts receivable	26,240	19,390
Office supplies	3,160	1,960
Office equipment	44,000	44,000
Trucks	148,000	157,000
Building	0	80,000
Land	0	60,000
Accounts payable	3,500	33,500
Note payable	0	40,000

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).

Check (2) Net income, \$23,290

(3) Debt ratio, 19.4%

Problem C-5A

Analyzing account balances and reconstructing transactions

C1 C3 A1 P2 

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.

Cash	\$37,641
Office supplies	890
Prepaid insurance	4,600
Office equipment	12,900
Accounts payable	12,900
Common stock	18,000
Dividends	3,329
Engineering fees earned	36,000
Rent expense	7,540

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.

Check (1) Trial balance totals, \$66,900

(3) Cash paid, \$16,359

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 valued at \$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 *c*.
- 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.

Problem C-6A

Recording transactions; posting to ledger; preparing a trial balance

C3 A1 P1 P2

Check (2) Ending balances: Cash, \$12,665; Office Equipment, \$50,900

(3) Trial balance totals, \$291,350

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 the company 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.

PROBLEM SET B

Problem C-1B

Preparing and posting journal entries; preparing a trial balance

C3 C4 A1 P1 P2

Check (2) Ending balances: Cash, \$17,262; Accounts Receivable, \$9,350; Accounts Payable, \$580

(3) Trial balance totals,
\$141,080

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 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

C3 C4 A1 P1 P2

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

Check (2) Ending balances: Cash, \$23,069; Accounts Receivable, \$6,750; Accounts Payable, \$249

(3) Total debits, \$60,599

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

C3 C4 A1 P1 P2

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 \$10,400 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.

Check (2) Ending balances: Cash, \$21,520; Accounts Receivable, \$9,800; Accounts Payable, \$550

(3) Total debits, \$74,330

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

December 31	2012	2013
Cash	\$20,000	\$ 5,000
Accounts receivable	35,000	25,000
Office supplies	8,000	13,500
Office equipment	40,000	40,000
Machinery	28,500	28,500
Building	0	250,000
Land	0	50,000
Accounts payable	4,000	12,000
Note payable	0	250,000

Problem C-4B

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

C2 A1 A2 P3



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).

Check (2) Net income, \$10,500

(3) Debt ratio, 63.6%

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-5B

Analyzing account balances and reconstructing transactions

C1 C3 A1 P2



Cash	\$19,982
Office supplies	760
Prepaid rent	1,800
Office equipment	12,250
Accounts payable	12,250
Common stock	15,000
Dividends	5,200
Consulting fees earned	20,400
Operating expenses	7,658

Required**Check** (1) Trial balance total, \$47,650

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

Analysis Component

(3) Cash paid, \$15,418

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 \$19,982 ending Cash balance.

Problem C-6BRecording transactions;
posting to ledger; preparing
a trial balance

C3 A1 P1 P2

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**Check** (2) Ending balances: Cash,
\$17,860; Office Equipment, \$15,600(3) Trial balance totals,
\$95,100

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.

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.

SERIAL PROBLEM

Success Systems

A1 P1 P2

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

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

Beyond the Numbers

REPORTING IN ACTION

A1 A2 

Polaris

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

A1 A2 

Polaris

Arctic Cat

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

(\$ thousands)	Polaris		Arctic Cat	
	Current Year	Prior Year	Current Year	Prior Year
Total liabilities	\$ 727,968	\$ 690,656	\$ 89,870	\$ 78,745
Total assets	1,228,024	1,061,647	272,906	246,084

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


C1 

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

C1 C2 A1 P3 

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.

TAKING IT TO THE NET

A1



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.

TEAMWORK IN ACTION

C1 C2 C4 A1

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.

ENTREPRENEURIAL DECISION

A1

A2



P3



Required

Identify at least two issues that Misa and Jennifer should consider when trying to decide on the method for financing their expansion.

ENTREPRENEURIAL DECISION

A1 A2 P3  

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.

Cash	\$ 3,600	Accounts Receivable	\$ 9,600	Prepaid Insurance	\$ 1,500
Prepaid Rent	9,400	Store Supplies	6,600	Equipment	50,000
Accounts Payable	2,200	Unearned Lesson Fees	15,600	Total Equity*	62,900
Annual net income	40,000				

* 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

C1

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

A2  

KTM
Polaris
Arctic Cat

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.

Key Figure	KTM	Polaris	Arctic Cat
Return on assets	4.3%	18.5%	4.8%
Debt ratio	54.8%	59.3%	32.9%

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 = $\$400,000/\$1,000,000 = \underline{\underline{40\%}}$