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The Accounting Information System

CHAPTER PREVIEW

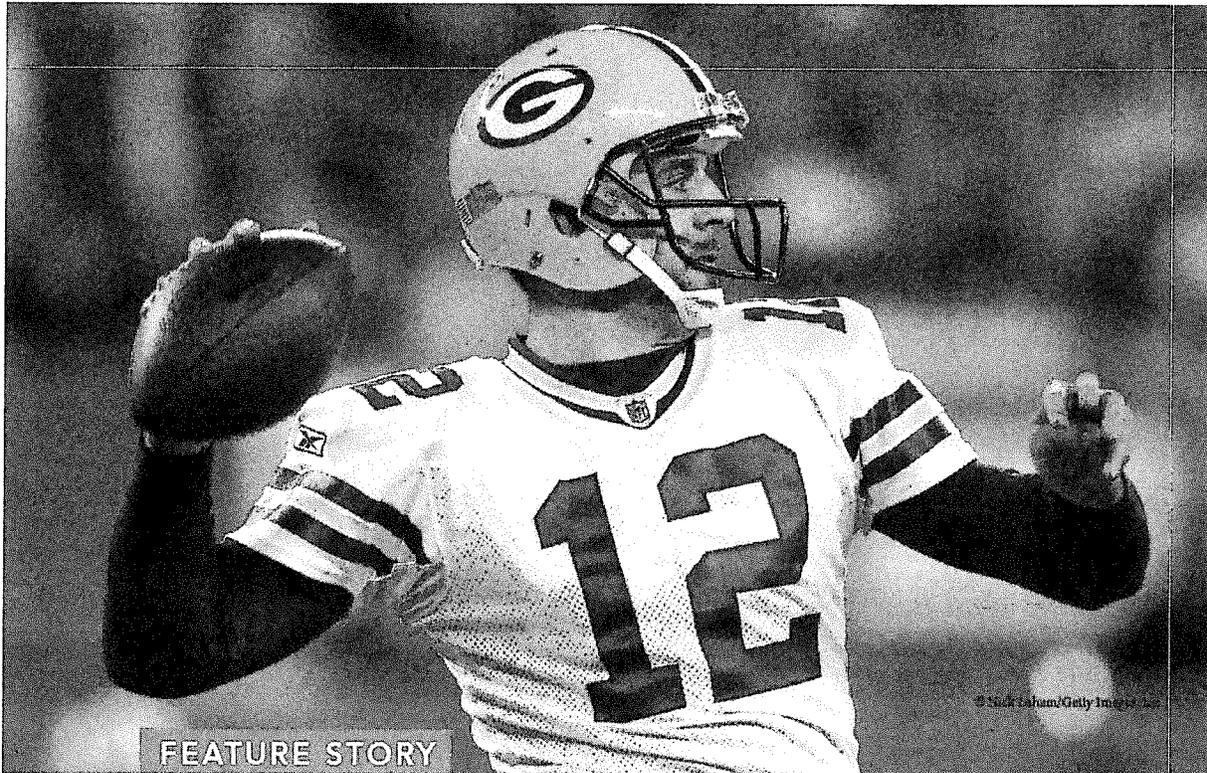
As indicated in the Feature Story, a reliable information system is a necessity for any company. The purpose of this chapter is to explain and illustrate the features of an accounting information system.

CHAPTER OUTLINE		
LEARNING OBJECTIVES		PRACTICE
1 Analyze the effect of business transactions on the basic accounting equation.	▶ <ul style="list-style-type: none"> Accounting transactions Analyzing transactions Summary of transactions 	DO IT! 1 Transaction Analysis
2 Explain how accounts, debits, and credits are used to record business transactions.	▶ <ul style="list-style-type: none"> Debits and credits Debit and credit procedures Stockholders' equity relationships Summary of debit/credit rules 	DO IT! 2 Debits and Credits for Balance Sheet Accounts
3 Indicate how a journal is used in the recording process.	▶ <ul style="list-style-type: none"> The recording process The journal 	DO IT! 3 Journal Entries
4 Explain how a ledger and posting help in the recording process.	▶ <ul style="list-style-type: none"> The ledger Chart of accounts Posting The recording process illustrated Summary illustration 	DO IT! 4 Posting
5 Prepare a trial balance.	▶ <ul style="list-style-type: none"> Limitations of a trial balance 	DO IT! 5 Trial Balance

Go to the **REVIEW AND PRACTICE** section at the end of the chapter for a targeted summary and exercises with solutions.

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Accidents Happen

How organized are you financially? Take a short quiz. Answer yes or no to each question:

- Does your wallet contain so many cash machine receipts that you've been declared a walking fire hazard?
- Do you wait until your debit card is denied before checking the status of your funds?
- Was Aaron Rodgers (the quarterback for the **Green Bay Packers**) playing high school football the last time you verified the accuracy of your bank account?

If you think it is hard to keep track of the many transactions that make up *your* life, imagine how difficult it is for a big corporation to do so. Not only that, but now consider how important it is for a big company to have good accounting records, especially if it has control of *your* life savings. **MF Global Holdings Ltd** was such a company. As a large investment broker, it held billions of dollars of investments for clients. If you had your life savings invested at MF Global, you might be slightly displeased if you heard this from one of its representatives: "You know, I kind of remember an account for someone with a name like yours—now what did we do with that?"

Unfortunately, that is almost exactly what happened to MF Global's clients shortly before it filed for bankruptcy. During the days immediately following the bankruptcy filing, regulators and auditors struggled to piece things together. In the words of one regulator, "Their books are a disaster ... we're trying to figure out what numbers are real numbers." One company that considered buying an interest in MF Global walked away from the deal because it "couldn't get a sense of what was on the balance sheet." That company said the information that should have been instantly available instead took days to produce.

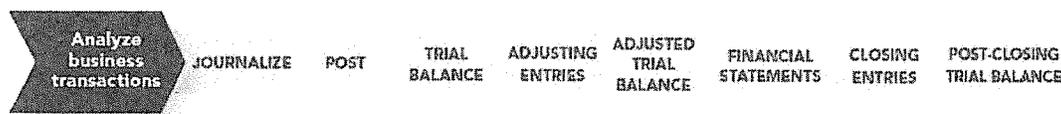
It now appears that MF Global did not properly segregate customer accounts from company accounts. And, because of its sloppy record-keeping, customers were not protected when the company had financial troubles. Total customer losses were approximately \$1 billion. As you can see, accounting matters!

Source: S. Patterson and A. Lucchetti, "Inside the Hunt for MF Global Cash," Wall Street Journal Online (November 11, 2011).

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LEARNING OBJECTIVE 1

Analyze the effect of business transactions on the basic accounting equation.



The **accounting cycle graphic** above illustrates the steps companies follow each period to record transactions and eventually prepare financial statements.

The system of collecting and processing transaction data and communicating financial information to decision-makers is known as the **accounting information system**. Factors that shape an accounting information system include the nature of the company's business, the types of transactions, the size of the company, the volume of data, and the information demands of management and others.

Most businesses use computerized accounting systems—sometimes referred to as electronic data processing (EDP) systems. These systems handle all the steps involved in the recording process, from initial data entry to preparation of the financial statements. In order to remain competitive, companies continually improve their accounting systems to provide accurate and timely data for decision-making. For example, in a recent annual report, **Tootsie Roll** stated, “We also invested in additional processing and data storage hardware during the year. We view information technology as a key strategic tool, and are committed to deploying leading edge technology in this area.” In addition, many companies have upgraded their accounting information systems in response to the requirements of Sarbanes-Oxley.

Accounting information systems rely on a process referred to as **the accounting cycle**. As you can see from the graphic above, the accounting cycle begins with the analysis of business transactions and ends with the preparation of a post-closing trial balance. We explain each of the steps in this chapter as well as in [Chapter 4](#).

In this chapter, in order to emphasize the underlying concepts and principles, we focus on a manual accounting system. The accounting concepts and principles do not change whether a system is computerized or manual.

ACCOUNTING TRANSACTIONS

To use an accounting information system, you need to know which economic events to recognize (record). Not all events are recorded and reported in the financial statements. For example, suppose **General Motors** hired a new employee and purchased a new computer. Are these events entered in its accounting records? The first event would not be recorded, but the second event would. We call economic events that require recording in the financial statements **accounting transactions**.

An accounting transaction occurs when assets, liabilities, or stockholders' equity items change as a result of some economic event. The purchase of a computer by **General Motors**, the payment of rent by **Microsoft**, and the sale of a multi-day guided trip by Sierra Corporation are examples of events that change a company's assets, liabilities, or stockholders' equity. [Illustration 3-1](#) summarizes the decision process companies use to decide whether or not to record economic events.

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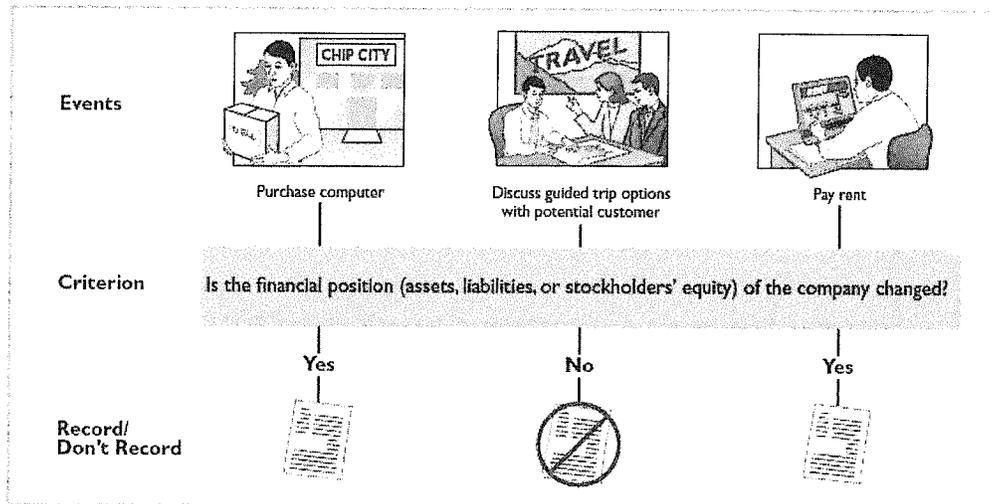


ILLUSTRATION 3-1
Transaction identification process

ANALYZING TRANSACTIONS

In [Chapter 1](#), you learned the basic accounting equation:

$$\text{Assets} = \text{Liabilities} + \text{Stockholders' Equity}$$

In this chapter, you will learn how to analyze transactions in terms of their effect on assets, liabilities, and stockholders' equity. **Transaction analysis** is the process of identifying the specific effects of economic events on the accounting equation.

The accounting equation must always balance. Each transaction has a dual (double-sided) effect on the equation. For example, if an individual asset is increased, there must be a corresponding:

- Decrease in another asset, *or*
- Increase in a specific liability, *or*
- Increase in stockholders' equity.

Two or more items could be affected when an asset is increased. For example, if a company purchases a computer for \$10,000 by paying \$6,000 in cash and signing a note for \$4,000, one asset (equipment) increases \$10,000, another asset (cash) decreases \$6,000, and a liability (notes payable) increases \$4,000. The result is that the accounting equation remains in balance—assets increased by a net \$4,000 and liabilities increased by \$4,000, as shown below.

<u>Assets</u>	=	<u>Liabilities</u>	+	<u>Stockholders' Equity</u>
+\$10,000		+\$4,000		
- 6,000				
<u>\$ 4,000</u>	=	<u>\$4,000</u>		

[Chapter 1](#) presented the financial statements for Sierra Corporation for its first month. You should review those financial statements (on page 16) at this time. To illustrate how economic events affect the accounting equation, we will examine events affecting Sierra during its first month.

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In order to analyze the transactions for Sierra, we will expand the basic accounting equation. This will allow us to better illustrate the impact of transactions on stockholders' equity. Recall from the balance sheets in Chapters 1 and 2 that stockholders' equity is comprised of two parts: common stock and retained earnings. Common stock is affected when the company issues new shares of stock in exchange for cash. Retained earnings is affected when the company recognizes revenue, incurs expenses, or pays dividends. Illustration 3-2 shows the expanded equation.

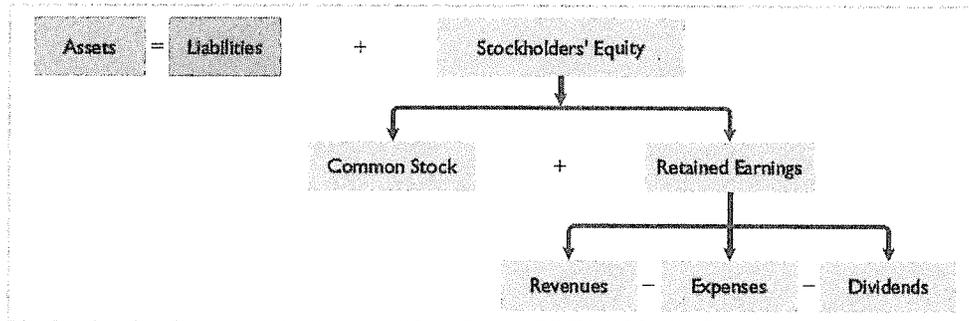


ILLUSTRATION 3-2
Expanded accounting equation

If you are tempted to skip ahead after you've read a few of the following transaction analyses, don't do it. Each has something unique to teach, something you'll need later. (We assure you that we've kept them to the minimum needed!)

DECISION TOOLS

The accounting equation is used to determine if an accounting transaction has occurred.

EVENT (1). INVESTMENT OF CASH BY STOCKHOLDERS. On October 1, cash of \$10,000 is invested in the business by investors in exchange for \$10,000 of common stock. This event is an accounting transaction that results in an increase in both assets and stockholders' equity.

Basic Analysis	The asset Cash is increased \$10,000; stockholders' equity (specifically Common Stock) is increased \$10,000.				
Equation Analysis	<u>Assets</u>	=	<u>Liabilities</u>	+	<u>Stockholders' Equity</u>
	Cash	=			Common Stock
	(1) +\$10,000				+\$10,000 Issued stock

The equation is in balance after the issuance of common stock. Keeping track of the source of each change in stockholders' equity is essential for later accounting activities. In particular, items recorded in the revenue and expense columns are used for the calculation of net income.

EVENT (2). NOTE ISSUED IN EXCHANGE FOR CASH. On October 1, Sierra borrowed \$5,000 from Castle Bank by signing a 3-month, 12%, \$5,000 note payable. This transaction results in an equal increase in assets and liabilities. The specific effect of this transaction and the cumulative effect of the first two transactions are as follows.

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Basic Analysis	The asset Cash is increased \$5,000; the liability Notes Payable is increased \$5,000.																																				
Equation Analysis	<table style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 15%;"></td> <td style="text-align: center;"><u>Assets</u></td> <td style="text-align: center;">=</td> <td style="text-align: center;"><u>Liabilities</u></td> <td style="text-align: center;">+</td> <td style="text-align: center;"><u>Stockholders' Equity</u></td> </tr> <tr> <td></td> <td style="text-align: center;">Cash</td> <td></td> <td style="text-align: center;">Notes Payable</td> <td></td> <td style="text-align: center;">Common Stock</td> </tr> <tr> <td></td> <td style="text-align: center;">\$10,000</td> <td></td> <td></td> <td></td> <td style="text-align: center;">\$10,000</td> </tr> <tr> <td style="text-align: center;">(2)</td> <td style="text-align: center;">+ 5,000</td> <td></td> <td style="text-align: center;">+ 5,000</td> <td></td> <td></td> </tr> <tr> <td></td> <td style="text-align: center;"><u>\$15,000</u></td> <td style="text-align: center;">=</td> <td style="text-align: center;"><u>\$5,000</u></td> <td style="text-align: center;">+</td> <td style="text-align: center;"><u>\$10,000</u></td> </tr> <tr> <td></td> <td></td> <td></td> <td></td> <td></td> <td style="text-align: center;">\$15,000</td> </tr> </table>		<u>Assets</u>	=	<u>Liabilities</u>	+	<u>Stockholders' Equity</u>		Cash		Notes Payable		Common Stock		\$10,000				\$10,000	(2)	+ 5,000		+ 5,000				<u>\$15,000</u>	=	<u>\$5,000</u>	+	<u>\$10,000</u>						\$15,000
	<u>Assets</u>	=	<u>Liabilities</u>	+	<u>Stockholders' Equity</u>																																
	Cash		Notes Payable		Common Stock																																
	\$10,000				\$10,000																																
(2)	+ 5,000		+ 5,000																																		
	<u>\$15,000</u>	=	<u>\$5,000</u>	+	<u>\$10,000</u>																																
					\$15,000																																

Total assets are now \$15,000, and liabilities plus stockholders' equity also total \$15,000.

EVENT (3). PURCHASE OF EQUIPMENT FOR CASH. On October 2, Sierra purchased equipment by paying \$5,000 cash to Superior Equipment Sales Co. This transaction results in an equal increase and decrease in Sierra's assets.

Basic Analysis	The asset Equipment is increased \$5,000; the asset Cash is decreased \$5,000.																																				
Equation Analysis	<table style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 15%;"></td> <td style="text-align: center;"><u>Assets</u></td> <td style="text-align: center;">=</td> <td style="text-align: center;"><u>Liabilities</u></td> <td style="text-align: center;">+</td> <td style="text-align: center;"><u>Stockholders' Equity</u></td> </tr> <tr> <td></td> <td style="text-align: center;">Cash + Equipment</td> <td></td> <td style="text-align: center;">Notes Payable</td> <td></td> <td style="text-align: center;">Common Stock</td> </tr> <tr> <td></td> <td style="text-align: center;">\$15,000</td> <td></td> <td style="text-align: center;">\$5,000</td> <td></td> <td style="text-align: center;">\$10,000</td> </tr> <tr> <td style="text-align: center;">(3)</td> <td style="text-align: center;">- 5,000 + 5,000</td> <td></td> <td></td> <td></td> <td></td> </tr> <tr> <td></td> <td style="text-align: center;"><u>\$10,000 + \$5,000</u></td> <td style="text-align: center;">=</td> <td style="text-align: center;"><u>\$5,000</u></td> <td style="text-align: center;">+</td> <td style="text-align: center;"><u>\$10,000</u></td> </tr> <tr> <td></td> <td style="text-align: center;">\$15,000</td> <td></td> <td></td> <td></td> <td style="text-align: center;">\$15,000</td> </tr> </table>		<u>Assets</u>	=	<u>Liabilities</u>	+	<u>Stockholders' Equity</u>		Cash + Equipment		Notes Payable		Common Stock		\$15,000		\$5,000		\$10,000	(3)	- 5,000 + 5,000						<u>\$10,000 + \$5,000</u>	=	<u>\$5,000</u>	+	<u>\$10,000</u>		\$15,000				\$15,000
	<u>Assets</u>	=	<u>Liabilities</u>	+	<u>Stockholders' Equity</u>																																
	Cash + Equipment		Notes Payable		Common Stock																																
	\$15,000		\$5,000		\$10,000																																
(3)	- 5,000 + 5,000																																				
	<u>\$10,000 + \$5,000</u>	=	<u>\$5,000</u>	+	<u>\$10,000</u>																																
	\$15,000				\$15,000																																

The total assets are now \$15,000, and liabilities plus stockholders' equity also total \$15,000.

EVENT (4). RECEIPT OF CASH IN ADVANCE FROM CUSTOMER. On October 2, Sierra received a \$1,200 cash advance from R. Knox, a client. Sierra received cash (an asset) for guide services for multi-day trips that it expects to complete in the future. Although Sierra received cash, **it does not record revenue until it has performed the work**. In some industries, such as the magazine and airline industries, customers are expected to prepay. These companies have a liability to the customer until they deliver the magazines or provide the flight. When the company eventually provides the product or service, it records the revenue.

Since Sierra received cash prior to performance of the service, Sierra has a liability for the work due.

Basic Analysis	The asset Cash is increased \$1,200; the liability Unearned Service Revenue is increased \$1,200 because the service has not been performed yet. That is, when an advance payment is received, unearned revenue (a liability) should be recorded in order to recognize the obligation that exists.																																				
Equation Analysis	<table style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 15%;"></td> <td style="text-align: center;"><u>Assets</u></td> <td style="text-align: center;">=</td> <td style="text-align: center;"><u>Liabilities</u></td> <td style="text-align: center;">+</td> <td style="text-align: center;"><u>Stockholders' Equity</u></td> </tr> <tr> <td></td> <td style="text-align: center;">Cash + Equipment</td> <td></td> <td style="text-align: center;">Notes Payable + Unearned Service Revenue</td> <td></td> <td style="text-align: center;">Common Stock</td> </tr> <tr> <td></td> <td style="text-align: center;">\$10,000 + \$5,000</td> <td></td> <td style="text-align: center;">\$5,000 +</td> <td></td> <td style="text-align: center;">\$10,000</td> </tr> <tr> <td style="text-align: center;">(4)</td> <td style="text-align: center;">+ 1,200</td> <td></td> <td style="text-align: center;">+ 1,200</td> <td></td> <td></td> </tr> <tr> <td></td> <td style="text-align: center;"><u>\$11,200 + \$5,000</u></td> <td style="text-align: center;">=</td> <td style="text-align: center;"><u>\$5,000 + \$1,200</u></td> <td style="text-align: center;">+</td> <td style="text-align: center;"><u>\$10,000</u></td> </tr> <tr> <td></td> <td style="text-align: center;">\$16,200</td> <td></td> <td style="text-align: center;">\$16,200</td> <td></td> <td></td> </tr> </table>		<u>Assets</u>	=	<u>Liabilities</u>	+	<u>Stockholders' Equity</u>		Cash + Equipment		Notes Payable + Unearned Service Revenue		Common Stock		\$10,000 + \$5,000		\$5,000 +		\$10,000	(4)	+ 1,200		+ 1,200				<u>\$11,200 + \$5,000</u>	=	<u>\$5,000 + \$1,200</u>	+	<u>\$10,000</u>		\$16,200		\$16,200		
	<u>Assets</u>	=	<u>Liabilities</u>	+	<u>Stockholders' Equity</u>																																
	Cash + Equipment		Notes Payable + Unearned Service Revenue		Common Stock																																
	\$10,000 + \$5,000		\$5,000 +		\$10,000																																
(4)	+ 1,200		+ 1,200																																		
	<u>\$11,200 + \$5,000</u>	=	<u>\$5,000 + \$1,200</u>	+	<u>\$10,000</u>																																
	\$16,200		\$16,200																																		

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EVENT (5). SERVICES PERFORMED FOR CASH. On October 3, Sierra received \$10,000 in cash (an asset) from Copa Company for guide services performed for a corporate event. Guide service is the principal revenue-producing activity of Sierra. **Revenue increases stockholders' equity.** This transaction, then, increases both assets and stockholders' equity.

Basic Analysts The asset Cash is increased \$10,000; the revenue Service Revenue is increased \$10,000.

Equation Analysis											
Assets		=	Liabilities			+	Stockholders' Equity				
Cash	+ Equip-ment	=	Notes Pay.	+ Unearned Serv. Rev.	=	Common Stock	+ Retained Earnings	- Rev.	- Exp.	- Div.	
\$11,200	\$5,000		\$5,000	\$1,200		\$10,000					
(5) +10,000								+ \$10,000			Service Revenue
\$21,200			\$5,000 + \$1,200				\$10,000 + \$10,000				
							\$26,200				

Often companies perform services "on account." That is, they perform services for which they are paid at a later date. Revenue, however, is recorded when services are performed. Therefore, revenues would increase when services are performed, even though cash has not been received. Instead of receiving cash, the company receives a different type of asset, an **account receivable**. Accounts receivable represent the right to receive payment at a later date. Suppose that Sierra had performed these services on account rather than for cash. This event would be reported using the accounting equation as:

Assets	=	Liabilities	+	Stockholders' Equity
Accounts Receivable	=			Revenues
+\$10,000				+\$10,000 Service Revenue

Later, when Sierra collects the \$10,000 from the customer, Accounts Receivable decreases by \$10,000, and Cash increases by \$10,000.

Assets		=	Liabilities	+	Stockholders' Equity
Cash	Accounts Receivable				
+\$10,000	-\$10,000				

Note that in this case, revenues are not affected by the collection of cash. Instead Sierra records an exchange of one asset (Accounts Receivable) for a different asset (Cash).

EVENT (6). PAYMENT OF RENT. On October 3, Sierra paid its office rent for the month of October in cash, \$900. This rent payment is a transaction that results in a decrease in an asset, cash.

Rent is a cost incurred by Sierra in its effort to generate revenues. It is treated as an expense because it pertains only to the current month. **Expenses decrease stockholders' equity.** Sierra records the rent payment by decreasing cash and increasing expenses to maintain the balance of the accounting equation.

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Basic Analysis The expense account Rent Expense is increased \$900 because the payment pertains only to the current month; the asset Cash is decreased \$900.

Equation Analysis

Assets		=	Liabilities		+	Stockholders' Equity				
Cash	+ Equip- ment		Notes Pay.	+ Unearned Serv. Rev.		Common Stock	Retained Earnings			
							+ Rev.	- Exp.	- Div.	
\$21,200	\$5,000		\$5,000	\$1,200		\$10,000	\$10,000			
(6) -900								-900		Rent Expense
<u>\$20,300</u>	<u>+ \$5,000</u>	=	<u>\$5,000</u>	<u>+ \$1,200</u>	+	<u>\$10,000</u>	<u>+ \$10,000</u>	<u>- \$900</u>		
\$25,300							\$25,300			

EVENT (7). PURCHASE OF INSURANCE POLICY FOR CASH. On October 4, Sierra paid \$600 for a one-year insurance policy that will expire next year on September 30. Payments of expenses that will benefit more than one accounting period are identified as assets called prepaid expenses or prepayments.

Basic Analysis The asset Cash is decreased \$600; the asset Prepaid Insurance is increased \$600.

Equation Analysis

Assets			=	Liabilities		+	Stockholders' Equity				
Cash	+ Prepaid Insurance	+ Equip- ment		Notes Pay.	+ Unearned Serv. Rev.		Common Stock	Retained Earnings			
								+ Rev.	- Exp.	- Div.	
\$20,300		\$5,000		\$5,000	\$1,200		\$10,000	\$10,000	\$900		
(7) -600	+600										
<u>\$19,700</u>	<u>+ \$600</u>	<u>+ \$5,000</u>	=	<u>\$5,000</u>	<u>+ \$1,200</u>	+	<u>\$10,000</u>	<u>+ \$10,000</u>	<u>- \$900</u>		
\$25,300								\$25,300			

The balance in total assets did not change; one asset account decreased by the same amount that another increased.

EVENT (8). PURCHASE OF SUPPLIES ON ACCOUNT. On October 5, Sierra purchased an estimated three months of supplies on account from Aero Supply for \$2,500. In this case, "on account" means that the company receives goods or services that it will pay for at a later date. This transaction increases both an asset (supplies) and a liability (accounts payable).

Basic Analysis The asset Supplies is increased \$2,500; the liability Accounts Payable is increased \$2,500.

Equation Analysis

Assets				=	Liabilities			+	Stockholders' Equity			
Cash	+ Supplies	+ Prep'd. Insur.	+ Equip- ment		Notes Pay.	+ Accounts Payable	+ Unearned Serv. Rev.		Common Stock	Retained Earnings		
										+ Rev.	- Exp.	- Div.
\$19,700		\$600	\$5,000		\$5,000		\$1,200		\$10,000	\$10,000	\$900	
(8)	+2,500					+2,500						
<u>\$19,700</u>	<u>+ \$2,500</u>	<u>+ \$600</u>	<u>+ \$5,000</u>	=	<u>\$5,000</u>	<u>+ \$2,500</u>	<u>+ \$1,200</u>	+	<u>\$10,000</u>	<u>+ \$10,000</u>	<u>- \$900</u>	
\$27,800									\$27,800			

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EVENT (9). HIRING OF NEW EMPLOYEES. On October 9, Sierra hired four new employees to begin work on October 15. Each employee will receive a weekly salary of \$500 for a five-day work week, payable every two weeks. Employees will receive their first paychecks on October 26. On the date Sierra hires the employees, there is no effect on the accounting equation because the assets, liabilities, and stockholders' equity of the company have not changed.

Basic Analysis An accounting transaction has not occurred. There is only an agreement that the employees will begin work on October 15. (See Event (11) for the first payment.)

EVENT (10). PAYMENT OF DIVIDEND. On October 20, Sierra paid a \$500 cash dividend. **Dividends** are a reduction of stockholders' equity but not an expense. Dividends are not included in the calculation of net income. Instead, a dividend is a distribution of the company's assets to its stockholders.

Basic Analysis The Dividends account is increased \$500; the asset Cash is decreased \$500.

Equation Analysis

Assets				=	Liabilities			+	Stockholders' Equity			
Cash	Sup- plies	Prepd. + Insur.	Equip- ment	=	Notes Pay.	Accts. Pay.	Unearned + Serv. Rev.	+	Common Stock	Retained Earnings		
										Rev.	- Exp.	- Div.
\$19,700	\$2,500	\$600	\$5,000	=	\$5,000	\$2,500	\$1,200	+	\$10,000	\$10,000	\$900	
(10) -500				=				+				- \$500
\$19,200 + \$2,500 + \$600 + \$5,000				=	\$5,000	+ \$2,500	+ \$1,200	+	\$10,000	+ \$10,000	- \$900	- \$500
\$27,300					\$27,300							

EVENT (11). PAYMENT OF CASH FOR EMPLOYEE SALARIES. Employees have worked two weeks, earning \$4,000 in salaries, which were paid on October 26. Salaries and Wages Expense is an expense that reduces stockholders' equity. In this transaction, both assets and stockholders' equity are reduced.

Basic Analysis The asset Cash is decreased \$4,000; the expense account Salaries and Wages Expense is increased \$4,000.

Equation Analysis

Assets				=	Liabilities			+	Stockholders' Equity			
Cash	Sup- plies	Prepd. + Insur.	Equip- ment	=	Notes Pay.	Accts. Pay.	Unearned + Serv. Rev.	+	Common Stock	Retained Earnings		
										Rev.	- Exp.	- Div.
\$19,200	\$2,500	\$600	\$5,000	=	\$5,000	\$2,500	\$1,200	+	\$10,000	\$10,000	\$ 900	\$500
(11) -4,000				=				+			- 4,000	Sal/Wages Expense
\$15,200 + \$2,500 + \$600 + \$5,000				=	\$5,000	+ \$2,500	+ \$1,200	+	\$10,000	+ \$10,000	- \$4,900	- \$500
\$23,300					\$23,300							

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INVESTOR INSIGHT

Why Accuracy Matters



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While most companies record transactions very carefully, the reality is that mistakes still happen. For example, bank regulators fined **Bank One Corporation** (now **JPMorgan Chase**) \$1.8 million because they felt that the unreliability of the bank's accounting system caused it to violate regulatory requirements.

Also, in recent years **Fannie Mae**, the government-chartered mortgage association, announced a series of large accounting errors. These announcements caused alarm among investors, regulators, and politicians because they feared that the errors might suggest larger, undetected problems. This was important because the home-mortgage market depends on Fannie Mae to buy hundreds of billions of dollars of mortgages each year from banks, thus enabling the banks to issue new mortgages.

Finally, before a major overhaul of its accounting system, the financial records of **Waste Management Company** were in such disarray that of the company's 57,000 employees, 10,000 were receiving pay slips that were in error.

The Sarbanes-Oxley Act was created to minimize the occurrence of errors like these by increasing every employee's responsibility for accurate financial reporting.

In order for these companies to prepare and issue financial statements, their accounting equations (debits and credits) must have been in balance at year-end. How could these errors or misstatements have occurred? (Go to **WileyPLUS** for this answer and additional questions.)

SUMMARY OF TRANSACTIONS

Illustration 3-3 summarizes the transactions of Sierra Corporation to show their cumulative effect on the basic accounting equation. It includes the transaction number in the first column on the left. The right-most column shows the specific effect of any transaction that affects stockholders' equity. Remember that Event (9) did not result in a transaction, so no entry is included for that event. The illustration demonstrates three important points:

- Each transaction is analyzed in terms of its effect on assets, liabilities, and stockholders' equity.
- The two sides of the equation must always be equal.
- The cause of each change in stockholders' equity must be indicated.

	Assets				=	Liabilities			+	Stockholders' Equity			
	Cash	Sup- plies	Prepd. Insur.	Equip- ment	Notes Pay.	Accts. Pay.	Unearned Serv. Rev.	Common Stock	Retained Earnings				
									Rev.	Exp.	Div.		
(1)	+\$10,000							+\$10,000				Issued stock	
(2)	+5,000				+\$5,000								
(3)	-5,000			+\$5,000									
(4)	+1,200						-\$1,200						
(5)	+10,000							+\$10,000				Service Revenue	
(6)	-900									-\$900		Rent Expense	
(7)	-600		+\$600										
(8)		+\$2,500				+\$2,500							
(10)	-500										-\$500	Dividends	
(11)	-4,000										-4,000	Sal/Wages Expense	
	<u>\$15,200</u>	<u>+\$2,500</u>	<u>+\$600</u>	<u>+\$5,000</u>	<u>=\$5,000</u>	<u>+\$2,500</u>	<u>+\$1,200</u>	<u>+\$10,000</u>	<u>+\$10,000</u>	<u>-\$4,900</u>	<u>-\$500</u>		
	\$23,300					\$23,300							

ILLUSTRATION 3-3
Summary of transactions

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DO IT! 1

Transaction Analysis

A tabular analysis of the transactions made by Roberta Mendez & Co., a certified public accounting firm, for the month of August is shown below. Each increase and decrease in stockholders' equity is explained.

Assets		=	Liabilities		+	Stockholders' Equity					
Cash	+	Equipment	=	Accounts Payable	+	Common Stock	+	Retained Earnings			
								Revenue	-	Expenses	
1. +\$25,000						+\$25,000					Issued stock
2.		+\$7,000		+\$7,000							
3. +8,000								+\$8,000			Service Revenue
4. -850										-\$850	Rent Expense
\$32,150	+	\$7,000	=	\$7,000	+	\$25,000	+	\$8,000	-	\$850	
\$39,150						\$39,150					

Describe each transaction that occurred for the month.

Action Plan

- ✓ Analyze the tabular analysis to determine the nature and effect of each transaction.
- ✓ Keep the accounting equation in balance.
- ✓ Remember that a change in an asset will require a change in another asset, a liability, or in stockholders' equity.

SOLUTION

1. The company issued shares of stock to stockholders for \$25,000 cash.
2. The company purchased \$7,000 of equipment on account.
3. The company received \$8,000 of cash in exchange for services performed.
4. The company paid \$850 for this month's rent.

Related exercise material: **BE3-1, BE3-2, BE3-3, DO IT! 3-1, E3-1, E3-2, E3-3, and E3-4.**

LEARNING OBJECTIVE 2

Explain how accounts, debits, and credits are used to record business transactions.

Rather than using a tabular summary like the one in Illustration 3-3 for Sierra Corporation, an accounting information system uses accounts. An **account** is an individual accounting record of increases and decreases in a specific asset, liability, stockholders' equity, revenue, or expense item. For example, Sierra Corporation has separate accounts for Cash, Accounts Receivable, Accounts Payable, Service Revenue, Salaries and Wages Expense, and so on. (Note that whenever we are referring to a specific account, we capitalize the name.)

In its simplest form, an account consists of three parts: (1) the title of the account, (2) a left or debit side, and (3) a right or credit side. Because the alignment of these parts of an account resembles the letter T, it is referred to as a **T-account**. The basic form of an account is shown in Illustration 3-4.

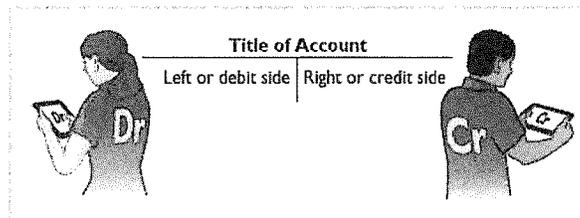


ILLUSTRATION 3-4
Basic form of account

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We use this form of account often throughout this textbook to explain basic accounting relationships.

DEBITS AND CREDITS

The term **debit** indicates the left side of an account, and **credit** indicates the right side. They are commonly abbreviated as **Dr.** for debit and **Cr.** for credit. They **do not** mean increase or decrease, as is commonly thought. We use the terms debit and credit repeatedly in the recording process to describe **where** entries are made in accounts. For example, the act of entering an amount on the left side of an account is called **debiting** the account. Making an entry on the right side is **crediting** the account.

When comparing the totals of the two sides, an account shows a **debit balance** if the total of the debit amounts exceeds the credits. An account shows a **credit balance** if the credit amounts exceed the debits. Note the position of the debit side and credit side in [Illustration 3-4](#).

The procedure of recording debits and credits in an account is shown in [Illustration 3-5](#) for the transactions affecting the Cash account of Sierra Corporation. The data are taken from the Cash column of the tabular summary in [Illustration 3-3](#).

Tabular Summary	Account Form	
Cash	Cash	
\$10,000	(Debits) 10,000	(Credits) 5,000
5,000	5,000	900
-5,000	1,200	600
1,200	10,000	500
10,000	Balance 15,200	4,000
-900	(Debit)	
-600		
-500		
-4,000		
<u>\$15,200</u>		

ILLUSTRATION 3-5

Tabular summary and account form for Sierra Corporation's Cash account

Every positive item in the tabular summary represents a receipt of cash; every negative amount represents a payment of cash. **Notice that in the account form, we record the increases in cash as debits and the decreases in cash as credits.** For example, the \$10,000 receipt of cash (in blue) is debited to Cash, and the -\$5,000 payment of cash (in red) is credited to Cash.

Having increases on one side and decreases on the other reduces recording errors and helps in determining the totals of each side of the account as well as the account balance. The balance is determined by netting the two sides (subtracting one amount from the other). The account balance, a debit of \$15,200, indicates that Sierra had \$15,200 more increases than decreases in cash. That is, since it started with a balance of zero, it has \$15,200 in its Cash account.

DEBIT AND CREDIT PROCEDURES

Each transaction must affect two or more accounts to keep the basic accounting equation in balance. In other words, **for each transaction, debits must equal credits.** The equality of debits and credits provides the basis for the double-entry accounting system.

Under the **double-entry system**, the two-sided effect of each transaction is recorded in appropriate accounts. This system provides a logical method for recording transactions. The double-entry system also helps to ensure the accuracy of the recorded amounts and helps to detect errors such as those at **MF Global** as discussed in the Feature Story. If every transaction is recorded with equal

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debits and credits, then the sum of all the debits to the accounts must equal the sum of all the credits. The double-entry system for determining the equality of the accounting equation is much more efficient than the plus/minus procedure used earlier.

INTERNATIONAL NOTE

Rules for accounting for specific events sometimes differ across countries. For example, European companies rely less on historical cost and more on fair value than U.S. companies. Despite the differences, the double-entry accounting system is the basis of accounting systems worldwide.

Dr./Cr. Procedures for Assets and Liabilities

In Illustration 3-5 for Sierra Corporation, increases in Cash—an asset—are entered on the left side, and decreases in Cash are entered on the right side. We know that both sides of the basic equation ($\text{Assets} = \text{Liabilities} + \text{Stockholders' Equity}$) must be equal. It therefore follows that increases and decreases in liabilities have to be recorded **opposite from** increases and decreases in assets. Thus, increases in liabilities are entered on the right or credit side, and decreases in liabilities are entered on the left or debit side. The effects that debits and credits have on assets and liabilities are summarized in Illustration 3-6.

Debits	Credits
Increase assets	Decrease assets
Decrease liabilities	Increase liabilities

ILLUSTRATION 3-6

Debit and credit effects—assets and liabilities

Asset accounts normally show debit balances. That is, debits to a specific asset account should exceed credits to that account. Likewise, **liability accounts normally show credit balances.** That is, credits to a liability account should exceed debits to that account. The **normal balances** may be diagrammed as in Illustration 3-7.

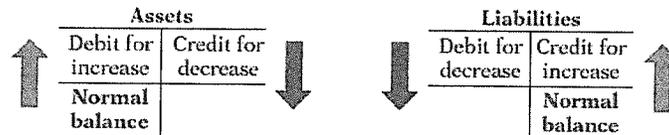


ILLUSTRATION 3-7

Normal balances—assets and liabilities

Knowing which is the normal balance in an account may help when you are trying to identify errors. For example, a credit balance in an asset account, such as Land, or a debit balance in a liability account, such as Salaries and Wages Payable, usually indicates errors in recording. Occasionally, however, an abnormal balance may be correct. The Cash account, for example, will have a credit balance when a company has overdrawn its bank balance by spending more than it has in its account. In automated accounting systems, the computer is programmed to flag violations of the normal balance and to print out error or exception reports. In manual systems, careful visual inspection of the accounts is required to detect normal balance problems.

▼ HELPFUL HINT

The normal balance is the side where increases in the account are recorded.

Dr./Cr. Procedures for Stockholders' Equity

In Chapter 1, we indicated that stockholders' equity is comprised of two parts: common stock and retained earnings. In the transaction events earlier in this chapter, you saw that revenues, expenses, and the payment of dividends affect retained earnings. Therefore, the subdivisions of stockholders' equity are common stock, retained earnings, dividends, revenues, and expenses.

COMMON STOCK Common stock is issued to investors in exchange for the stockholders' investment. The Common Stock account is increased by credits and decreased by debits. For example,

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when cash is invested in the business, Cash is debited and Common Stock is credited. The effects of debits and credits on the Common Stock account are shown in Illustration 3-8.

Debits	Credits
Decrease Common Stock	Increase Common Stock

ILLUSTRATION 3-8
Debit and credit effects—common stock

The normal balance in the Common Stock account may be diagrammed as in Illustration 3-9.

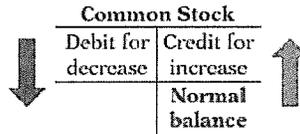


ILLUSTRATION 3-9
Normal balance—common stock

RETAINED EARNINGS Retained earnings is net income that is retained in the business. It represents the portion of stockholders' equity that has been accumulated through the profitable operation of the company. Retained Earnings is increased by credits (for example, by net income) and decreased by debits (for example, by a net loss), as shown in Illustration 3-10.

Debits	Credits
Decrease Retained Earnings	Increase Retained Earnings

ILLUSTRATION 3-10
Debit and credit effects—retained earnings

The normal balance for the Retained Earnings account may be diagrammed as in Illustration 3-11.

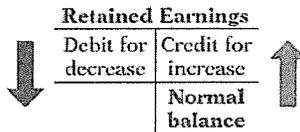


ILLUSTRATION 3-11
Normal balance—retained earnings

DIVIDENDS A dividend is a distribution by a corporation to its stockholders. The most common form of distribution is a cash dividend. Dividends result in a reduction of the stockholders' claims on retained earnings. Because dividends reduce stockholders' equity, increases in the Dividends account are recorded with debits. As shown in Illustration 3-12, the Dividends account normally has a debit balance.

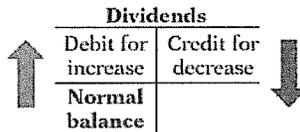


ILLUSTRATION 3-12
Normal balance—dividends

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REVENUES AND EXPENSES When a company recognizes revenues, stockholders' equity is increased. Revenue accounts are increased by credits and decreased by debits.

Expenses decrease stockholders' equity. Thus, expense accounts are increased by debits and decreased by credits. The effects of debits and credits on revenues and expenses are shown in Illustration 3-13.

Debits	Credits
Decrease revenue	Increase revenue
Increase expenses	Decrease expenses

ILLUSTRATION 3-13
Debit and credit effects—revenues and expenses

Credits to revenue accounts should exceed debits; debits to expense accounts should exceed credits. Thus, **revenue accounts normally show credit balances, and expense accounts normally show debit balances.** The normal balances may be diagrammed as in Illustration 3-14.

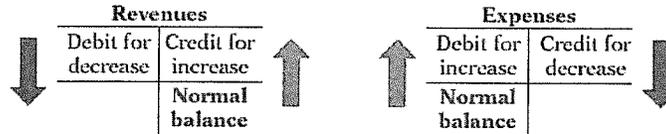
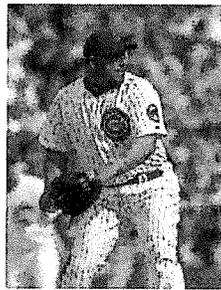


ILLUSTRATION 3-14
Normal balances—revenues and expenses

INVESTOR INSIGHT

Chicago Cubs
Keeping Score



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The **Chicago Cubs** baseball team has these major revenue and expense accounts:

Revenues	Expenses
Admissions (ticket sales)	Players' salaries
Concessions	Administrative salaries
Television and radio	Travel
Advertising	Ballpark maintenance

Do you think that the **Chicago Bears** football team would be likely to have the same major revenue and expense accounts as the Cubs? (Go to **WileyPLUS** for this answer and additional questions.)

STOCKHOLDERS' EQUITY RELATIONSHIPS

Companies report the subdivisions of stockholders' equity in various places in the financial statements:

- Common stock and retained earnings: in the stockholders' equity section of the balance sheet.
- Dividends: on the retained earnings statement.
- Revenues and expenses: on the income statement.

Dividends, revenues, and expenses are eventually transferred to retained earnings at the end of the period. As a result, a change in any one of these three items affects stockholders' equity. Illustration 3-15 shows the relationships of the accounts affecting stockholders' equity.

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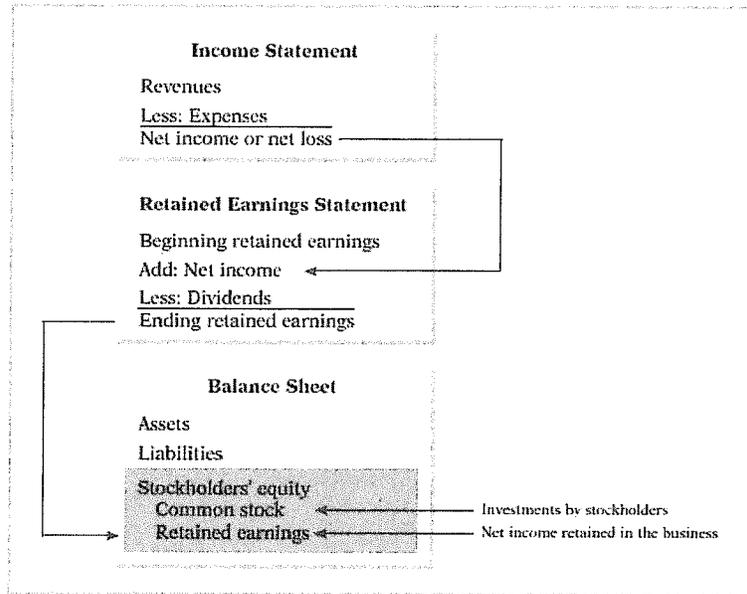


ILLUSTRATION 3-15
 Stockholders' equity relationships

SUMMARY OF DEBIT/CREDIT RULES

Illustration 3-16 summarizes the debit/credit rules and effects on each type of account. **Study this diagram carefully.** It will help you understand the fundamentals of the double-entry system. No matter what the transaction, total debits must equal total credits in order to keep the accounting equation in balance.

Basic Equation	Assets	=	Liabilities	+	Stockholders' Equity									
Expanded Basic Equation	Assets	=	Liabilities	+	Common Stock	+	Retained Earnings	+	Revenues	-	Expenses	-	Dividends	
Debit / Credit Rules	Dr. + Cr. -		Dr. - Cr. +		Dr. - Cr. +		Dr. - Cr. +		Dr. - Cr. +		Dr. + Cr. -		Dr. + Cr. -	

ILLUSTRATION 3-16
 Summary of debit/credit rules

DO IT! 2

Debits and Credits for Balance Sheet Accounts

Kate Browne, president of Hair It Is Inc., has just rented space in a shopping mall for the purpose of opening and operating a beauty salon. Long before opening day and before purchasing equipment, hiring assistants, and remodeling the space, Kate was strongly advised to set up a double-entry set of accounting records in which to record all of her business transactions. Identify the balance sheet accounts that Hair It Is Inc. will likely need to record the transactions necessary to establish and open for business. Also, indicate whether the normal balance of each account is a debit or a credit.

Action Plan

- ✓ First identify asset accounts for each different type of asset invested in the business.
- ✓ Then identify liability accounts for debts incurred by the business.
- ✓ Hair It Is Inc. needs only one stockholders' equity account, Common Stock, when it begins the business. The other stockholders' equity account, Retained Earnings, will be needed after the business is operating.

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Companies may use various kinds of journals, but every company has at least the most basic form of journal, a **general journal**. **The journal makes three significant contributions to the recording process:**

1. It discloses in one place the **complete effect of a transaction**.
2. It provides a **chronological record** of transactions.
3. It **helps to prevent or locate errors** because the debit and credit amounts for each entry can be readily compared.

Entering transaction data in the journal is known as **journalizing**. To illustrate the technique of journalizing, let's look at the first three transactions of Sierra Corporation in equation form.

On October 1, Sierra issued common stock in exchange for \$10,000 cash:

$$\begin{array}{rcl}
 \underline{\text{Assets}} & = & \underline{\text{Liabilities}} + \underline{\text{Stockholders' Equity}} \\
 \text{Cash} & = & \text{Common Stock} \\
 +\$10,000 & & +\$10,000 \text{ Issued stock}
 \end{array}$$

On October 1, Sierra borrowed \$5,000 by signing a note:

$$\begin{array}{rcl}
 \underline{\text{Assets}} & = & \underline{\text{Liabilities}} + \underline{\text{Stockholders' Equity}} \\
 \text{Cash} & = & \text{Notes Payable} \\
 +\$5,000 & & +\$5,000
 \end{array}$$

On October 2, Sierra purchased equipment for \$5,000:

$$\begin{array}{rcl}
 \underline{\text{Assets}} & = & \underline{\text{Liabilities}} + \underline{\text{Stockholders' Equity}} \\
 \text{Cash} & & \text{Equipment} \\
 -\$5,000 & & +\$5,000
 \end{array}$$

Sierra makes separate journal entries for each transaction. A complete entry consists of (1) the date of the transaction, (2) the accounts and amounts to be debited and credited, and (3) a brief explanation of the transaction. These transactions are journalized in Illustration 3-18.

GENERAL JOURNAL			
Date	Account Titles and Explanation	Debit	Credit
2017			
Oct. 1	Cash	10,000	
	Common Stock (Issued stock for cash)		10,000
1	Cash	5,000	
	Notes Payable (Issued 3-month, 12% note payable for cash)		5,000
2	Equipment	5,000	
	Cash (Purchased equipment for cash)		5,000

ILLUSTRATION 3-18
Recording transactions in journal form

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Note the following features of the journal entries.

1. The date of the transaction is entered in the Date column.
2. The account to be debited is entered first at the left. The account to be credited is then entered on the next line, indented under the line above. The indentation differentiates debits from credits and decreases the possibility of switching the debit and credit amounts.
3. The amounts for the debits are recorded in the Debit (left) column, and the amounts for the credits are recorded in the Credit (right) column.
4. A brief explanation of the transaction is given.

It is important to use correct and specific account titles in journalizing. Erroneous account titles lead to incorrect financial statements. Some flexibility exists initially in selecting account titles. The main criterion is that each title must appropriately describe the content of the account. For example, a company could use any of these account titles for recording the cost of delivery trucks: Equipment, Delivery Equipment, Delivery Trucks, or Trucks. Once the company chooses the specific title to use, however, it should record under that account title all subsequent transactions involving the account.

ACCOUNTING ACROSS THE ORGANIZATION

Microsoft

Boosting Profits



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Microsoft originally designed the Xbox 360 to have 256 megabytes of memory. But the design department said that amount of memory wouldn't support the best special effects. The purchasing department said that adding more memory would cost \$30—which was 10% of the estimated selling price of \$300. The marketing department, however, "determined that adding the memory would let Microsoft reduce marketing costs and attract more game developers, boosting royalty revenue. It would also extend the life of the console, generating more sales."

As a result of these changes, Xbox enjoyed great success. But, it does have competitors. Its newest video game console, Xbox One, is now in a battle with **Sony's** Playstation4 for market share. How to compete? First, Microsoft bundled the critically acclaimed Titanfall with its Xbox One. By including the game most Xbox One buyers were going to purchase anyway, Microsoft was making its console more attractive. In addition, retailers are also discounting the Xbox, which should get the momentum going for increased sales. What Microsoft is doing is making sure that Xbox One is the center of the home entertainment system in the long run.

Sources: Robert A. Guth, "New Xbox Aim for Microsoft: Profitability," Wall Street Journal (May 24, 2005), p. C1; and David Thier, "Will Microsoft Give the Xbox One a \$50 Price Cut?" www.Forbes.com (March 26, 2014).

In what ways is this Microsoft division using accounting to assist in its effort to become more profitable? (Go to **WileyPLUS** for this answer and additional questions.)

DO IT! 3

Journal Entries

The following events occurred during the first month of business of Hair It Is Inc., Kate Browne's beauty salon:

1. Issued common stock to shareholders in exchange for \$20,000 cash.
2. Purchased \$4,800 of equipment on account (to be paid in 30 days).
3. Interviewed three people for the position of stylist.

Prepare the entries to record the transactions.

Action Plan

- ✓ Make sure to provide a complete and accurate representation of the transactions' effects on the assets, liabilities, and stockholders' equity of the business.

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SOLUTION

The three activities are recorded as follows.

1. Cash	20,000	
Common Stock (Issued stock for cash)		20,000
2. Equipment	4,800	
Accounts Payable (Purchased equipment on account)		-4,800
3. No entry because no transaction occurred.		

Related exercise material: **BE3-6, BE3-9, DO IT! 3-3, E3-7, E3-9, E3-10, E3-11, and E3-12.**

ETHICS NOTE

Business documents provide evidence that transactions actually occurred. **International Outsourcing Services, LLC** was accused of submitting fraudulent documents (store coupons) to companies such as **Kraft Foods** and **PepsiCo** for reimbursement of as much as \$250 million. Use of proper business documents reduces the likelihood of fraudulent activity.

LEARNING OBJECTIVE 4

Explain how a ledger and posting help in the recording process.



THE LEDGER

The entire group of accounts maintained by a company is referred to collectively as the **ledger**. The ledger provides the balance in each of the accounts as well as keeps track of changes in these balances.

Companies may use various kinds of ledgers, but every company has a general ledger. A **general ledger** contains all the asset, liability, stockholders' equity, revenue, and expense accounts, as shown in Illustration 3-19 (page 120). Whenever we use the term **ledger** in this textbook without additional specification, it will mean the general ledger.

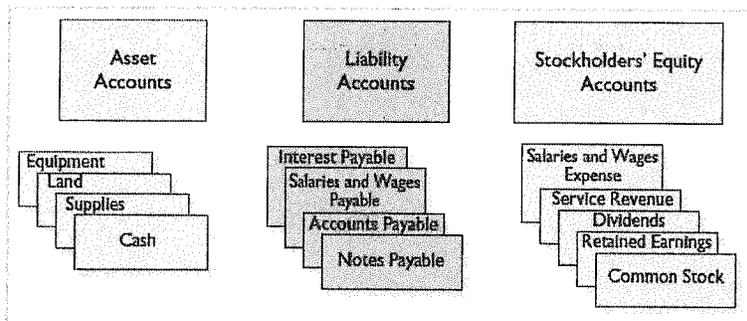


ILLUSTRATION 3-19
The general ledger

CHART OF ACCOUNTS

The number and type of accounts used differ for each company, depending on the size, complexity, and type of business. For example, the number of accounts depends on the amount of detail desired by management. The management of one company may want one single account for all types of utility expense. Another may keep separate expense accounts for each type of utility expenditure,

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such as gas, electricity, and water. A small corporation like Sierra Corporation will not have many accounts compared with a corporate giant like **Ford Motor Company**. Sierra may be able to manage and report its activities in 20 to 30 accounts, whereas Ford requires thousands of accounts to keep track of its worldwide activities.

Most companies list the accounts in a **chart of accounts**. They may create new accounts as needed during the life of the business. Illustration 3-20 shows the chart of accounts for Sierra in the order that they are typically listed (assets, liabilities, stockholders' equity, revenues, and expenses). **Accounts shown in red are used in this chapter**; accounts shown in black are explained in later chapters.

SIERRA CORPORATION Chart of Accounts				
Assets	Liabilities	Stockholders' Equity	Revenues	Expenses
Cash	Notes Payable	Common Stock	Service Revenue	Salaries and Wages Expense
Accounts Receivable	Accounts Payable	Retained Earnings		Supplies Expense
Supplies	Interest Payable	Dividends		Rent Expense
Prepaid Insurance	Unearned	Income Summary		Insurance Expense
Equipment	Service Revenue			Interest Expense
Accumulated Depreciation—Equipment	Salaries and Wages Payable			Depreciation Expense

ILLUSTRATION 3-20
Chart of accounts for Sierra Corporation

POSTING

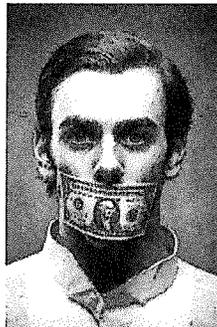
The procedure of transferring journal entry amounts to ledger accounts is called **posting**. **This phase of the recording process accumulates the effects of journalized transactions in the individual accounts.** Posting involves these steps:

1. In the ledger, enter in the appropriate columns of the debited account(s) the date and debit amount shown in the journal.
2. In the ledger, enter in the appropriate columns of the credited account(s) the date and credit amount shown in the journal.

ETHICS INSIGHT

Credit Suisse Group

A Convenient Overstatement



© Nano Silva/Stockphoto

Sometimes a company's investment securities suffer a permanent decline in value below their original cost. When this occurs, the company is supposed to reduce the recorded value of the securities on its balance sheet ("write them down" in common financial lingo) and record a loss. It appears, however, that during the financial crisis of 2008, employees at some financial institutions chose to look the other way as the value of their investments skidded.

A number of Wall Street traders that worked for the investment bank **Credit Suisse Group** were charged with intentionally overstating the value of securities that had suffered declines of approximately \$2.85 billion. One reason that they may have been reluctant to record the losses is out of fear that the company's shareholders and clients would panic if they saw the magnitude of the losses. However, personal self-interest might have been equally to blame—the bonuses of the traders were tied to the value of the investment securities.

Source: S. Pulliam, J. Eaglesham, and M. Siconolfi, "U.S. Plans Changes on Bond Fraud," Wall Street Journal Online (February 1, 2012).

What incentives might employees have had to overstate the value of these investment securities on the company's financial statements? (Go to **WileyPLUS** for this answer and additional questions.)

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THE RECORDING PROCESS ILLUSTRATED

Illustrations 3-21 through 3-31 on the following pages show the basic steps in the recording process using the October transactions of Sierra Corporation. Sierra's accounting period is a month. A basic analysis and a debit-credit analysis precede the journalizing and posting of each transaction. Study these transaction analyses carefully. **The purpose of transaction analysis is first to identify the type of account involved and then to determine whether a debit or a credit to the account is required.** You should always perform this type of analysis before preparing a journal entry. Doing so will help you understand the journal entries discussed in this chapter as well as more complex journal entries to be described in later chapters.

<p>Event 1</p> <p>Basic Analysis</p> <p>Equation Analysis</p> <p>Debit-Credit Analysis</p> <p>Journal Entry</p> <p>Posting</p>	<p>On October 1, stockholders invest \$10,000 cash in an outdoor guide service company to be known as Sierra Corporation.</p> <p>The asset Cash is increased \$10,000; stockholders' equity (specifically Common Stock) is increased \$10,000.</p> <table border="0" style="margin-left: 20px;"> <tr> <td style="text-align: right;">Assets</td> <td style="text-align: center;">=</td> <td style="text-align: center;">Liabilities</td> <td style="text-align: center;">+</td> <td style="text-align: center;">Stockholders' Equity</td> </tr> <tr> <td style="text-align: right;">Cash</td> <td style="text-align: center;">=</td> <td></td> <td></td> <td style="text-align: center;">Common Stock</td> </tr> <tr> <td style="text-align: right;">(1) +\$10,000</td> <td></td> <td></td> <td></td> <td style="text-align: center;">+\$10,000 Issued stock</td> </tr> </table> <p>Debits increase assets: debit Cash \$10,000. Credits increase stockholders' equity: credit Common Stock \$10,000.</p> <table border="0" style="margin-left: 20px;"> <tr> <td style="border-right: 1px solid black; padding-right: 5px;">Oct. 1</td> <td style="border-right: 1px solid black; padding-right: 5px;">Cash</td> <td style="border-right: 1px solid black; padding-right: 5px;"></td> <td style="border-right: 1px solid black; padding-right: 5px;">10,000</td> <td style="padding-right: 5px;">10,000</td> </tr> <tr> <td style="border-right: 1px solid black;"></td> <td style="border-right: 1px solid black;">Common Stock</td> <td style="border-right: 1px solid black;">(Issued stock for cash)</td> <td></td> <td></td> </tr> </table> <table border="0" style="margin-left: 20px; margin-top: 10px;"> <tr> <td style="border-right: 1px solid black; padding-right: 5px;"></td> <td style="border-right: 1px solid black; padding-right: 5px;">Cash</td> <td style="border-right: 1px solid black; padding-right: 5px;"></td> <td style="border-right: 1px solid black; padding-right: 5px;"></td> <td style="padding-right: 5px;"></td> </tr> <tr> <td style="border-right: 1px solid black;">Oct. 1</td> <td style="border-right: 1px solid black;">10,000</td> <td style="border-right: 1px solid black;"></td> <td style="border-right: 1px solid black;"></td> <td></td> </tr> </table> <table border="0" style="margin-left: 20px; margin-top: 10px;"> <tr> <td style="border-right: 1px solid black; padding-right: 5px;"></td> <td style="border-right: 1px solid black; padding-right: 5px;">Common Stock</td> <td style="border-right: 1px solid black; padding-right: 5px;"></td> <td style="border-right: 1px solid black; padding-right: 5px;"></td> <td style="padding-right: 5px;"></td> </tr> <tr> <td style="border-right: 1px solid black;">Oct. 1</td> <td style="border-right: 1px solid black;">10,000</td> <td style="border-right: 1px solid black;"></td> <td style="border-right: 1px solid black;"></td> <td></td> </tr> </table>	Assets	=	Liabilities	+	Stockholders' Equity	Cash	=			Common Stock	(1) +\$10,000				+\$10,000 Issued stock	Oct. 1	Cash		10,000	10,000		Common Stock	(Issued stock for cash)				Cash				Oct. 1	10,000					Common Stock				Oct. 1	10,000				<p><i>Cash flow analyses show the impact of each transaction on cash.</i></p> <table border="0" style="margin-left: 20px;"> <tr> <td style="border-top: 1px solid black; border-bottom: 1px solid black; padding: 5px;">Cash Flows</td> <td style="border-top: 1px solid black; border-bottom: 1px solid black; padding: 5px;">+10,000</td> </tr> </table>	Cash Flows	+10,000
Assets	=	Liabilities	+	Stockholders' Equity																																													
Cash	=			Common Stock																																													
(1) +\$10,000				+\$10,000 Issued stock																																													
Oct. 1	Cash		10,000	10,000																																													
	Common Stock	(Issued stock for cash)																																															
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Oct. 1	10,000																																																
	Common Stock																																																
Oct. 1	10,000																																																
Cash Flows	+10,000																																																

ILLUSTRATION 3-21
Investment of cash by stockholders

Cash flow analyses show the impact of each transaction on cash.

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Cash Flows	
+5,000	

Event 2 On October 1, Sierra borrows cash of \$5,000 by signing a 3-month, 12%, \$5,000 note payable.

Basic Analysis The asset Cash is increased \$5,000; the liability Notes Payable is increased \$5,000.

Equation Analysis

	<u>Assets</u>	=	<u>Liabilities</u>	+	<u>Stockholders' Equity</u>
	Cash	=	Notes Payable		
(2)	+5,000		+5,000		

Debit-Credit Analysis Debits increase assets: debit Cash \$5,000. Credits increase liabilities: credit Notes Payable \$5,000.

Journal Entry

Oct. 1	Cash	5,000	
	Notes Payable (Issued 3-month, 12% note payable for cash)		5,000

Posting

<u>Cash</u>		<u>Notes Payable</u>	
Oct. 1	10,000	Oct. 1	5,000
	5,000		

ILLUSTRATION 3-22 Issue of note payable

Cash Flows	
-5,000	

Event 3 On October 2, Sierra used \$5,000 cash to purchase equipment.

Basic Analysis The asset Equipment is increased \$5,000; the asset Cash is decreased \$5,000.

Equation Analysis

	<u>Assets</u>	=	<u>Liabilities</u>	+	<u>Stockholders' Equity</u>
	Cash + Equipment				
(3)	-5,000 +5,000				

Debit-Credit Analysis Debits increase assets: debit Equipment \$5,000. Credits decrease assets: credit Cash \$5,000.

Journal Entry

Oct. 2	Equipment	5,000	
	Cash (Purchased equipment for cash)		5,000

Posting

<u>Cash</u>		<u>Equipment</u>	
Oct. 1	10,000	Oct. 2	5,000
	5,000	Oct. 2	5,000

ILLUSTRATION 3-23 Purchase of equipment

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Event 4 On October 2, Sierra received a \$1,200 cash advance from R. Knox, a client, for guide services for multi-day trips that are expected to be completed in the future.

Basic Analysis The asset Cash is increased \$1,200; the liability Unearned Service Revenue is increased \$1,200 because the service has not been performed yet. That is, when an advance payment is received, unearned revenue (a liability) should be recorded in order to recognize the obligation that exists.

Equation Analysis

	<u>Assets</u>	=	<u>Liabilities</u>	+	<u>Stockholders' Equity</u>
(4)	Cash	=	Unearned Serv. Rev.		
	+\$1,200		+\$1,200		

Debit-Credit Analysis Debits increase assets: debit Cash \$1,200. Credits increase liabilities: credit Unearned Service Revenue \$1,200.

Journal Entry

Oct. 2	Cash		1,200	
	Unearned Service Revenue (Received advance from R. Knox for future services)			1,200

Posting

Cash		Unearned Service Revenue	
Oct. 1	10,000	Oct. 2	5,000
1	5,000		
2	1,200		

Cash Flows
+1,200

ILLUSTRATION 3-24 Receipt of cash in advance from customer

Event 5 On October 3, Sierra received \$10,000 in cash from Copa Company for guide services performed in October.

Basic Analysis The asset Cash is increased \$10,000; the revenue Service Revenue is increased \$10,000.

Equation Analysis

	<u>Assets</u>	=	<u>Liabilities</u>	+	<u>Stockholders' Equity</u>
(5)	Cash	=	Revenues		
	+\$10,000		+\$10,000 Service Revenue		

Debit-Credit Analysis Debits increase assets: debit Cash \$10,000. Credits increase revenues: credit Service Revenue \$10,000.

Journal Entry

Oct. 3	Cash		10,000	
	Service Revenue (Received cash for services performed)			10,000

Posting

Cash		Service Revenue	
Oct. 1	10,000	Oct. 2	5,000
1	5,000		
2	1,200		
3	10,000		

Cash Flows
+10,000

ILLUSTRATION 3-25 Services performed for cash

Cash Flows
-900

Event 6

On October 3, Sierra paid office rent for October in cash, \$900.

Basic Analysis

The expense account Rent Expense is increased \$900 because the payment pertains only to the current month; the asset Cash is decreased \$900.

Equation Analysis

	<u>Assets</u>	=	<u>Liabilities</u>	+	<u>Stockholders' Equity</u>
(6)	Cash	=			Expenses
	-\$900				-\$900 Rent Expense

Debit-Credit Analysis

Debits increase expenses: debit Rent Expense \$900.
Credits decrease assets: credit Cash \$900.

Journal Entry

Oct. 3	Rent Expense		900	
	Cash	(Paid cash for October office rent)		900

Posting

Cash		Rent Expense	
Oct. 1	10,000	Oct. 2	5,000
1	5,000	3	900
2	1,200		
3	10,000		

ILLUSTRATION 3-26
Payment of rent with cash

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Cash Flows	
-600	

Event 7

On October 4, Sierra paid \$600 for a 1-year insurance policy that will expire next year on September 30.

Basic Analysis

The asset Cash is decreased \$600. Payments of expenses that will benefit more than one accounting period are identified as prepaid expenses or prepayments. When a payment is made, an asset account is debited in order to show the service or benefit that will be received in the future. Therefore, the asset Prepaid Insurance is increased \$600.

Equation Analysis

Assets		=	Liabilities	+	Stockholders' Equity
Cash	+ Prepaid Insurance				
(7) -\$600	+\$600				

Debit-Credit Analysis

Debits increase assets: debit Prepaid Insurance \$600.
Credits decrease assets: credit Cash \$600.

Journal Entry

Oct. 4	Prepaid Insurance		600	
	Cash	(Paid 1-year policy; effective date October 1)		600

Posting

	Cash		Prepaid Insurance		
Oct. 1	10,000	Oct. 2	5,000	Oct. 4	600
1	5,000	3	900		
2	1,200	4	600		
3	10,000				

ILLUSTRATION 3-27
Purchase of insurance policy with cash

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Event 8 On October 5, Sierra purchased an estimated 3 months of supplies on account from Aero Supply for \$2,500.

Basic Analysis The asset Supplies is increased \$2,500; the liability Accounts Payable is increased \$2,500.

Equation Analysis

<u>Assets</u>	=	<u>Liabilities</u>	+	<u>Stockholders' Equity</u>
Supplies	=	Accounts Payable		
(8) +\$2,500		+\$2,500		

Debit-Credit Analysis

Debits increase assets: debit Supplies \$2,500.
Credits increase liabilities: credit Accounts Payable \$2,500.

Journal Entry

Oct. 5	Supplies	Accounts Payable	2,500	2,500
	(Purchased supplies on account from Aero Supply)			

Posting

<u>Supplies</u>		<u>Accounts Payable</u>	
Oct. 5	2,500	Oct. 5	2,500

Cash Flows
no effect

ILLUSTRATION 3-28
Purchase of supplies on account

Event 9 On October 9, Sierra hired four employees to begin work on October 15. Each employee will receive a weekly salary of \$500 for a 5-day work week, payable every 2 weeks—first payment made on October 26.

Basic Analysis An accounting transaction has not occurred. There is only an agreement that the employees will begin work on October 15. Thus, a debit-credit analysis is not needed because there is no accounting entry. (See transaction of October 26 (Event 11) for first payment.)

ILLUSTRATION 3-29
Hiring of new employees

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Cash Flows
-500

Event 10

On October 20, Sierra paid a \$500 cash dividend to stockholders.

Basic Analysis

The Dividends account is increased \$500; the asset Cash is decreased \$500.

Equation Analysis

	<u>Assets</u>	=	<u>Liabilities</u>	+	<u>Stockholders' Equity</u>
(10)	Cash	=			Dividends
	-500				-500

Debit-Credit Analysis

Debits increase dividends: debit Dividends \$500.
Credits decrease assets: credit Cash \$500.

Journal Entry

Oct. 20	Dividends Cash (Declared and paid a cash dividend)	500	500
---------	--	-----	-----

Posting

Cash				Dividends	
Oct. 1	10,000	Oct. 2	5,000	Oct. 20	500
1	5,000	3	900		
2	1,200	4	600		
3	10,000	20	500		

ILLUSTRATION 3-30
Payment of dividend

Cash Flows
-4,000

Event 11

On October 26, Sierra paid employee salaries of \$4,000 in cash. (See October 9 event.)

Basic Analysis

The expense account Salaries and Wages Expense is increased \$4,000; the asset Cash is decreased \$4,000.

Equation Analysis

	<u>Assets</u>	=	<u>Liabilities</u>	+	<u>Stockholders' Equity</u>
(11)	Cash	=			Expenses
	-4,000				-4,000 Salaries and Wages Expense

Debit-Credit Analysis

Debits increase expenses: debit Salaries and Wages Expense \$4,000.
Credits decrease assets: credit Cash \$4,000.

Journal Entry

Oct. 26	Salaries and Wages Expense Cash (Paid salaries to date)	4,000	4,000
---------	---	-------	-------

Posting

Cash				Salaries and Wages Expense	
Oct. 1	10,000	Oct. 2	5,000	Oct. 26	4,000
1	5,000	3	900		
2	1,200	4	600		
3	10,000	20	500		
		26	4,000		

ILLUSTRATION 3-31
Payment of cash for employee salaries

▼ **HELPFUL HINT**

Many liabilities have the word "payable" in their title. But, note that Unearned Service Revenue is considered a liability even though the word *payable* is not used.

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SUMMARY ILLUSTRATION OF JOURNALIZING AND POSTING

The journal for Sierra Corporation for the month of October is summarized in Illustration 3-32. The ledger is shown in Illustration 3-33 (on page 118) with all balances highlighted in red.

GENERAL JOURNAL			
Date	Account Titles and Explanation	Debit	Credit
2017			
Oct. 1	Cash Common Stock (Issued stock for cash)	10,000	10,000
1	Cash Notes Payable (Issued 3-month, 12% note payable for cash)	5,000	5,000
2	Equipment Cash (Purchased equipment for cash)	5,000	5,000
2	Cash Unearned Service Revenue (Received advance from R. Knox for future service)	1,200	1,200
3	Cash Service Revenue (Received cash for services performed)	10,000	10,000
3	Rent Expense Cash (Paid cash for October office rent)	900	900
4	Prepaid Insurance Cash (Paid 1-year policy; effective date October 1)	600	600
5	Supplies Accounts Payable (Purchased supplies on account from Aero Supply)	2,500	2,500
20	Dividends Cash (Declared and paid a cash dividend)	500	500
26	Salaries and Wages Expense Cash (Paid salaries to date)	4,000	4,000

ILLUSTRATION 3-32
General journal for Sierra Corporation

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GENERAL LEDGER			
Cash		Unearned Service Revenue	
Oct. 1	10,000	Oct. 2	1,200
1	5,000		
2	1,200	Bal.	1,200
3	10,000		
		Oct. 2	5,000
		3	900
		4	600
		20	500
		26	4,000
Bal.	15,200		
Supplies		Common Stock	
Oct. 5	2,500		
		Oct. 1	10,000
Bal.	2,500	Bal.	10,000
Prepaid Insurance		Dividends	
Oct. 4	600	Oct. 20	500
Bal.	600	Bal.	500
Equipment		Service Revenue	
Oct. 2	5,000		
		Oct. 3	10,000
Bal.	5,000	Bal.	10,000
Notes Payable		Salaries and Wages Expense	
		Oct. 26	4,000
		Bal.	4,000
		Oct. 1	5,000
		Bal.	5,000
Accounts Payable		Rent Expense	
		Oct. 3	900
		Bal.	900
		Oct. 5	2,500
		Bal.	2,500

ILLUSTRATION 3-33
General ledger for Sierra Corporation

DO IT! 4

Posting

Selected transactions from the journal of Faital Inc. during its first month of operations are presented below. Post these transactions to T-accounts.

Date	Account Titles	Debit	Credit
July 1	Cash	30,000	
	Common Stock		30,000
9	Accounts Receivable	6,000	
	Service Revenue		6,000
24	Cash	4,000	
	Accounts Receivable		4,000

Action Plan

- ✓ Journalize transactions to keep track of financial activities (receipts, payments, receivables, payables, etc.).
- ✓ To make entries useful, classify and summarize them by posting the entries to specific ledger accounts.

SOLUTION

<table border="1" style="width: 100%; border-collapse: collapse;"> <thead> <tr> <th colspan="2" style="text-align: center;">Cash</th> </tr> </thead> <tbody> <tr> <td style="width: 50%;">July 1</td> <td style="text-align: right;">30,000</td> </tr> <tr> <td>24</td> <td style="text-align: right;">4,000</td> </tr> <tr> <td colspan="2" style="text-align: center;">Common Stock</td> </tr> <tr> <td>July 1</td> <td style="text-align: right;">30,000</td> </tr> </tbody> </table>	Cash		July 1	30,000	24	4,000	Common Stock		July 1	30,000	<table border="1" style="width: 100%; border-collapse: collapse;"> <thead> <tr> <th colspan="2" style="text-align: center;">Accounts Receivable</th> </tr> </thead> <tbody> <tr> <td style="width: 50%;">July 9</td> <td style="text-align: right;">6,000</td> </tr> <tr> <td>July 24</td> <td style="text-align: right;">4,000</td> </tr> <tr> <td colspan="2" style="text-align: center;">Service Revenue</td> </tr> <tr> <td>July 9</td> <td style="text-align: right;">6,000</td> </tr> </tbody> </table>	Accounts Receivable		July 9	6,000	July 24	4,000	Service Revenue		July 9	6,000
Cash																					
July 1	30,000																				
24	4,000																				
Common Stock																					
July 1	30,000																				
Accounts Receivable																					
July 9	6,000																				
July 24	4,000																				
Service Revenue																					
July 9	6,000																				

Related exercise material: BE3-10, DO IT! 3-4, and E3-14.

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LEARNING OBJECTIVE 5

Prepare a trial balance.



A **trial balance** lists accounts and their balances at a given time. A company usually prepares a trial balance at the end of an accounting period. The accounts are listed in the order in which they appear in the ledger. Debit balances are listed in the left column and credit balances in the right column. The totals of the two columns must be equal.

The trial balance proves the mathematical equality of debits and credits after posting. Under the double-entry system, this equality occurs when the sum of the debit account balances equals the sum of the credit account balances. **A trial balance may also uncover errors in journalizing and posting.** For example, a trial balance may well have detected the error at **MF Global** discussed in the Feature Story. **In addition, a trial balance is useful in the preparation of financial statements.**

These are the procedures for preparing a trial balance:

1. List the account titles and their balances.
2. Total the debit column and total the credit column.
3. Verify the equality of the two columns.

Illustration 3-34 presents the trial balance prepared from the ledger of Sierra Corporation. Note that the total debits, \$28,700, equal the total credits, \$28,700.

 SIERRA CORPORATION Trial Balance October 31, 2017		
	<u>Debit</u>	<u>Credit</u>
Cash	\$ 15,200	
Supplies	2,500	
Prepaid Insurance	600	
Equipment	5,000	
Notes Payable		\$ 5,000
Accounts Payable		2,500
Unearned Service Revenue		1,200
Common Stock		10,000
Dividends	500	
Service Revenue		10,000
Salaries and Wages Expense	4,000	
Rent Expense	900	
	<u>\$28,700</u>	<u>\$28,700</u>

ILLUSTRATION 3-34
Sierra Corporation trial balance

DECISION TOOLS

A trial balance proves that debits equal credits.

▼ HELPFUL HINT

Note that the order of presentation in the trial balance is:

- Assets
- Liabilities
- Stockholders' equity
- Revenues
- Expenses

LIMITATIONS OF A TRIAL BALANCE

A trial balance does not prove that all transactions have been recorded or that the ledger is correct. Numerous errors may exist even though the trial balance column totals agree. For example, the trial balance may balance even when any of the following occurs: (1) a transaction is not journalized, (2) a correct journal entry is not posted, (3) a journal entry is posted twice, (4) incorrect accounts are

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used in journalizing or posting, or (5) offsetting errors are made in recording the amount of a transaction. In other words, as long as equal debits and credits are posted, even to the wrong account or in the wrong amount, the total debits will equal the total credits. Nevertheless, despite these limitations, the trial balance is a useful screen for finding errors and is frequently used in practice.

ETHICS NOTE

An **error** is the result of an unintentional mistake. It is neither ethical nor unethical. An **irregularity** is an intentional misstatement, which is viewed as unethical.

KEEPING AN EYE ON CASH

The Cash account shown below reflects all of the inflows and outflows of cash that occurred during October for Sierra Corporation (see Illustrations 3-21 to 3-31). We have also provided a description of each transaction that affected the Cash account.

1. Oct. 1 Issued stock for \$10,000 cash.
2. Oct. 1 Issued note payable for \$5,000 cash.
3. Oct. 2 Purchased equipment for \$5,000 cash.
4. Oct. 2 Received \$1,200 cash in advance from customer.
5. Oct. 3 Received \$10,000 cash for services performed.
6. Oct. 3 Paid \$900 cash for October rent.
7. Oct. 4 Paid \$600 cash for one-year insurance policy.
8. Oct. 20 Paid \$500 cash dividend to stockholders.
9. Oct. 26 Paid \$4,000 cash salaries.

The Cash account and the related cash transactions indicate why cash changed during October. However, to make this information useful for analysis, it is summarized in a statement of cash flows. The statement of cash flows classifies each transaction as an operating activity, an investing activity, or a financing activity. A user of this statement can then determine the amount of net cash provided by operating activities, the amount of cash used for investing purposes, and the amount of cash provided by financing activities.

Cash			
Oct. 1	10,000	Oct. 2	5,000
1	5,000	3	900
2	1,200	4	600
3	10,000	20	500
		26	4,000
Bal.	15,200		

Operating activities are the types of activities the company performs to generate profits. Sierra is an outdoor guide business, so its operating activities involve providing guide services. Activities 4, 5, 6, 7, and 9 relate to cash received or spent to directly support its guide services.

Investing activities include the purchase or sale of long-lived assets used in operating the business, or the purchase or sale of investment securities (stocks and bonds of companies other than Sierra). Activity 3, the purchase of equipment, is an investing activity.

The primary types of **financing activities** are borrowing money, issuing shares of stock, and paying dividends. The financing activities of Sierra are Activities 1, 2, and 8.

DO IT! 5

Trial Balance

The following accounts come from the ledger of SnowGo Corporation at December 31, 2017.

Equipment	\$88,000	Common Stock	\$20,000
Dividends	8,000	Salaries and Wages Payable	2,000
Accounts Payable	22,000	Notes Payable (due in 3 months)	19,000
Salaries and Wages Expense	42,000	Utilities Expense	3,000
Accounts Receivable	4,000	Prepaid Insurance	6,000
Service Revenue	95,000	Cash	7,000

Prepare a trial balance in good form.

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Action Plan

- ✓ Determine normal balances and list accounts in the order they appear in the ledger.
- ✓ Accounts with debit balances appear in the left column, and those with credit balances in the right column.
- ✓ Total the debit and credit columns to prove equality.

SOLUTION

SNOWGO CORPORATION		
Trial Balance		
December 31, 2017		
	<u>Debit</u>	<u>Credit</u>
Cash	\$ 7,000	
Accounts Receivable	4,000	
Prepaid Insurance	6,000	
Equipment	88,000	
Notes Payable		\$ 19,000
Accounts Payable		22,000
Salaries and Wages Payable		2,000
Common Stock		20,000
Dividends	8,000	
Service Revenue		95,000
Utilities Expense	3,000	
Salaries and Wages Expense	42,000	
	<u>\$158,000</u>	<u>\$158,000</u>

Related exercise material: **BE3-11, BE3-12, DO IT! 3-5, E3-13, E3-15, E3-16, E3-17, E3-18, E3-19, E3-20, E3-21, and E3-22.**

USING DECISION TOOLS—KANSAS FARMERS' VERTICALLY INTEGRATED COOPERATIVE, INC.

The **Kansas Farmers' Vertically Integrated Cooperative, Inc. (K-VIC)** was formed by over 200 northeast Kansas farmers in the late 1980s. Its purpose is to process raw materials, primarily grain and meat products grown by K-VIC's members, into end-user food products and then to distribute the products nationally. Profits not needed for expansion or investment are returned to the members annually, on a pro rata basis, according to the fair value of the grain and meat products received from each farmer.

Assume that the following trial balance was prepared for K-VIC.

KANSAS FARMERS' VERTICALLY INTEGRATED COOPERATIVE, INC.		
Trial Balance		
December 31, 2017		
(in thousands)		
	<u>Debit</u>	<u>Credit</u>
Accounts Receivable	\$ 712,000	
Accounts Payable		\$ 673,000
Buildings	365,000	
Cash	32,000	
Cost of Goods Sold	2,384,000	
Notes Payable (due in 2018)		12,000
Inventory	1,291,000	
Land	110,000	
Mortgage Payable		873,000
Equipment	63,000	
Retained Earnings		822,000
Sales Revenue		3,741,000
Salaries and Wages Payable		62,000
Salaries and Wages Expense	651,000	
Maintenance and Repairs Expense	500,000	
	<u>\$6,108,000</u>	<u>\$6,183,000</u>

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Because the trial balance is not in balance, you have checked with various people responsible for entering accounting data and have discovered the following.

1. The purchase of 35 new trucks, costing \$7 million and paid for with cash, was not recorded.
2. A data entry clerk accidentally deleted the account name for an account with a credit balance of \$472 million, so the amount was added to the Mortgage Payable account in the trial balance.
3. December cash sales revenue of \$75 million was credited to the Sales Revenue account, but the other half of the entry was not made.
4. \$50 million of salaries expense were mistakenly charged to Maintenance and Repairs Expense.

Instructions

Answer these questions.

- (a) Which mistake(s) have caused the trial balance to be out of balance?
- (b) Should all of the items be corrected? Explain.
- (c) What is the name of the account the data entry clerk deleted?
- (d) Make the necessary corrections and prepare a correct trial balance with accounts listed in proper order.
- (e) On your trial balance, write BAL beside the accounts that go on the balance sheet and INC beside those that go on the income statement.

SOLUTION

- (a) Only mistake #3 has caused the trial balance to be out of balance.
- (b) All of the items should be corrected. The misclassification error (mistake #4) on the salaries expense would not affect bottom-line net income, but it does affect the amounts reported in the two expense accounts.
- (c) There is no Common Stock account, so that must be the account that was deleted by the data entry clerk.
- (d) and (e)

KANSAS FARMERS' VERTICALLY INTEGRATED COOPERATIVE, INC.			
Trial Balance			
December 31, 2017			
(in thousands)			
	<u>Debit</u>	<u>Credit</u>	
Cash (\$32,000 – \$7,000 + \$75,000)	\$ 100,000		BAL
Accounts Receivable	712,000		BAL
Inventory	1,291,000		BAL
Land	110,000		BAL
Buildings	365,000		BAL
Equipment (\$63,000 + \$7,000)	70,000		BAL
Accounts Payable		\$ 673,000	BAL
Salaries and Wages Payable		62,000	BAL
Notes Payable (due in 2018)		12,000	BAL
Mortgage Payable (\$873,000 – \$472,000)		401,000	BAL
Common Stock		472,000	BAL
Retained Earnings		822,000	BAL
Sales Revenue		3,741,000	INC
Cost of Goods Sold	2,384,000		INC
Salaries and Wages Expense (\$651,000 + \$50,000)	701,000		INC
Maintenance and Repairs Expense (\$500,000 – \$50,000)	450,000		INC
	<u>\$6,183,000</u>	<u>\$6,183,000</u>	

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REVIEW AND PRACTICE

LEARNING OBJECTIVE REVIEW

- Analyze the effect of business transactions on the basic accounting equation.** Each business transaction must have a dual effect on the accounting equation. For example, if an individual asset is increased, there must be a corresponding (a) decrease in another asset, or (b) increase in a specific liability, or (c) increase in stockholders' equity.
- Explain how accounts, debits, and credits are used to record business transactions.** An account is an individual accounting record of increases and decreases in specific asset, liability, and stockholders' equity items.
The terms debit and credit are synonymous with left and right. Assets, dividends, and expenses are increased by debits and decreased by credits. Liabilities, common stock, retained earnings, and revenues are increased by credits and decreased by debits.
- Indicate how a journal is used in the recording process.** The basic steps in the recording process are (a) analyze each transaction in terms of its effect on the accounts, (b) enter the transaction information in a journal, and (c) transfer the journal information to the appropriate accounts in the ledger.
The initial accounting record of a transaction is entered in a journal before the data are entered in the accounts. A journal (a) discloses in one place the complete effect of a transaction, (b) provides a chronological record of transactions, and (c) prevents or locates errors because the debit and credit amounts for each entry can be readily compared.
- Explain how a ledger and posting help in the recording process.** The entire group of accounts maintained by a company is referred to collectively as a ledger. The ledger provides the balance in each of the accounts as well as keeps track of changes in these balances.
Posting is the procedure of transferring journal entries to the ledger accounts. This phase of the recording process accumulates the effects of journalized transactions in the individual accounts.
- Prepare a trial balance.** A trial balance is a list of accounts and their balances at a given time. The primary purpose of the trial balance is to prove the mathematical equality of debits and credits after posting. A trial balance also uncovers errors in journalizing and posting and is useful in preparing financial statements.

 DECISION TOOLS REVIEW			
DECISION CHECKPOINTS	INFO NEEDED FOR DECISION	TOOL TO USE FOR DECISION	HOW TO EVALUATE RESULTS
Has an accounting transaction occurred?	Details of the event	Accounting equation	If the event affected assets, liabilities, or stockholders' equity, then record as a transaction.
How do you determine that debits equal credits?	All account balances	Trial balance	List the account titles and their balances; total the debit and credit columns; verify equality.

GLOSSARY REVIEW

- Account** An individual accounting record of increases and decreases in specific asset, liability, stockholders' equity, revenue, or expense items.
- Accounting information system** The system of collecting and processing transaction data and communicating financial information to decision-makers.
- Accounting transactions** Events that require recording in the financial statements because they affect assets, liabilities, or stockholders' equity.
- Chart of accounts** A list of a company's accounts.
- Credit** The right side of an account.
- Debit** The left side of an account.
- Double-entry system** A system that records the two-sided effect of each transaction in appropriate accounts.
- General journal** The most basic form of journal.
- General ledger** A ledger that contains all asset, liability, stockholders' equity, revenue, and expense accounts.
- Journal** An accounting record in which transactions are initially recorded in chronological order.
- Journalizing** The procedure of entering transaction data in the journal.
- Ledger** The group of accounts maintained by a company.
- Posting** The procedure of transferring journal entry amounts to the ledger accounts.
- T-account** The basic form of an account.
- Trial balance** A list of accounts and their balances at a given time.

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PRACTICE MULTIPLE-CHOICE QUESTIONS

(LO 1)

1. The effects on the basic accounting equation of performing services for cash are to:
- increase assets and decrease stockholders' equity.
 - increase assets and increase stockholders' equity.
 - increase assets and increase liabilities.
 - increase liabilities and increase stockholders' equity.

(LO 1)

2. Genesis Company buys a \$900 machine on credit. This transaction will affect the:
- income statement only.
 - balance sheet only.
 - income statement and retained earnings statement only.
 - income statement, retained earnings statement, and balance sheet.

(LO 1)

3. Which of the following events is **not** recorded in the accounting records?
- Equipment is purchased on account.
 - An employee is terminated.
 - A cash investment is made into the business.
 - Company pays dividend to stockholders.

(LO 1)

4. During 2017, Gibson Company assets decreased \$50,000 and its liabilities decreased \$90,000. Its stockholders' equity therefore:
- increased \$40,000.
 - decreased \$140,000.
 - decreased \$40,000.
 - increased \$140,000.

(LO 2)

5. Which statement about an account is **true**?
- In its simplest form, an account consists of two parts.
 - An account is an individual accounting record of increases and decreases in specific asset, liability, and stockholders' equity items.
 - There are separate accounts for specific assets and liabilities but only one account for stockholders' equity items.
 - The left side of an account is the credit, or decrease, side.

(LO 2)

6. Debits:
- increase both assets and liabilities.
 - decrease both assets and liabilities.
 - increase assets and decrease liabilities.
 - decrease assets and increase liabilities.

(LO 2)

7. A revenue account:
- is increased by debits.
 - is decreased by credits.
 - has a normal balance of a debit.
 - is increased by credits.

(LO 2)

8. Which accounts normally have debit balances?
- Assets, expenses, and revenues.
 - Assets, expenses, and retained earnings.
 - Assets, liabilities, and dividends.
 - Assets, dividends, and expenses.

(LO 2)

9. Paying an account payable with cash affects the components of the accounting equation in the following way:
- Decreases stockholders' equity and decreases liabilities.
 - Increases assets and decreases liabilities.
 - Decreases assets and increases stockholders' equity.
 - Decreases assets and decreases liabilities.

(LO 3)

10. Which is **not** part of the recording process?
- Analyzing transactions.
 - Preparing an income statement.
 - Entering transactions in a journal.
 - Posting journal entries.

(LO 3)

11. Which of these statements about a journal is **false**?
- It contains only revenue and expense accounts.
 - It provides a chronological record of transactions.
 - It helps to locate errors because the debit and credit amounts for each entry can be readily compared.
 - It discloses in one place the complete effect of a transaction.

(LO 4)

12. A ledger:

- (a) contains only asset and liability accounts.
- (b) should show accounts in alphabetical order.
- (c) is a collection of the entire group of accounts maintained by a company.
- (d) provides a chronological record of transactions.

(LO 4)

13. Posting:

- (a) normally occurs before journalizing.
- (b) transfers ledger transaction data to the journal.
- (c) is an optional step in the recording process.
- (d) transfers journal entries to ledger accounts.

(LO 5)

14. A trial balance:

- (a) is a list of accounts with their balances at a given time.
- (b) proves that proper account titles were used.
- (c) will not balance if a correct journal entry is posted twice.
- (d) proves that all transactions have been recorded.

(LO 5)

15. A trial balance will **not** balance if:

- (a) a correct journal entry is posted twice.
- (b) the purchase of supplies on account is debited to Supplies and credited to Cash.
- (c) a \$100 cash dividend is debited to Dividends for \$1,000 and credited to Cash for \$100.
- (d) a \$450 payment on account is debited to Accounts Payable for \$45 and credited to Cash for \$45.

SOLUTIONS

1. **(b)** When services are performed for cash, assets are increased and stockholders' equity is increased. The other choices are therefore incorrect.
2. **(b)** When equipment is purchased on credit, assets are increased and liabilities are increased. These are both balance sheet accounts. The other choices are incorrect because neither the income statement nor the retained earnings statement is affected.
3. **(b)**

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Termination of an employee is not a recordable event in the accounting records. The other choices all represent events that are recorded.

4. **(a)** Since assets decreased by \$50,000 and liabilities decreased by \$90,000, stockholders' equity has to increase by \$40,000 to keep the accounting equation balanced. The other choices are therefore incorrect.
5. **(b)** An account is an individual accounting record of increases and decreases in specific asset, liability, and stockholders' equity items. The other choices are incorrect because (a) in its simplest form, an account consists of three parts: a title and debit and credit side; (c) there are specific accounts for different types of stockholders' equity, such as Common Stock, Retained Earnings, and Dividends; and (d) the left side of an account is the debit side.
6. **(c)** Debits increase assets and decrease liabilities. The other choices are therefore incorrect.
7. **(d)** Revenues are increased by credits. Revenues have a normal credit balance. The other choices are therefore incorrect.
8. **(d)** Assets, dividends, and expenses have normal debit balances. The other choices are incorrect because (a) revenues have a normal credit balance, (b) retained earnings has a normal credit balance, and (c) liabilities have a normal credit balance.
9. **(d)** When paying an account payable with cash, the asset cash decreases. Accounts payable, a liability, decreases as well. The other choices are therefore incorrect.
10. **(b)** Preparing an income statement is not part of the recording process. Choices (a) analyzing transactions, (c) entering transactions in a journal, and (d) posting transactions are all steps in the recording process.
11. **(a)** A journal contains entries affecting all accounts, not just revenue and expense accounts. The other choices are true statements.
12. **(c)** A ledger is a collection of the entire group of accounts maintained by a company. The other choices are therefore incorrect.
13. **(d)** Posting transfers journal entries to ledger accounts. The other choices are incorrect because posting (a) occurs after journalizing, (b) transfers the information contained in journal entries to the ledger, and (c) is a required step in the recording process. If posting is not done, the ledger accounts will not reflect changes in the accounts resulting from transactions.
14. **(a)** A trial balance is a list of accounts with their balances at a given time. The other choices are incorrect because (b) it does not confirm that proper account titles were used; (c) if a journal entry is posted twice, the trial balance will still balance; and (d) a trial balance does not prove that all transactions have been recorded.
15. **(c)** The entry will cause the trial balance to be out of balance. The other choices are incorrect because although these entries are incorrect, they will still allow the trial balance to balance.

PRACTICE EXERCISES

Prepare a tabular presentation.

(LO 1)

1. Legal Services Inc. was incorporated on July 1, 2017. During the first month of operations, the following transactions occurred.
 1. Stockholders invested \$10,000 in cash in exchange for common stock of Legal Services Inc.
 2. Paid \$800 for July rent on office space.
 3. Purchased office equipment on account \$3,000.
 4. Performed legal services for clients for cash \$1,500.
 5. Borrowed \$700 cash from a bank on a note payable.
 6. Performed legal services for client on account \$2,000.
 7. Paid monthly expenses: salaries \$500, utilities \$300, and advertising \$100.

Instructions

Prepare a tabular summary of the transactions.

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SOLUTION

I. Trans- action	Assets			=	Liabilities		+	Stockholders' Equity			
	Cash	+ Accounts Receivable	+ Equipment	=	Notes Payable	+ Accounts Payable	+ Common Stock	Retained Earnings			
								Rev.	- Exp.	- Div.	
(1)	+\$10,000			=			+\$10,000				Issued Stock
(2)	-800			=							Rent Expense
(3)			+\$3,000	=		+\$3,000					
(4)	+1,500			=				+\$1,500			Service Revenue
(5)	+700			=		+\$700					
(6)		-\$2,000		=				+\$2,000			Service Revenue
(7)	-500			=							Sal/Wages Exp.
	-300			=							Utilities Expense
	-100			=							Advertising Expense
	<u>\$10,500</u>	<u>+</u> <u>\$2,000</u>	<u>+</u> <u>\$3,000</u>	=	<u>\$700</u>	<u>+</u> <u>\$3,000</u>	<u>+</u> <u>\$10,000</u>	<u>+</u> <u>\$3,500</u>	<u>-</u> <u>\$1,700</u>		
		\$15,500					\$15,500				

Journalize transactions.

(LO 3)

2. Presented below is information related to Conan Real Estate Agency.

- Oct. 1 Arnold Conan begins business as a real estate agent with a cash investment of \$18,000 in exchange for common stock.
- 2 Hires an administrative assistant.
- 3 Purchases office equipment for \$1,700, on account.
- 6 Sells a house and lot for B. Clinton; bills B. Clinton \$4,200 for realty services performed.
- 27 Pays \$900 on the balance related to the transaction of October 3.
- 30 Pays the administrative assistant \$2,800 in salary for October.

Instructions

Journalize the transactions. (You may omit explanations.)

SOLUTION

2 GENERAL JOURNAL			
Date	Account Titles and Explanation	Debit	Credit
Oct. 1	Cash	18,000	
	Common Stock		18,000
2	No entry required		
3	Equipment	1,700	
	Accounts Payable		1,700
6	Accounts Receivable	4,200	
	Service Revenue		4,200
27	Accounts Payable	900	
	Cash		900
30	Salaries and Wages Expense	2,800	
	Cash		2,800

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PRACTICE PROBLEM

Journalize transactions, post, and prepare a trial balance.

(LO 3, 4, 5)

Bob Sample and other student investors opened Campus Carpet Cleaning, Inc. on September 1, 2017. During the first month of operations, the following transactions occurred.

- Sept. 1 Stockholders invested \$20,000 cash in the business.
- 2 Paid \$1,000 cash for store rent for the month of September.
- 3 Purchased industrial carpet-cleaning equipment for \$25,000, paying \$10,000 in cash and signing a \$15,000 6-month, 12% note payable.
- 4 Paid \$1,200 for 1-year accident insurance policy.
- 10 Received bill from the *Daily News* for advertising the opening of the cleaning service, \$200.
- 15 Performed services on account for \$6,200.
- 20 Paid a \$700 cash dividend to stockholders.
- 30 Received \$5,000 from customers billed on September 15.

The chart of accounts for the company is the same as for Sierra Corporation except for the following additional account: Advertising Expense.

Instructions

- (a) Journalize the September transactions.
- (b) Open ledger accounts and post the September transactions.
- (c) Prepare a trial balance at September 30, 2017.

SOLUTION

(a) GENERAL JOURNAL			
Date	Account Titles and Explanation	Debit	Credit
2017			
Sept. 1	Cash	20,000	
	Common Stock		20,000
	(Issued stock for cash)		
2	Rent Expense	1,000	
	Cash		1,000
	(Paid September rent)		
3	Equipment	25,000	
	Cash		10,000
	Notes Payable		15,000
	(Purchased cleaning equipment for cash and 6-month, 12% note payable)		
4	Prepaid Insurance	1,200	
	Cash		1,200
	(Paid 1-year insurance policy)		
10	Advertising Expense	200	
	Accounts Payable		200
	(Received bill from <i>Daily News</i> for advertising)		
15	Accounts Receivable	6,200	
	Service Revenue		6,200
	(Services performed on account)		
20	Dividends	700	
	Cash		700
	(Declared and paid a cash dividend)		
30	Cash	5,000	
	Accounts Receivable		5,000
	(Collection of accounts receivable)		

(b) GENERAL LEDGER			
Cash		Common Stock	
Sept. 1 20,000	Sept. 2 1,000		Sept. 1 20,000
30 5,000	3 10,000		Bal. 20,000
	4 1,200		
	20 700		
Bal. 12,100			
Accounts Receivable		Dividends	
Sept. 15 6,200	Sept. 30 5,000	Sept. 20 700	
Bal. 1,200		Bal. 700	
Prepaid Insurance		Service Revenue	
Sept. 4 1,200			Sept. 15 6,200
Bal. 1,200			Bal. 6,200
Equipment		Advertising Expense	
Sept. 3 25,000		Sept. 10 200	
Bal. 25,000		Bal. 200	
Notes Payable		Rent Expense	
	Sept. 3 15,000	Sept. 2 1,000	
	Bal. 15,000	Bal. 1,000	
Accounts Payable			
	Sept. 10 200		
	Bal. 200		

(c) CAMPUS CARPET CLEANING, INC.		
Trial Balance September 30, 2017		
	<u>Debit</u>	<u>Credit</u>
Cash	\$12,100	
Accounts Receivable	1,200	
Prepaid Insurance	1,200	
Equipment	25,000	
Notes Payable		\$15,000
Accounts Payable		200
Common Stock		20,000
Dividends	700	
Service Revenue		6,200
Advertising Expense	200	
Rent Expense	1,000	
	<u>\$41,400</u>	<u>\$41,400</u>

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QUESTIONS

1. Describe the accounting information system.
2. Can a business enter into a transaction that affects only the left side of the basic accounting equation? If so, give an example.
3. Are the following events recorded in the accounting records? Explain your answer in each case.
 - (a) A major stockholder of the company dies.
 - (b) Supplies are purchased on account.
 - (c) An employee is fired.
 - (d) The company pays a cash dividend to its stockholders.
4. Indicate how each business transaction affects the basic accounting equation.
 - (a) Paid cash for janitorial services.
 - (b) Purchased equipment for cash.
 - (c) Issued common stock to investors in exchange for cash.
 - (d) Paid an account payable in full.
5. Why is an account referred to as a T-account?
6. The terms debit and credit mean "increase" and "decrease," respectively. Do you agree? Explain.
7. Barry Barack, a fellow student, contends that the double-entry system means each transaction must be recorded twice. Is Barry correct? Explain.
8. Misty Reno, a beginning accounting student, believes debit balances are favorable and credit balances are unfavorable. Is Misty correct? Discuss.
9. State the rules of debit and credit as applied to (a) asset accounts, (b) liability accounts, and (c) the Common Stock account.
10. What is the normal balance for each of these accounts?
 - (a) Accounts Receivable.
 - (b) Cash.
 - (c) Dividends.
 - (d) Accounts Payable.
 - (e) Service Revenue.
 - (f) Salaries and Wages Expense.
 - (g) Common Stock.
11. Indicate whether each account is an asset, a liability, or a stockholders' equity account, and whether it would have a normal debit or credit balance.
 - (a) Accounts Receivable.
 - (b) Accounts Payable.
 - (c) Equipment.
 - (d) Dividends.
 - (e) Supplies.
12. For the following transactions, indicate the account debited and the account credited.
 - (a) Supplies are purchased on account.
 - (b) Cash is received on signing a note payable.
 - (c) Employees are paid salaries in cash.
13. For each account listed here, indicate whether it generally will have debit entries only, credit entries only, or both debit and credit entries.
 - (a) Cash.
 - (b) Accounts Receivable.
 - (c) Dividends.
 - (d) Accounts Payable.
 - (e) Salaries and Wages Expense.
 - (f) Service Revenue.
14. What are the normal balances for the following accounts of **Apple**? (a) Accounts Receivable, (b) Accounts Payable, (c) Sales, and (d) Selling, General, and Administrative Expenses.
15. What are the basic steps in the recording process?
16. (a) When entering a transaction in the journal, should the debit or credit be written first?
 - (b) Which should be indented, the debit or the credit?
17. (a) Should accounting transaction debits and credits be recorded directly in the ledger accounts?
 - (b) What are the advantages of first recording transactions in the journal and then posting to the ledger?
18. Journalize these accounting transactions.
 - (a) Stockholders invested \$12,000 in the business in exchange for common stock.
 - (b) Insurance of \$800 is paid for the year.
 - (c) Supplies of \$1,800 are purchased on account.
 - (d) Cash of \$7,500 is received for services rendered.
19. (a) What is a ledger?
 - (b) Why is a chart of accounts important?
20. What is a trial balance and what are its purposes?
21. Brad Tyler is confused about how accounting information flows through the accounting system. He believes information flows in this order:
 - (a) Debits and credits are posted to the ledger.
 - (b) Accounting transaction occurs.
 - (c) Information is entered in the journal.
 - (d) Financial statements are prepared.
 - (e) Trial balance is prepared.

Indicate to Brad the proper flow of the information.

22.  Two students are discussing the use of a trial balance. They wonder whether the following errors, each considered separately, would prevent the trial balance from balancing. What would you tell them?
- (a) The bookkeeper debited Cash for \$600 and credited Salaries and Wages Expense for \$600 for payment of wages.
 - (b) Cash collected on account was debited to Cash for \$800, and Service Revenue was credited for \$80.
-

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BRIEF EXERCISES

Determine effect of transactions on basic accounting equation.

(LO 1), C

BE3-1 Presented below are three economic events. On a sheet of paper, list the letters (a), (b), and (c) with columns for assets, liabilities, and stockholders' equity. In each column, indicate whether the event increased (+), decreased (-), or had no effect (NE) on assets, liabilities, and stockholders' equity.

- (a) Purchased supplies on account.
- (a) Received cash for performing a service.
- (a) Expenses paid in cash.

Determine effect of transactions on basic accounting equation.

(LO 1), AP

BE3-2 During 2017, Manion Corp. entered into the following transactions.

1. Borrowed \$60,000 by issuing bonds.
2. Paid \$9,000 cash dividend to stockholders.
3. Received \$13,000 cash from a previously billed customer for services performed.
4. Purchased supplies on account for \$3,100.

Using the following tabular analysis, show the effect of each transaction on the accounting equation. Put explanations for changes to Stockholders' Equity in the right-hand margin. For Retained Earnings, use separate columns for Revenues, Expenses, and Dividends if necessary. Use Illustration 3-3 (page 99) as a model.

Assets			=	Liabilities		+	Stockholders' Equity	
Cash	+ Accounts Receivable	+ Supplies	=	Accounts Payable	+ Bonds Payable	+	Common Stock	+ Retained Earnings

Determine effect of transactions on basic accounting equation.

(LO 1), AP

BE3-3 During 2017, Rostock Company entered into the following transactions.

1. Purchased equipment for \$286,176 cash.
2. Issued common stock to investors for \$137,590 cash.
3. Purchased inventory of \$68,480 on account.

Using the following tabular analysis, show the effect of each transaction on the accounting equation. Put explanations for changes to Stockholders' Equity in the right-hand margin. For Retained Earnings, use separate columns for Revenues, Expenses, and Dividends if necessary. Use Illustration 3-3 (page 99) as a model.

Assets			=	Liabilities		+	Stockholders' Equity	
Cash	+ Inventory	+ Equipment	=	Accounts Payable	+	Common Stock	+ Retained Earnings	

Indicate debit and credit effects.

(LO 2), K

BE3-4 For each of the following accounts, indicate the effect of a debit or a credit on the account and the normal balance.

- (a) Accounts Payable.
- (b) Advertising Expense.
- (c) Service Revenue.
- (d) Accounts Receivable.
- (e) Retained Earnings.
- (f) Dividends.

Identify accounts to be debited and credited.

(LO 2), C

BE3-5 Transactions for Jayne Company for the month of June are presented below. Identify the accounts to be debited and credited for each transaction.

- June 1 Issues common stock to investors in exchange for \$5,000 cash.
- 2 Buys equipment on account for \$1,100.
- 3 Pays \$740 to landlord for June rent.
- 12 Sends Wil Wheaton a bill for \$700 after completing welding work.

Journalize transactions.

(LO 3), AP

BE3-6 Use the data in BE3-5 and journalize the transactions. (You may omit explanations.)

Identify steps in the recording process.

(LO 3), C

BE3-7 Rae Mohlee, a fellow student, is unclear about the basic steps in the recording process. Identify and briefly explain the steps in the order in which they occur.

Indicate basic debit–credit analysis.

(LO 3), C

BE3-8 Tilton Corporation has the following transactions during August of the current year. Indicate (a) the basic analysis and (b) the debit–credit analysis illustrated on pages 111–116.

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- Aug. 1 Issues shares of common stock to investors in exchange for \$10,000.
- 4 Pays insurance in advance for 3 months, \$1,500.
- 16 Receives \$900 from clients for services rendered.
- 27 Pays the secretary \$620 salary.

Journalize transactions.
(LO 3), AP

BE3-9 Use the data in BE3-8 and journalize the transactions. (You may omit explanations.)

Post journal entries to T-accounts.
(LO 4), AP

BE3-10 Selected transactions for Montes Company are presented below in journal form (without explanations). Post the transactions to T-accounts.

Date	Account Title	Debit	Credit
May 5	Accounts Receivable	3,800	
	Service Revenue		3,800
12	Cash	1,600	
	Accounts Receivable		1,600
15	Cash	2,000	
	Service Revenue		2,000

Prepare a trial balance.
(LO 5), AP

BE3-11 From the ledger balances below, prepare a trial balance for Peete Company at June 30, 2017. All account balances are normal.

Accounts Payable	\$ 1,000
Cash	5,400
Common Stock	18,000
Dividends	1,200
Equipment	13,000
Service Revenue	\$8,600
Accounts Receivable	3,000
Salaries and Wages Expense	4,000
Rent Expense	1,000

Prepare a corrected trial balance.
(LO 5), AN

BE3-12 An inexperienced bookkeeper prepared the following trial balance that does not balance. Prepare a correct trial balance, assuming all account balances are normal.

BIRELLIE COMPANY
Trial Balance
December 31, 2017

	Debit	Credit
Cash	\$20,800	
Prepaid Insurance		\$ 3,500
Accounts Payable		2,500
Unearned Service Revenue	1,800	
Common Stock		10,000
Retained Earnings		6,600
Dividends		5,000
Service Revenue		25,600
Salaries and Wages Expense	14,600	
Rent Expense		2,600
	\$37,200	\$55,800

DO IT!

EXERCISES

Prepare tabular analysis.
(LO 1), AP

DO IT! 3-4 Transactions made by Mickelson Co. for the month of March are shown below. Prepare a tabular analysis that shows the effects of these transactions on the expanded accounting equation, similar to that shown in Illustration 3-3 (page 99).

- The company performed \$20,000 of services for customers on account.
- The company received \$20,000 in cash from customers who had been billed for services [in transaction (1)].

3. The company received a bill for \$1,800 of advertising but will not pay it until a later date.
4. Mickelson Co. paid a cash dividend of \$3,000.

Identify normal balances.

(LO 2), C

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DO IT! 3-2 Boyd Docker has just rented space in a strip mall. In this space, he will open a photography studio, to be called SnapShot! A friend has advised Boyd to set up a double-entry set of accounting records in which to record all of his business transactions.

Identify the balance sheet accounts that Boyd will likely need to record the transactions needed to open his business (a corporation). Indicate whether the normal balance of each account is a debit or credit.

Record business activities.

(LO 3), AP

DO IT! 3-3 Boyd Docker engaged in the following activities in establishing his photography studio, SnapShot!:

1. Opened a bank account in the name of SnapShot! and deposited \$8,000 of his own money into this account in exchange for common stock.
2. Purchased photography supplies at a total cost of \$950. The business paid \$400 in cash, and the balance is on account.
3. Obtained estimates on the cost of photography equipment from three different manufacturers.

Prepare the journal entries to record the transactions.

Post transactions.

(LO 4), AP

DO IT! 3-4 Boyd Docker recorded the following transactions during the month of April.

Apr. 3	Cash	3,400	
	Service Revenue		3,400
	16 Rent Expense	500	
	Cash		500
	20 Salaries and Wages Expense	300	
	Cash		300

Post these entries to the Cash account of the general ledger to determine the ending balance in cash. The beginning balance in cash on April 1 was \$1,900.

Prepare a trial balance.

(LO 5), AP

DO IT! 3-5 The following accounts are taken from the ledger of Chillin' Company at December 31, 2017.

Notes Payable	\$20,000	Cash	\$6,000
Common Stock	25,000	Supplies	5,000
Equipment	76,000	Rent Expense	2,000
Dividends	8,000	Salaries and Wages Payable	3,000
Salaries and Wages Expense	38,000	Accounts Payable	9,000
Service Revenue	86,000	Accounts Receivable	8,000

Prepare a trial balance in good form.

EXERCISES

Analyze the effect of transactions.

(LO 1), C

E3-1 Selected transactions for Thyme Advertising Company, Inc. are listed here.

1. Issued common stock to investors in exchange for cash received from investors.
2. Paid monthly rent.
3. Received cash from customers when service was performed.
4. Billed customers for services performed.
5. Paid dividend to stockholders.
6. Incurred advertising expense on account.
7. Received cash from customers billed in (4).
8. Purchased additional equipment for cash.
9. Purchased equipment on account.

Instructions

Describe the effect of each transaction on assets, liabilities, and stockholders' equity. For example, the first answer is (1) Increase in assets and increase in stockholders' equity.

Analyze the effect of transactions on assets, liabilities, and stockholders' equity.

(LO 1), AP

E3-2 Brady Company entered into these transactions during May 2017, its first month of operations.

1. Stockholders invested \$40,000 in the business in exchange for common stock of the company.

2. Purchased computers for office use

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for \$30,000 from Ladd on account.

3. Paid \$4,000 cash for May rent on storage space.
4. Performed computer services worth \$19,000 on account.
5. Performed computer services for Wharton Construction Company for \$5,000 cash.
6. Paid Western States Power Co. \$8,000 cash for energy usage in May.
7. Paid Ladd for the computers purchased in (2).
8. Incurred advertising expense for May of \$1,300 on account.
9. Received \$12,000 cash from customers for contracts billed in (4).

Instructions

Using the following tabular analysis, show the effect of each transaction on the accounting equation. Put explanations for changes to Stockholders' Equity in the right-hand margin. Use Illustration 3-3 (page 99) as a model.

Assets				=	Liabilities		+	Stockholders' Equity			
Accounts					Accounts			Common		Retained Earnings	
Cash	+ Receivable	+ Equipment	=	Payable	+ Bonds	+ Stock	+ Revenues	- Expenses	- Dividends		

Determine effect of transactions on basic accounting equation.

(LO 1), AP

E3-3 During 2017, its first year of operations as a delivery service, Persimmon Corp. entered into the following transactions.

1. Issued shares of common stock to investors in exchange for \$100,000 in cash.
2. Borrowed \$45,000 by issuing bonds.
3. Purchased delivery trucks for \$60,000 cash.
4. Received \$16,000 from customers for services performed.
5. Purchased supplies for \$4,700 on account.
6. Paid rent of \$5,200.
7. Performed services on account for \$10,000.
8. Paid salaries of \$28,000.
9. Paid a dividend of \$11,000 to shareholders.

Instructions

Using the following tabular analysis, show the effect of each transaction on the accounting equation. Put explanations for changes to Stockholders' Equity in the right-hand margin. Use Illustration 3-3 (page 99) as a model.

Assets				=	Liabilities		+	Stockholders' Equity				
Accounts					Accounts			Common		Retained Earnings		
Cash	+ Receivable	+ Supplies	+ Equip-	=	Payable	+ Payable	+ Stock	+ Revenues	- Expenses	- Dividends		

Analyze transactions and compute net income.

(LO 1), AP

E3-4 A tabular analysis of the transactions made during August 2017 by Wolfe Company during its first month of operations is shown below. Each increase and decrease in stockholders' equity is explained.

Assets				=	Liabilities		+	Stockholders' Equity				
Accounts					Accounts			Common		Retained Earnings		
Cash	+ A/R	+ Supp.	+ Equip.	=	Payable	+ Payable	+ Stock	+ Rev.	- Exp.	- Div.		
1. +\$20,000							+\$20,000					Com. Stock
2. -1,000			+\$5,000		+\$4,000							
3. -750		+\$750										
4. +4,100	+\$5,400							-\$9,500				Serv. Rev.
5. -1,500					-1,500							
6. -2,000											-\$2,000	Div.
7. -800									-\$ 800			Rent Exp.
8. +450	-450											
9. -3,000									-3,000			Salar. Exp.
10.						+300			-300			Util. Exp.

Instructions

- (a) Describe each transaction.
- (b) Determine how much stockholders' equity increased for the month.
- (c) Compute the net income for the month.

Prepare an income statement, retained earnings statement, and balance sheet.

(LO 2), AP

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E3-5 The tabular analysis of transactions for Wolfe Company is presented in E3-4.

Instructions

Prepare an income statement and a retained earnings statement for August and a classified balance sheet at August 31, 2017.

Identify normal account balance and corresponding financial statement.

(LO 2), K

E3-6 The following accounts, in alphabetical order, were selected from recent financial statements of **Krispy Kreme Doughnuts, Inc.**

Accounts Payable	Interest Income
Accounts Receivable	Inventories
Common Stock	Prepaid Expenses
Depreciation Expense	Property and Equipment
Interest Expense	Revenues

Instructions

For each account, indicate (a) whether the normal balance is a debit or a credit, and (b) the financial statement—balance sheet or income statement—where the account should be presented.

Identify debits, credits, and normal balances and journalize transactions.

(LO 2, 3), AP

E3-7 Selected transactions for Front Room, an interior decorator corporation, in its first month of business, are as follows.

1. Issued stock to investors for \$15,000 in cash.
2. Purchased used car for \$10,000 cash for use in business.
3. Purchased supplies on account for \$300.
4. Billed customers \$3,700 for services performed.
5. Paid \$200 cash for advertising at the start of the business.
6. Received \$1,100 cash from customers billed in transaction (4).
7. Paid creditor \$300 cash on account.
8. Paid dividends of \$400 cash to stockholders.

Instructions

(a) For each transaction indicate (a) the basic type of account debited and credited (asset, liability, stockholders' equity); (b) the specific account debited and credited (Cash, Rent Expense, Service Revenue, etc.); (c) whether the specific account is increased or decreased; and (d) the normal balance of the specific account. Use the following format, in which transaction (1) is given as an example.

Trans- action	Account Debited				Account Credited			
	(a) Basic Type	(b) Specific Account	(c) Effect	(d) Normal Balance	(a) Basic Type	(b) Specific Account	(c) Effect	(d) Normal Balance
1	Asset	Cash	Increase	Debit	Stock- holders' equity	Common Stock	Increase	Credit

(b) Journalize the transactions. Do not provide explanations.

Analyze transactions and determine their effect on accounts.

(LO 2), C

E3-8 This information relates to McCall Real Estate Agency.

- Oct. 1 Stockholders invest \$30,000 in exchange for common stock of the corporation.
- 2 Hires an administrative assistant at an annual salary of \$36,000.
- 3 Buys office furniture for \$3,800, on account.
- 6 Sells a house and lot for E. C. Roads; commissions due from Roads, \$10,800 (not paid by Roads at this time).
- 10 Receives cash of \$140 as commission for acting as rental agent renting an apartment.
- 27 Pays \$700 on account for the office furniture purchased on October 3.
- 30 Pays the administrative assistant \$3,000 in salary for October.

Instructions

Prepare the debit–credit analysis for each transaction, as illustrated on pages 111–116.

Journalize transactions.

(LO 3), AP

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E3-9 Transaction data for McCall Real Estate Agency are presented in E3-8.

Instructions

Journalize the transactions. Do not provide explanations.

Journalize a series of transactions.

(LO 3), AP

E3-10 The May transactions of Chulak Corporation were as follows.

- May 4 Paid \$700 due for supplies previously purchased on account.
- 7 Performed advisory services on account for \$6,800.
- 8 Purchased supplies for \$850 on account.
- 9 Purchased equipment for \$1,000 in cash.
- 17 Paid employees \$530 in cash.
- 22 Received bill for equipment repairs of \$900.
- 29 Paid \$1,200 for 12 months of insurance policy. Coverage begins June 1.

Instructions

Journalize the transactions. Do not provide explanations.

Journalize a series of transactions.

(LO 3), AP

E3-11 Selected transactions for Sophie's Dog Care are as follows during the month of March.

- March 1 Paid monthly rent of \$1,200.
- 3 Performed services for \$140 on account.
- 5 Performed services for cash of \$75.
- 8 Purchased equipment for \$600. The company paid cash of \$80 and the balance was on account.
- 12 Received cash from customers billed on March 3.
- 14 Paid wages to employees of \$525.
- 22 Paid utilities of \$72.
- 24 Borrowed \$1,500 from Grafton State Bank by signing a note.
- 27 Paid \$220 to repair service for plumbing repairs.
- 28 Paid balance amount owed from equipment purchase on March 8.
- 30 Paid \$1,800 for six months of insurance.

Instructions

Journalize the transactions. Do not provide explanations.

Record journal entries.

(LO 3), AP

E3-12 On April 1, Adventures Travel Agency, Inc. began operations. The following transactions were completed during the month.

1. Issued common stock for \$24,000 cash.
2. Obtained a bank loan for \$7,000 by issuing a note payable.
3. Paid \$11,000 cash to buy equipment.
4. Paid \$1,200 cash for April office rent.
5. Paid \$1,450 for supplies.
6. Purchased \$600 of advertising in the *Daily Herald*, on account.
7. Performed services for \$18,000: cash of \$2,000 was received from customers, and the balance of \$16,000 was billed to customers on account.
8. Paid \$400 cash dividend to stockholders.
9. Paid the utility bill for the month, \$2,000.
10. Paid *Daily Herald* the amount due in transaction (6).
11. Paid \$40 of interest on the bank loan obtained in transaction (2).
12. Paid employees' salaries, \$6,400.
13. Received \$12,000 cash from customers billed in transaction (7).
14. Paid income tax, \$1,500.

Instructions

Journalize the transactions. Do not provide explanations.

Post journal entries and prepare a trial balance.

(LO 4, 5), AP

E3-13 Transaction data and journal entries for McCall Real Estate Agency are presented in E3-8 and E3-9.

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Instructions

- (a) Post the transactions to T-accounts.
- (b) Prepare a trial balance at October 31, 2017.

Analyze transactions, prepare journal entries, and post transactions to T-accounts.

(LO 1, 3, 4), AP

Cash				Common Stock			
Oct. 1	7,000	Oct. 4	400			Oct. 1	7,000
10	980	12	1,500			25	2,000
10	8,000	15	250				
20	700	30	300				
25	2,000	31	500				
Accounts Receivable				Dividends			
Oct. 6	800	Oct. 20	700	Oct. 30	300		
20	920						
Supplies				Service Revenue			
Oct. 4	400	Oct. 31	180			Oct. 6	800
						10	980
						20	920
Equipment				Salaries and Wages Expense			
Oct. 3	3,000			Oct. 31	500		
Notes Payable				Supplies Expense			
		Oct. 10	8,000	Oct. 31	180		
Accounts Payable				Rent Expense			
Oct. 12	1,500	Oct. 3	3,000	Oct. 15	250		

Instructions

- (a) Reproduce the journal entries for only the transactions that **occurred on October 1, 10, and 20**, and provide explanations for each.
 (b) Prepare a trial balance at October 31, 2017. (*Hint*: Compute ending balances of T-accounts first.)

Journalize transactions, post transactions to T-accounts, and prepare trial balance.

(LO 3, 4, 5), AP

E3-18 Beyers Corporation provides security services. Selected transactions for Beyers are presented below.

- Oct. 1 Issued common stock in exchange for \$66,000 cash from investors.
 2 Hired part-time security consultant. Salary will be \$2,000 per month. First day of work will be October 15.
 4 Paid 1 month of rent for building for \$2,000.
 7 Purchased equipment for \$18,000, paying \$4,000 cash and the balance on account.
 8 Paid \$500 for advertising.
 10 Received bill for equipment repair cost of \$390.
 12 Provided security services for event for \$3,200 on account.
 16 Purchased supplies for \$410 on account.
 21 Paid balance due from October 7 purchase of equipment.
 24 Received and paid utility bill for \$148.
 27 Received payment from customer for October 12 services performed.
 31 Paid employee salaries and wages of \$5,100.

Instructions

Journalize the transactions. Do not provide explanations.

Post the transactions to T-accounts.

Prepare a trial balance at October 31, 2017. (*Hint*: Compute ending balances of T-accounts first.)

Analyze errors and their effects on trial balance.

(LO 5), AN

E3-19 The bookkeeper for Birmingham Corporation made these errors in journalizing and posting.

- A credit posting of \$400 to Accounts Receivable was omitted.
- A debit posting of \$750 for Prepaid Insurance was debited to Insurance Expense.
- A

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collection on account of \$100 was journalized and posted as a debit to Cash \$100 and a credit to Accounts Payable \$100.

4. A credit posting of \$300 to Income Taxes Payable was made twice.
5. A cash purchase of supplies for \$250 was journalized and posted as a debit to Supplies \$25 and a credit to Cash \$25.
6. A debit of \$395 to Advertising Expense was posted as \$359.

Instructions

For each error, indicate (a) whether the trial balance will balance; if the trial balance will not balance, indicate (b) the amount of the difference and (c) the trial balance column that will have the larger total. Consider each error separately. Use the following form, in which error 1 is given as an example.

	(a)	(b)	(c)
	Error In Balance	Difference	Larger Column
1	No	\$400	Debit

Prepare a trial balance and financial statements.

(LO 5), AP

E3-20 The accounts in the ledger of Rapid Delivery Service contain the following balances on July 31, 2017.

Accounts Receivable	\$13,400
Accounts Payable	8,400
Cash	?
Equipment	59,360
Maintenance and Repairs Expense	1,958
Insurance Expense	900
Notes Payable (due 2020)	28,450
Prepaid Insurance	\$ 2,200
Service Revenue	15,500
Dividends	700
Common Stock	40,000
Salaries and Wages Expense	7,428
Salaries and Wages Payable	820
Retained Earnings (July 1, 2017)	5,200

Instructions

- (a) Prepare a trial balance with the accounts arranged as illustrated in the chapter, and fill in the missing amount for Cash.
- (b) Prepare an income statement, a retained earnings statement, and a classified balance sheet for the month of July 2017.

Classify transactions as cash-flow activities.

(LO 5), AP

E3-21 Review the transactions listed in E3-1 for Thyme Advertising Company. Classify each transaction as either an operating activity, investing activity, or financing activity, or if no cash is exchanged, as a noncash event.

Classify transactions as cash-flow activities.

(LO 5), AP

E3-22 Review the transactions listed in E3-3 for Persimmon Corp. Classify each transaction as either an operating activity, investing activity, or financing activity, or if no cash is exchanged, as a noncash event.

EXERCISES: SET B AND CHALLENGE EXERCISES

Visit the book's companion website, at www.wiley.com/college/kimmel, and choose the Student Companion site to access Exercises: Set B and Challenge Exercises.

PROBLEMS: SET A

Analyze transactions and compute net income.

(LO 1), AP



P3-1A On April 1, Wonder Travel Agency Inc. was established. These transactions were completed during the month.

1. Stockholders invested \$30,000 cash in the company in exchange for common stock.
2. Paid \$900 cash for April office rent.
3. Purchased office equipment for \$3,400 cash.
4. Purchased \$200 of advertising in the *Chicago Tribune*, on account.

5. Paid \$500 cash for office supplies.
6. Performed services worth \$12,000. Cash of \$3,000 is received from customers, and the balance of \$9,000 is billed to customers on account.
7. Paid \$400 cash dividend.
8. Paid

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Chicago Tribune amount due in transaction (4).

- 9. Paid employees' salaries \$1,800.
- 10. Received \$9,000 in cash from customers billed previously in transaction (6).

Instructions

(a) Prepare a tabular analysis of the transactions using these column headings: Cash, Accounts Receivable, Supplies, Equipment, Accounts Payable, Common Stock, and Retained Earnings (with separate columns for Revenues, Expenses, and Dividends). Include margin explanations for any changes in Retained Earnings.

(a) Cash \$34,800

Total assets \$38,700

(b) From an analysis of the Retained Earnings columns, compute the net income or net loss for April.

Analyze transactions and prepare financial statements.



(LO 1, 2), AP

P3-2A Nona Curry started her own consulting firm, Curry Consulting Inc., on May 1, 2017. The following transactions occurred during the month of May.

- May 1 Stockholders invested \$15,000 cash in the business in exchange for common stock.
- 2 Paid \$600 for office rent for the month.
- 3 Purchased \$500 of supplies on account.
- 5 Paid \$150 to advertise in the *County News*.
- 9 Received \$1,400 cash for services performed.
- 12 Paid \$200 cash dividend.
- 15 Performed \$4,200 of services on account.
- 17 Paid \$2,500 for employee salaries.
- 20 Paid for the supplies purchased on account on May 3.
- 23 Received a cash payment of \$1,200 for services performed on account on May 15.
- 26 Borrowed \$5,000 from the bank on a note payable.
- 29 Purchased office equipment for \$2,000 paying \$200 in cash and the balance on account.
- 30 Paid \$180 for utilities.

Instructions

(a) Show the effects of the previous transactions on the accounting equation using the following format. Assume the note payable is to be repaid within the year.

Assets				=	Liabilities		+	Stockholders' Equity			
Date	Cash	+ Accounts Receivable	+ Supplies + Equipment	=	Notes Payable	+ Accounts Payable	+	Common Stock	+ Retained Earnings	- Expenses	- Dividends

Include margin explanations for any changes in Retained Earnings.

(a) Cash \$18,270

Total assets \$23,770

(b) Prepare an income statement for the month of May 2017.

(b) Net income \$2,170

(c) Prepare a classified balance sheet at May 31, 2017.

Analyze transactions and prepare an income statement, retained earnings statement, and balance sheet.



(LO 1, 2), AP

P3-3A Bindy Crawford created a corporation providing legal services, Bindy Crawford Inc., on July 1, 2017. On July 31 the balance sheet showed Cash \$4,000, Accounts Receivable \$2,500, Supplies \$500, Equipment \$5,000, Accounts Payable \$4,200, Common Stock \$6,200, and Retained Earnings \$1,600. During August, the following transactions occurred.

- Aug. 1 Collected \$1,100 of accounts receivable due from customers.
- 4 Paid \$2,700 cash for accounts payable due.
- 9 Performed services worth \$5,400, of which \$3,600 is collected in cash and the balance is due in September.
- 15 Purchased additional office equipment for \$4,000, paying \$700 in cash and the balance on account.
- 19 Paid salaries \$1,400, rent for August \$700, and advertising expenses \$350.
- 23 Paid a cash dividend of \$700.
- 26 Borrowed \$5,000 from American Federal Bank; the money was borrowed on a 4-month note payable.
- 31 Incurred utility expenses for the month on account \$380.

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Instructions

- (a) Prepare a tabular analysis of the August transactions beginning with July 31 balances. The column heading should be Cash + Accounts Receivable + Supplies + Equipment = Notes Payable + Accounts Payable + Common Stock + Retained Earnings + Revenue. Include margin explanations for any changes in Retained Earnings.

(a) Cash \$7,150

- (b) Prepare an income statement for August, a retained earnings statement for August, and a classified balance sheet at August 31.

(b) Net income \$2,570

Ret. earnings \$3,470

Journalize a series of transactions.

(LO 3), AP



P3-4A Bradley's Miniature Golf and Driving Range Inc. was opened on March 1 by Bob Dean. These selected events and transactions occurred during March.

- Mar. 1 Stockholders invested \$50,000 cash in the business in exchange for common stock of the corporation.
- 3 Purchased Sneed's Golf Land for \$38,000 cash. The price consists of land \$23,000, building \$9,000, and equipment \$6,000. (Record this in a single entry.)
- 5 Advertised the opening of the driving range and miniature golf course, paying advertising expenses of \$1,200 cash.
- 6 Paid cash \$2,400 for a 1-year insurance policy.
- 10 Purchased golf clubs and other equipment for \$5,500 from Tahoe Company, payable in 30 days.
- 18 Received golf fees of \$1,600 in cash from customers for golf services performed.
- 19 Sold 100 coupon books for \$25 each in cash. Each book contains 10 coupons that enable the holder to play one round of miniature golf or to hit one bucket of golf balls. (*Hint:* The revenue should not be recognized until the customers use the coupons.)
- 25 Paid a \$500 cash dividend.
- 30 Paid salaries of \$800.
- 30 Paid Tahoe Company in full for equipment purchased on March 10.
- 31 Received \$900 in cash from customers for golf services performed.

The company uses these accounts: Cash, Prepaid Insurance, Land, Buildings, Equipment, Accounts Payable, Unearned Service Revenue, Common Stock, Retained Earnings, Dividends, Service Revenue, Advertising Expense, and Salaries and Wages Expense.

Instructions

Journalize the March transactions, including explanations. Bradley's records golf fees as service revenue.

Journalize transactions, post, and prepare a trial balance.

(LO 3, 4, 5), AP



P3-5A Ayala Architects incorporated as licensed architects on April 1, 2017. During the first month of the operation of the business, these events and transactions occurred:

- Apr. 1 Stockholders invested \$18,000 cash in exchange for common stock of the corporation.
- 1 Hired a secretary-receptionist at a salary of \$375 per week, payable monthly.
- 2 Paid office rent for the month \$900.
- 3 Purchased architectural supplies on account from Birmingham Company \$1,300.
- 10 Completed blueprints on a carport and billed client \$1,900 for services.
- 11 Received \$700 cash advance from M. Jason to design a new home.
- 20 Received \$2,800 cash for services completed and delivered to S. Melvin.
- 30 Paid secretary-receptionist for the month \$1,500.
- 30 Paid \$300 to Birmingham Company for accounts payable due.

The company uses these accounts: Cash, Accounts Receivable, Supplies, Accounts Payable, Unearned Service Revenue, Common Stock, Service Revenue, Salaries and Wages Expense, and Rent Expense.

Instructions

- (a) Journalize the transactions, including explanations.
- (b) Post to the ledger T-accounts.
- (c) Prepare a trial balance on April 30, 2017.

(c) Cash \$18,800

Tot. trial balance \$24,400

Journalize transactions, post, and prepare a trial balance.

(LO 3, 4, 5), AP



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P3-6A This is the trial balance of Lacey Company on September 30.

LACEY COMPANY
Trial Balance
September 30, 2017

	<u>Debit</u>	<u>Credit</u>
Cash	\$19,200	
Accounts Receivable	2,600	
Supplies	2,100	
Equipment	8,000	
Accounts Payable		\$ 4,800
Unearned Service Revenue		1,100
Common Stock		15,000
Retained Earnings		11,000
	<u>\$31,900</u>	<u>\$31,900</u>

The October transactions were as follows.

- Oct. 5 Received \$1,300 in cash from customers for accounts receivable due.
- 10 Billed customers for services performed \$5,100.
- 15 Paid employee salaries \$1,200.
- 17 Performed \$600 of services in exchange for cash.
- 20 Paid \$1,900 to creditors for accounts payable due.
- 29 Paid a \$300 cash dividend.
- 31 Paid utilities \$400.

Instructions

- (a) Prepare a general ledger using T-accounts. Enter the opening balances in the ledger accounts as of October 1. Provision should be made for these additional accounts: Dividends, Service Revenue, Salaries and Wages Expense, and Utilities Expense. (*Hint: The October 1 beginning amounts are the September 30 balances in the trial balance above.*)
- (b) Journalize the transactions, including explanations.
- (c) Post to the ledger accounts.
- (d) Prepare a trial balance on October 31, 2017.

(d) Cash \$17,300

Tot. trial balance \$35,700

Prepare a correct trial balance.

(LO 5), AN



P3-7A This trial balance of Washburn Co. does not balance.

WASHBURN CO.
Trial Balance
June 30, 2017

	<u>Debit</u>	<u>Credit</u>
Cash		\$ 3,090
Accounts Receivable	\$ 3,190	
Supplies	800	
Equipment	3,000	
Accounts Payable		3,686
Unearned Service Revenue	1,200	
Common Stock		9,000
Dividends	800	
Service Revenue		3,480
Salaries and Wages Expense	3,600	
Utilities Expense	910	
	<u>\$13,500</u>	<u>\$19,256</u>

Each of the listed accounts has a normal balance per the general ledger. An examination of the ledger and journal reveals the following errors:

1. Cash received from a customer on account was debited for \$780, and Accounts Receivable was credited for the same amount. The actual collection was for \$870.
2. The purchase of a printer on account for \$340 was recorded as a debit to Supplies for \$340 and a credit to Accounts Payable for \$340.
3. Services were performed on account for a client for \$900. Accounts Receivable was debited for \$90 and Service Revenue was credited for \$900.
4. A debit posting to Salaries and Wages Expense of \$700 was omitted.
5. A payment on account

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for \$206 was credited to Cash for \$206 and credited to Accounts Payable for \$260.

6. Payment of a \$600 cash dividend to Washburn's stockholders was debited to Salaries and Wages Expense for \$600 and credited to Cash for \$600.

Instructions

Prepare the correct trial balance. (*Hint:* All accounts have normal balances.)

Tot. trial balance \$16,900

Journalize transactions, post, and prepare a trial balance.

(LO 3, 4, 5), AP



P3-8A The Triquel Theater Inc. was recently formed. It began operations in March 2017. The Triquel is unique in that it will show only triple features of sequential theme movies. On March 1, the ledger of The Triquel showed Cash \$16,000, Land \$38,000, Buildings (concession stand, projection room, ticket booth, and screen) \$22,000, Equipment \$16,000, Accounts Payable \$12,000, and Common Stock \$80,000. During the month of March, the following events and transactions occurred.

- Mar. 2 Rented the first three *Star Wars* movies (*Star Wars*®, *The Empire Strikes Back*, and *The Return of the Jedi*) to be shown for the first three weeks of March. The film rental was \$10,000; \$2,000 was paid in cash and \$8,000 will be paid on March 10.
- 3 Ordered the first three *Star Trek* movies to be shown the last 10 days of March. It will cost \$500 per night.
- 9 Received \$9,900 cash from admissions.
- 10 Paid balance due on *Star Wars* movies' rental and \$2,900 on March 1 accounts payable.
- 11 The Triquel Theater contracted with R. Lazlo to operate the concession stand. Lazlo agrees to pay The Triquel 15% of gross receipts, payable monthly, for the rental of the concession stand.
- 12 Paid advertising expenses \$500.
- 20 Received \$8,300 cash from customers for admissions.
- 20 Received the *Star Trek* movies and paid rental fee of \$5,000.
- 31 Paid salaries of \$3,800.
- 31 Received statement from R. Lazlo showing gross receipts from concessions of \$10,000 and the balance due to The Triquel of \$1,500 ($\$10,000 \times .15$) for March. Lazlo paid half the balance due and will remit the remainder on April 5.
- 31 Received \$20,000 cash from customers for admissions.

In addition to the accounts identified above, the chart of accounts includes Accounts Receivable, Service Revenue, Rent Revenue, Advertising Expense, Rent Expense, and Salaries and Wages Expense.

Instructions

- (a) Using T-accounts, enter the beginning balances to the ledger.
- (b) Journalize the March transactions, including explanations. The Triquel records admission revenue as service revenue, concession revenue as sales revenue, and film rental expense as rent expense.
- (c) Post the March journal entries to the ledger.
- (d) Prepare a trial balance on March 31, 2017.

(d) Cash \$ 32,750
Tot. trial balance \$128,800

Journalize transactions, post, and prepare a trial balance.

(LO 3, 4, 5), AP

P3-9A On July 31, 2017, the general ledger of Hills Legal Services Inc. showed the following balances: Cash \$4,000, Accounts Receivable \$1,500, Supplies \$500, Equipment \$5,000, Accounts Payable \$4,100, Common Stock \$3,500, and Retained Earnings \$3,400. During August, the following transactions occurred.

- Aug. 3 Collected \$1,200 of accounts receivable due from customers.
- 5 Received \$1,300 cash for issuing common stock to new investors.
- 6 Paid \$2,700 cash on accounts payable.
- 7 Performed legal services of \$6,500, of which \$3,000 was collected in cash and the remainder was due on account.
- 12 Purchased additional equipment for \$1,200, paying \$400 in cash and the balance on account.
- 14 Paid salaries \$3,500, rent \$900, and advertising expenses \$275 for the month of August.
- 18 Collected the balance for the services performed on August 7.
- 20 Paid cash dividend of \$500 to stockholders.
- 24 Billed a client

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\$1,000 for legal services performed.

- 26 Received \$2,000 from Laurentian Bank; the money was borrowed on a bank note payable that is due in 6 months.
- 27 Agreed to perform legal services for a client in September for \$4,500. The client will pay the amount owing after the services have been performed.
- 28 Received the utility bill for the month of August in the amount of \$275; it is not due until September 15.
- 31 Paid income tax for the month \$500.

Instructions

- (a) Using T-accounts, enter the beginning balances to the ledger.
- (b) Journalize the August transactions.
- (c) Post the August journal entries to the ledger.
- (d) Prepare a trial balance on August 31, 2017.

(d) Cash	\$6,225	
Tot. trial balance		\$20,175

Journalize transactions, post, and prepare trial balance.

(LO 3, 4, 5), AP

P3-10A Pamper Me Salon Inc.'s general ledger at April 30, 2017, included the following: Cash \$5,000, Supplies \$500, Equipment \$24,000, Accounts Payable \$2,100, Notes Payable \$10,000, Unearned Service Revenue (from gift certificates) \$1,000, Common Stock \$5,000, and Retained Earnings \$11,400. The following events and transactions occurred during May.

- May 1 Paid rent for the month of May \$1,000.
- 4 Paid \$1,100 of the account payable at April 30.
- 7 Issued gift certificates for future services for \$1,500 cash.
- 8 Received \$1,200 cash from customers for services performed.
- 14 Paid \$1,200 in salaries to employees.
- 15 Received \$800 in cash from customers for services performed.
- 15 Customers receiving services worth \$700 used gift certificates in payment.
- 21 Paid the remaining accounts payable from April 30.
- 22 Received \$1,000 in cash from customers for services performed.
- 22 Purchased supplies of \$700 on account. All of these were used during the month.
- 25 Received a bill for advertising for \$500. This bill is due on June 13.
- 25 Received and paid a utilities bill for \$400.
- 29 Received \$1,700 in cash from customers for services performed.
- 29 Customers receiving services worth \$600 used gift certificates in payment.
- 31 Interest of \$50 was paid on the note payable.
- 31 Paid \$1,200 in salaries to employees.
- 31 Paid income tax payment for the month \$150.

Instructions

- (a) Using T-accounts, enter the beginning balances in the general ledger as of April 30, 2017.
- (b) Journalize the May transactions.
- (c) Post the May journal entries to the general ledger.
- (d) Prepare a trial balance on May 31, 2017.

(d) Cash	\$5,100	
Tot. trial balance		\$34,800

Analyze errors and their effects on the trial balance.

(LO 5), AN

P3-11A The bookkeeper for Roger's Dance Studio made the following errors in journalizing and posting.

- 1. A credit to Supplies of \$600 was omitted.
- 2. A debit posting of \$300 to Accounts Payable was inadvertently debited to Accounts Receivable.
- 3. A purchase of supplies on account of \$450 was debited to Supplies for \$540 and credited to Accounts Payable for \$540.
- 4. A credit posting of \$680 to Interest Payable was posted twice.
- 5. A debit posting to Income Taxes Payable for \$250 and a credit posting to Cash for \$250 were made twice.
- 6. A debit posting for \$1,200 of Dividends was inadvertently posted to Salaries and Wages Expense instead.
- 7. A credit to Service Revenue for \$450 was inadvertently posted as a debit to Service Revenue.
- 8. A credit to Accounts Receivable of \$250 was credited to Accounts Payable.

Instructions

For each error, indicate (a) whether the trial balance will balance, (b) the amount of the difference if the trial balance will not balance, and (c) the trial balance column that will have the larger total.

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Consider each error separately. Use the following form, in which error 1 is given as an example.

	(a)	(b)	(c)
Error	In Balance	Difference	Larger Column
1	No	\$600	Debit

PROBLEMS: SET B AND SET C

Visit the book's companion website, at www.wiley.com/college/kimmel, and choose the Student Companion site to access Problems: Set B and Set C.

CONTINUING PROBLEM

Cookie Creations

(Note: This is a continuation of the Cookie Creations problem from Chapters 1 and 2.)

CC3 In November 2017, after having incorporated Cookie Creations Inc., Natalie begins operations. She has decided not to pursue the offer to supply cookies to Biscuits. Instead, the company will focus on offering cooking classes.



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Go to the book's companion website, www.wiley.com/college/kimmel, to see the completion of this problem.

EXPAND YOUR | CRITICAL THINKING

FINANCIAL REPORTING PROBLEM: Apple Inc.



E CT3-1 The financial statements of **Apple Inc.** in Appendix A at the back of this textbook contain the following selected accounts, all in thousands of dollars.

Common Stock	\$ 23,313
Accounts Payable	30,196
Accounts Receivable	17,460
Selling, General, and Administrative Expenses	11,993
Inventories	2,111
Net Property, Plant, and Equipment	20,624
Net Sales	182,795

Instructions

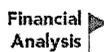
- (a) What is the increase and decrease side for each account? What is the normal balance for each account?
 (b) Identify the probable other account in the transaction and the effect on that account when:

1. Accounts Receivable is decreased.
2. Accounts Payable is decreased.
3. Inventories is increased.

(c) Identify the other account(s) that ordinarily would be involved when:

1. Interest Expense is increased.
2. Property, Plant, and Equipment is increased.

COMPARATIVE ANALYSIS PROBLEM: Columbia Sportswear Company vs. VF Corporation



E CT3-2 The financial statements of **Columbia Sportswear Company** are presented in Appendix B. Financial statements of **VF Corporation** are presented in Appendix C.

Instructions

- (a) Based on the information contained in these financial statements, determine the normal balance for:

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Columbia Sportswear	VF
(1) Accounts Receivable	(1) Inventories
(2) Net Property, Plant, and Equipment	(2) Income Taxes
(3) Accounts Payable	(3) Accrued Liabilities
(4) Retained Earnings	(4) Common Stock
(5) Net Sales	(5) Interest Expense

(b) Identify the other account ordinarily involved when:

1. Accounts Receivable is increased.
2. Notes Payable is decreased.
3. Equipment is increased.
4. Interest Revenue is increased.

COMPARATIVE ANALYSIS PROBLEM: Amazon.com, Inc. vs. Wal-Mart Stores, Inc.

Financial Analysis

E **CT3-3 Amazon.com, Inc.**'s financial statements are presented in Appendix **B**. Financial statements of **Wal-Mart Stores, Inc.** are presented in Appendix **E**.

Instructions

(a) Based on the information contained in the financial statements, determine the normal balance of the listed accounts for each company.

Amazon	Wal-Mart
1. Interest Expense	1. Product Revenues
2. Cash and Cash Equivalents	2. Inventories
3. Accounts Payable	3. Cost of Sales

(b) Identify the other account ordinarily involved when:

1. Accounts Receivable is increased.
2. Interest Expense is increased.
3. Salaries and Wages Payable is decreased.
4. Service Revenue is increased.

INTERPRETING FINANCIAL STATEMENTS

Financial Analysis

E **CT3-4 Chieftain International, Inc.**, is an oil and natural gas exploration and production company. A recent balance sheet reported \$208 million in assets with only \$4.6 million in liabilities, all of which were short-term accounts payable.

During the year, Chieftain expanded its holdings of oil and gas rights, drilled 37 new wells, and invested in expensive 3-D seismic technology. The company generated \$19 million cash from operating activities and paid no dividends. It had a cash balance of \$102 million at the end of the year.

Instructions

- (a) Name at least two advantages to Chieftain from having no long-term debt. Can you think of disadvantages?
- (b) What are some of the advantages to Chieftain from having this large a cash balance? What is a disadvantage?
- (c) Why do you suppose Chieftain has the \$4.6 million balance in accounts payable, since it appears that it could have made all its purchases for cash?

REAL-WORLD FOCUS

E **CT3-5 Purpose:** This activity provides information about career opportunities for CPAs.

Address: www.startherereplaces.com/why-accounting, or go to www.wiley.com/college/kimmel

Instructions

Go the address shown above and then answer the following questions.

- (a) Where do CPAs work?
- (b) What skills does a CPA need?
- (c) What

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is the salary range for a CPA at a large firm during the first three years? What is the salary range for chief financial officers and treasurers at large corporations?

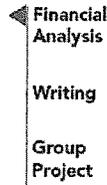
S CT3-6 The January 27, 2011, edition of the *New York Times* contains an article by Richard Sandomir entitled "N.F.L. Finances, as Seen Through Packers' Records." The article discusses the fact that the **Green Bay Packers** are the only NFL team that publicly publishes its annual report.

Instructions

Read the article and answer the following questions.

- (a) Why are the Green Bay Packers the only professional football team to publish and distribute an annual report?
- (b) Why is the football players' labor union particularly interested in the Packers' annual report?
- (c) In addition to the players' labor union, what other outside party might be interested in the annual report?
- (d) Even though the Packers' revenue increased in recent years, the company's operating profit fell significantly. How does the article explain this decline?

DECISION-MAKING ACROSS THE ORGANIZATION



E CT3-7 Saira Morrow operates Dressage Riding Academy, Inc. The academy's primary sources of revenue are riding fees and lesson fees, which are provided on a cash basis. Saira also boards horses for owners, who are billed monthly for boarding fees. In a few cases, boarders pay in advance of expected use. For its revenue transactions, the academy maintains these accounts: Cash, Accounts Receivable, Unearned Service Revenue, and Service Revenue.

The academy owns 10 horses, a stable, a riding corral, riding equipment, and office equipment. These assets are accounted for in the following accounts: Horses, Buildings, and Equipment.

The academy employs stable helpers and an office employee, who receive weekly salaries. At the end of each month, the mail usually brings bills for advertising, utilities, and veterinary service. Other expenses include feed for the horses and insurance. For its expenses, the academy maintains the following accounts: Supplies, Prepaid Insurance, Accounts Payable, Salaries and Wages Expense, Advertising Expense, Utilities Expense, Maintenance and Repairs Expense, Supplies Expense, and Insurance Expense.

Saira's sole source of personal income is dividends from the academy. Thus, the corporation declares and pays periodic dividends. To account for stockholders' equity in the business and dividends, two accounts are maintained: Common Stock and Dividends.

During the first month of operations, an inexperienced bookkeeper was employed. Saira asks you to review the following eight entries of the 50 entries made during the month. In each case, the explanation for the entry is correct.

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May 1	Cash Unearned Service Revenue (Issued common stock in exchange for \$15,000 cash)	15,000	15,000
5	Cash Service Revenue (Received \$250 cash for lesson fees)	250	250
7	Cash Service Revenue (Received \$500 for boarding of horses beginning June 1)	500	500
9	Supplies Expense Cash (Purchased estimated 5 months' supply of feed and hay for \$1,500 on account)	1,500	1,500
14	Equipment Cash (Purchased desk and other office equipment for \$800 cash)	80	800
15	Salaries and Wages Expense Cash (Issued check to Saira Morrow for personal use)	400	400
20	Cash Service Revenue (Received \$154 cash for riding fees)	145	154
31	Maintenance and Repairs Expense Accounts Receivable (Received bill of \$75 from carpenter for repair services performed)	75	75

Instructions

With the class divided into groups, answer the following.

- For each journal entry that is correct, so state. For each journal entry that is incorrect, prepare the entry that should have been made by the bookkeeper.
- Which of the incorrect entries would prevent the trial balance from balancing?
- What was the correct net income for May, assuming the bookkeeper originally reported net income of \$4,500 after posting all 50 entries?
- What was the correct cash balance at May 31, assuming the bookkeeper reported a balance of \$12,475 after posting all 50 entries?

COMMUNICATION ACTIVITY

S CT3-8 Klean Sweep Company offers home cleaning service. Two recurring transactions for the company are billing customers for services performed and paying employee salaries. For example, on March 15 bills totaling \$6,000 were sent to customers, and \$2,000 was paid in salaries to employees.

Instructions

Write a memorandum to your instructor that explains and illustrates the steps in the recording process for each of the March 15 transactions. Use the format illustrated in the textbook under the heading "The Recording Process Illustrated" (pp. 111–116).

ETHICS CASE

E CT3-9 Vanessa Jones is the assistant chief accountant at IBT Company, a manufacturer of computer chips and cellular phones. The company presently has total sales of \$20 million. It is the end of the first quarter and Vanessa is hurriedly trying to prepare a trial balance so that quarterly financial statements can be prepared and released to management and the regulatory agencies. The total credits on the trial balance exceed the debits by \$1,000.

In order to meet the 4 p.m. deadline, Vanessa decides to force the debits and credits into balance by adding the amount of the difference to the Equipment account. She chose Equipment because it is one of the larger account balances; percentage-wise, it will be the least misstated. Vanessa plugs the difference! She believes that the difference is quite small and will not affect anyone's decisions. She wishes that she had another few days to find the error but realizes that the financial statements are already late.

Instructions

- Who are the stakeholders in this situation?
- What ethical issues are involved?
- What are Vanessa's alternatives?

E CT3-10 The July 28, 2007, issue of the *Wall Street Journal* includes an article by Kathryn Kranhold entitled "GE's Accounting Draws Fresh Focus on News of Improper Sales Bookings."

Instructions

Read the article and answer the following questions.

- What improper activity did the employees at GE engage in?
- Why might the employees have engaged in this activity?
- What were

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the implications for the employees who engaged in this activity?

(d) What does it mean to "restate" financial results? Why didn't GE restate its results to correct for the improperly reported locomotive sales?

ALL ABOUT YOU

E CT3-11 In their annual reports to stockholders, companies must report or disclose information about all liabilities, including potential liabilities related to environmental clean-up. There are many situations in which you will be asked to provide personal financial information about your assets, liabilities, revenues, and expenses. Sometimes you will face difficult decisions regarding what to disclose and how to disclose it.

Instructions

Suppose that you are putting together a loan application to purchase a home. Based on your income and assets, you qualify for the mortgage loan, but just barely. How would you address each of the following situations in reporting your financial position for the loan application? Provide responses for each of the following questions.

- (a) You signed a guarantee for a bank loan that a friend took out for \$20,000. If your friend doesn't pay, you will have to pay. Your friend has made all of the payments so far, and it appears he will be able to pay in the future.
- (b) You were involved in an auto accident in which you were at fault. There is the possibility that you may have to pay as much as \$50,000 as part of a settlement. The issue will not be resolved before the bank processes your mortgage request.
- (c) The company at which you work isn't doing very well, and it has recently laid off employees. You are still employed, but it is quite possible that you will lose your job in the next few months.



A Look at IFRS

LEARNING OBJECTIVE 6

Compare the procedures for the recording process under GAAP and IFRS.

International companies use the same set of procedures and records to keep track of transaction data. Thus, the material in [Chapter 4](#) dealing with the account, general rules of debit and credit, and steps in the recording process—the journal, ledger, and chart of accounts—is the same under both GAAP and IFRS.

KEY POINTS

Following are the key similarities and differences between GAAP and IFRS as related to the recording process.

Similarities

- Transaction analysis is the same under IFRS and GAAP.
- Both the IASB and the FASB go beyond the basic definitions provided in the textbook for the key elements of financial statements, that is assets, liabilities, equity, revenues, and expenses. The implications of the expanded definitions are discussed in more advanced accounting courses.
- As shown in the textbook, dollar signs are typically used only in the trial balance and the financial statements. The same practice is followed under IFRS, using the currency of the country where the reporting company is headquartered.
- A trial balance under IFRS follows the same format as shown in the textbook.

Differences

IFRS relies less on historical cost and more on fair value than do FASB standards.

Internal controls

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are a system of checks and balances designed to prevent and detect fraud and errors. While most public U.S. companies have these systems in place, many non-U.S. companies have never completely documented the controls nor had an independent auditor attest to their effectiveness.

LOOKING TO THE FUTURE

The basic recording process shown in this textbook is followed by companies around the globe. It is unlikely to change in the future. The definitional structure of assets, liabilities, equity, revenues, and expenses may change over time as the IASB and FASB evaluate their overall conceptual framework for establishing accounting standards.

IFRS Practice

IFRS SELF-TEST QUESTIONS

1. Which statement is **correct** regarding IFRS?
 - (a) IFRS reverses the rules of debits and credits, that is, debits are on the right and credits are on the left.
 - (b) IFRS uses the same process for recording transactions as GAAP.
 - (c) The chart of accounts under IFRS is different because revenues follow assets.
 - (d) None of the above statements are correct.
2. The expanded accounting equation under IFRS is as follows:
 - (a) $\text{Assets} = \text{Liabilities} + \text{Common Stock} + \text{Retained Earnings} + \text{Revenues} - \text{Expenses} + \text{Dividends}$.
 - (b) $\text{Assets} + \text{Liabilities} = \text{Common Stock} + \text{Retained Earnings} + \text{Revenues} - \text{Expenses} - \text{Dividends}$.
 - (c) $\text{Assets} = \text{Liabilities} + \text{Common Stock} + \text{Retained Earnings} + \text{Revenues} - \text{Expenses} - \text{Dividends}$.
 - (d) $\text{Assets} = \text{Liabilities} + \text{Common Stock} + \text{Retained Earnings} - \text{Revenues} - \text{Expenses} - \text{Dividends}$.
3. A trial balance:
 - (a) is the same under IFRS and GAAP.
 - (b) proves that transactions are recorded correctly.
 - (c) proves that all transactions have been recorded.
 - (d) will not balance if a correct journal entry is posted twice.
4. One difference between IFRS and GAAP is that:
 - (a) GAAP uses accrual-accounting concepts and IFRS uses primarily the cash basis of accounting.
 - (b) IFRS uses a different posting process than GAAP.
 - (c) IFRS uses more fair value measurements than GAAP.
 - (d) the limitations of a trial balance are different between IFRS and GAAP.
5. The general policy for using proper currency signs (dollar, yen, pound, etc.) is the same for both IFRS and this textbook. This policy is as follows:
 - (a) Currency signs only appear in ledgers and journal entries.
 - (b) Currency signs are only shown in the trial balance.
 - (c) Currency signs are shown for all compound journal entries.
 - (d) Currency signs are shown in trial balances and financial statements.

INTERNATIONAL FINANCIAL REPORTING PROBLEM: Louis Vuitton

IFRS3-1 The financial statements of **Louis Vuitton** are presented in Appendix E. Instructions for accessing and using the company's complete annual report, including the notes to its financial statements, are also provided in Appendix E.

Instructions

Describe in which statement each of the following items is reported, and the position in the statement (e.g., current asset).

- (a) Other operating income and expense.
- (b) Cash and cash equivalents.
- (c) Trade accounts payable.
- (d) Cost of net financial debt.

Answers to IFRS Self-Test Questions

1. b 2. c 3. a 4. c d. d