

Analyzing and Recording Transactions



RETHINK[®]

Rethink Accounting!

Vancouver, BC—Rethink Advertising’s unique approach to marketing has attracted clients that include A&W, A&P, B.C. Automobile Association, Okanagan Springs Brewery, MJB Coffee, and *Maclean’s*. The owners—Graiss, Shepansky, and Staples—established Rethink in 1999 and the company has since grown to 30 employees.

When it comes to accounting, the owners agree that the hands-on approach they each learned in post-secondary studies has provided them with invaluable tools that have been critical to their understanding of how to grow the business. Tom Shepansky, a marketing grad, says that “The most important information for us as a small business relates to revenues, cost control, and obviously the impact on our equity. Initially, our balance sheet was irrelevant because we had no equity. A&W, our first big name account, asked us to provide them with our balance sheet.

The CFO was amused by our lack of resources but was willing to give us our first big break. We’ve come a long way since then but we still take the approach to grow our company conservatively, out of profits.” Rethink lists two sources of revenue in its chart of accounts: Consulting Revenue related to strategy and creative development, and Production Revenue for the making of physical ads and signs. Expenses are detailed on a line item basis to help the owners monitor where to spend more and where to spend less.

Tom Shepansky’s advice to business students, especially non-accountants, is to have a solid understanding of accounting. “You need to talk to your accountant about what is going on in the business. You have to be able to ask the tough questions and make the even tougher decisions. How can you do that without a solid understanding of the numbers? Accounting is the foundation of business and allows you to develop a sound and detailed financial plan to be able to grow revenues but, as important, manage expenses. Cash flow and poor money management have killed more companies than anything else. Pay attention to your receivables and take an active interest in the changes in all account balances. Learn to respect and value the numbers or they will come back to haunt you.”

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Learning Objectives

- LO¹ Explain the accounting cycle.
- LO² Describe an account, its use, and its relationship to the ledger.
- LO³ Define debits and credits and explain their role in double-entry accounting.
- LO⁴ Describe a chart of accounts and its relationship to the ledger.
- LO⁵ Analyze the impact of transactions on accounts.
- LO⁶ Record transactions in a journal and post entries to a ledger.
- LO⁷ Prepare and explain the use of a trial balance.

Chapter Preview

We explained in Chapter 2 how the accounting equation P.42 helps us understand and analyze transactions and events. Analyzing financial transactions is the first step in the *accounting cycle*. Chapters 3 through 5 continue to explain and demonstrate each of the steps in the accounting cycle. All accounting systems use steps similar to those described here. These procedures are important because they lead to financial statements P.34. Financial statements—in particular the information contained in the income statement—are what Rethink in the opening article used to grow the business.

We begin by providing an overview of the accounting cycle. We describe *accounts* and explain their purpose. *Debits* and *credits* are introduced, which enables us to describe the process of recording transactions in a *journal* and *posting* them to a *ledger*. We return to transactions of Finlay Interiors, first introduced in Chapter 2, to illustrate many of these procedures.

The Accounting Cycle

LO¹ Explain the accounting cycle.

The **accounting cycle** refers to the steps in preparing financial statements for users. It is called a cycle because the steps are repeated each reporting period. Exhibit 3.1 illustrates the accounting cycle. Chapter 2 introduced transaction analysis, the first step in the accounting cycle. Chapter 3 will focus on the next three steps of the accounting cycle. Step 7, the preparation of financial statements, was introduced in Chapter 2 but is reinforced in Chapters 3 and 4 and is expanded upon in Chapter 5.

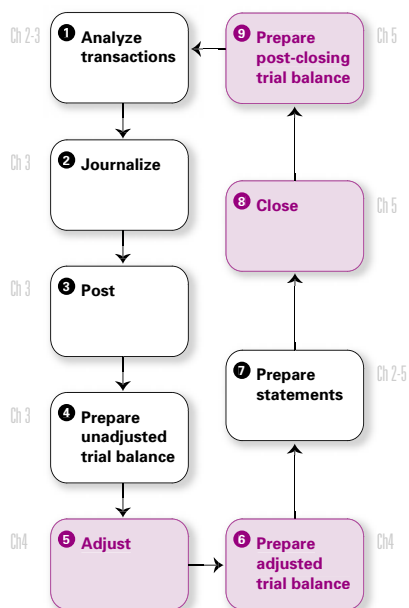
Accounts

LO² Describe an account, its use, and its relationship to the ledger.

This section explains the importance of an account to accounting and business. We also describe several crucial elements of an accounting system, including ledgers, T-accounts, debits and credits, double-entry accounting, and the chart of accounts.

Exhibit 3.1

Accounting Cycle

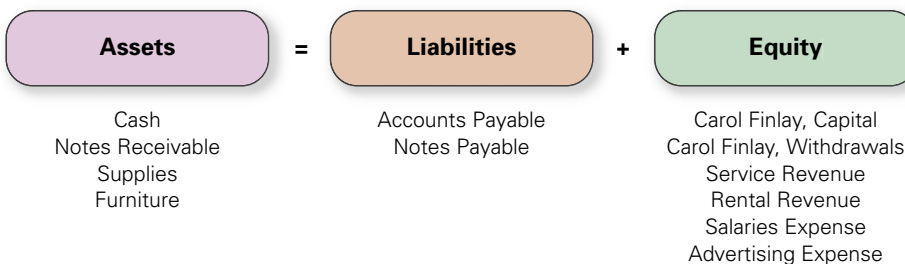


The Account

An **account** is a detailed record of increases and decreases in a specific asset, liability, or equity item. Information is taken from accounts, analyzed, summarized, and presented in useful reports and financial statements for users. Separate accounts¹ are kept for each type of asset, liability, and equity item. Exhibit 3.2 shows examples of the different types of accounts used by Finlay Interiors.

Exhibit 3.2

Types of Accounts for Finlay Interiors



¹ As an example of an account, Exhibit 3.10 shows the Cash account as one of several asset accounts used by Finlay Interiors.

A **ledger** is a record containing all accounts used by a business. This is often in electronic form and is what we mean when we refer to the *books*. Manual systems will record accounts on separate pages in a special booklet. Each company will have its own unique set of accounts to suit its type of operation. The remainder of this section introduces accounts that are important to most organizations.

Asset Accounts

Assets are resources controlled by an organization that have current and future benefits. They have value and are used in the operations of the business to create revenue. For example, Furniture is an asset held by Finlay Interiors for the purpose of creating rental revenue in current and future periods. A separate account is maintained for each asset.

Cash increases and decreases are recorded in a Cash account. Examples are coins, currency, cheques, money orders, and chequing account balances.

Receivables are amounts that the business is expecting to receive in the future. Types of receivables include:

- **Accounts receivable**, which occur when services are performed for or goods are sold to customers in return for promises to pay in the future. These transactions are said to be *on credit* or *on account*. Accounts receivable are *increased* by services performed or goods sold on credit and *decreased* by customer payments.
- **Notes receivable** (or a **promissory note**), which is an unconditional written promise to pay a definite sum of money on demand or on a defined future date(s).

Prepaid Expenses contain payments made for assets that are to be used in the near future. As these assets are used up, the costs of the used assets become expenses. Examples include Office Supplies, Store Supplies, Prepaid Rent, and Prepaid Insurance. A prepaid cost can be initially recorded as an expense *if* it is used up before the end of the period.

Equipment includes assets such as computers, printers, desks, chairs, counters, showcases and cash registers. These assets are used in the operations of a business for more than one accounting period.

Buildings are assets owned by an organization that can provide space for a store, an office, a warehouse, or a factory. Buildings are assets because they provide benefits.

Land owned by a business is shown as an asset. The cost of land is separated from the cost of buildings located on the land to provide more useful information in financial statements.

Liability Accounts

Liabilities are obligations to transfer assets or provide services to other entities. An organization often has several different liabilities, each of which is represented by a separate account that shows amounts owed to each creditor. The more common liability accounts are described here.

Payables are promises by a business to pay later for an asset or service already received. Types of payables include:

- **Accounts payable**, which occur with the purchase of merchandise, supplies, equipment, or services made by a promise to pay later.
- **Notes payable**, which occur when an organization formally recognizes a promise to pay by signing a promissory note.

Unearned revenues result when customers pay in advance for products or services. Because cash from these transactions is received before revenues are earned,

the seller considers them unearned revenues in accordance with the revenue recognition principle. Unearned revenue is a liability because a service or product is *owed* to a customer. It will be earned when the service or product is delivered in the future. Examples of unearned revenue include magazine subscriptions collected in advance by a publisher, sales of gift certificates by stores, airline tickets sold in advance, and rent collected in advance by a landlord.

WestJet Airlines Ltd. reported *advance ticket sales* of \$44,195,000 on December 31, 2002.

See Appendix I.

Other Liabilities include wages payable, taxes payable, and interest payable. Each of these is often recorded in a separate liability account. If they are not large in amount, two or more of them may be added and reported as a single amount on the balance sheet.

The liabilities section of **WestJet Airlines Ltd.'s** balance sheet at December 31, 2002, included income taxes payable of \$7,982,000.

See Appendix I.

Exhibit 3.3

Equity Transactions as Analyzed in Chapter 2

Owner's Equity	Explanation
Carol Finlay, Capital	
\$10,000	Investment
<hr/>	
\$10,000	
<hr/>	
\$10,000	
+ 2,200	Consulting Revenue
\$12,200	
- 1,000	Rent Expense
\$11,200	
- 700	Salaries Expense
\$10,500	
+ 1,600	Consulting Revenue
+ 300	Rental Revenue
\$12,400	
<hr/>	
\$12,400	
<hr/>	
\$12,400	
- 600	Withdrawal
\$11,800	
<hr/>	
\$11,800	

Equity Accounts

We described in the previous chapter four types of transactions that affect owner's equity: (1) investments by the owner, (2) withdrawals by the owner, (3) revenues, and (4) expenses. In Chapter 2, we entered all equity transactions in a single column under the owner's name as copied in Exhibit 3.3. When we later prepared the income statement and the statement of owner's equity [P. 37](#), we had to review the items in that column to classify them properly in financial statements.

A preferred approach is to use separate accounts, as illustrated under the Equity heading in Exhibit 3.2.

Owner Capital records owner investments. The capital account is identified by including the owner's name. The owner's capital account includes transactions in addition to owner investments, but these will be discussed in Chapter 5.

Owner withdrawals are recorded in an account with the name of the owner and the word *Withdrawals*. This account is also sometimes called the owner's *Personal* account or *Drawing* account.

Revenues and expenses incurred for a period is information required by decision makers. Businesses use a variety of accounts to report revenues earned and expenses incurred on income statements. Examples of revenue accounts are Sales, Commissions Earned, Professional Fees Earned, Rent Revenue, Earned Subscription Fees, and Interest Earned. Examples of expense accounts are Advertising Expense, Store Supplies Expense, Office Salaries Expense, Office Supplies Expense, Rent Expense, Utilities Expense, and Insurance Expense.

We can get an idea of the variety of revenues by looking at the chart of accounts in Appendix III. It lists accounts needed to solve some of the exercises and problems in this book.²

² Different companies can use different account titles than those listed in the appendix. For example, a company might use *Interest Revenue* instead of *Interest Earned*, or *Subscription Fees Revenue* or *Subscription Fees Earned* instead of *Earned Subscription Fees*, or *Rental Expense* instead of *Rent Expense*. It is only important that an account title describes the item it represents. We must use our good judgement when reading financial statements since titles can differ even within the same industry.

1. Explain the accounting cycle.
2. Classify the following accounts as either assets, liabilities, or equity: (1) Prepaid Rent, (2) Unearned Fees, (3) Buildings, (4) Owner Capital, (5) Wages Payable, and (6) Office Supplies.
3. What is the difference between the accounts Rent Earned, Rent Revenue, and Earned Rent?



T-Account

A **T-account** is a helpful learning tool that represents an account in the ledger. It shows the effects of individual transactions on specific accounts. The T-account is so named because it looks like the letter T. It is shown in Exhibit 3.4.

Account Title	
(Left side) <i>Debit</i>	(Right side) <i>Credit</i>

Exhibit 3.4
The T-Account

The format of a T-account includes: (1) the account title on top, (2) a left or debit side, and (3) a right or credit side. Debits and credits are explained in the next section. A T-account provides one side for recording increases in the item and the other side for decreases. As an example, the T-account for Finlay Interiors' Cash account after recording the transactions in Chapter 2 is in Exhibit 3.5.

T-accounts are used throughout this text to help illustrate debits and credits and to solve accounting problems. ***This form of account is a learning tool and is typically not used in actual accounting systems. However, many professional accountants often find T-accounts useful for analytical purposes.***

Balance of an Account

An **account balance** is the difference between the increases and decreases recorded in an account. To determine the balance, we:

1. Compute the total increases shown on one side (including the beginning balance)
2. Compute the total decreases shown on the other side
3. Subtract the sum of the decreases from the sum of the increases, and
4. Calculate the account balance.

The total increases in Finlay Interiors' Cash account are \$14,100, the total decreases are \$5,700, and the account balance is \$8,400. The T-account in Exhibit 3.5 shows how we calculate the \$8,400 balance:

Cash			
Investment by owner	10,000	2,500	Purchase of supplies
Received from providing consulting services	2,200	1,000	Payment of rent
Collection of account receivable	1,900	700	Payment of salary
		900	Payment of account payable
		600	Withdrawal by owner
Total increases	14,100	5,700	Total decreases
Less decreases	– 5,700		
Balance	8,400		

Exhibit 3.5
Computing the Balance
of a T-Account



LO³ Define debits and credits and explain their role in double-entry accounting.

Debits and Credits

The left side of a T-account is always called the **debit** side, often abbreviated Dr. The right side is always called the **credit** side, abbreviated Cr.³ To enter amounts on the left side of an account is to *debit* the account. To enter amounts on the right side is to *credit* the account. The difference between total debits and total credits for an account is the account balance. When the sum of debits exceeds the sum of credits, the account has a *debit balance*. It has a *credit balance* when the sum of credits exceeds the sum of debits. When the sum of debits equals the sum of credits, the account has a zero balance. This dual method of recording transactions as debits and credits is an essential feature of *double-entry accounting*, and is the topic of the next section.

Double-Entry Accounting

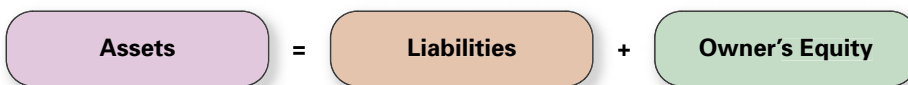
Debits = Credits

Double-entry accounting means every transaction affects and is recorded in at least two accounts. *The total amount debited must equal the total amount credited* for each transaction. Therefore, the sum of the debits for all entries must equal the sum of the credits for all entries. As well, the sum of debit account balances in the ledger must equal the sum of credit account balances. The only reason that the sum of debit balances would not equal the sum of credit balances is if an error had occurred. Double-entry accounting helps to prevent errors by assuring that debits and credits for each transaction are equal.

The system for recording debits and credits follows from the accounting equation in Exhibit 3.6.

Exhibit 3.6

Accounting Equation



Assets are on the left side of this equation. Liabilities and equity are on the right side. Like any mathematical equation, increases or decreases on one side have equal effects on the other side. For example, the net increase in assets must be accompanied by an identical net increase in the liabilities and equity side. Some transactions only affect one side of the equation. This means that two or more accounts on one side are affected, but their net effect on this one side is zero.

The debit and credit effects for asset, liability, and owner's equity accounts are captured in Exhibit 3.7.

Exhibit 3.7

Debit and Credit Effects for Accounts

Assets		=	Liabilities		+	Owner's Equity	
↑	↓		↓	↑		↓	↑
Debit for increases +	Credit for decreases -		Debit for decreases -	Credit for increases +		Debit for decreases -	Credit for increases +

³ These abbreviations are remnants of 18th-century English recordkeeping practices where the terms *Debitor* and *Creditor* were used instead of *debit* and *credit*. The abbreviations use the first and last letters of these terms where **Dr** resulted from **D**ebitor, and **Cr** from **C**reditor, just as we still do for *Saint* (St.) and *Doctor* (Dr.).

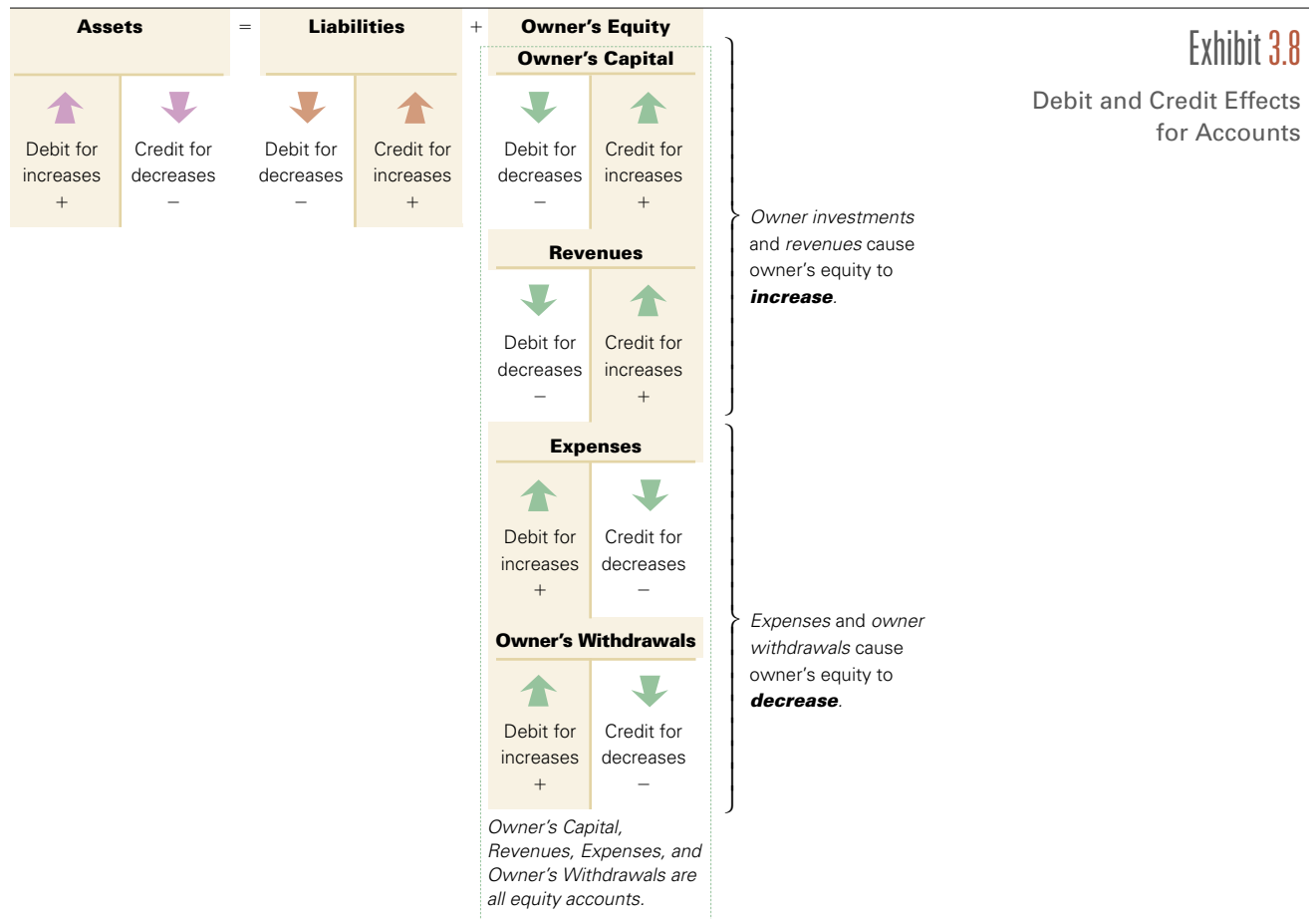
Three important rules for recording transactions in a double-entry accounting system follow from Exhibit 3.7:

1. Increases in assets are debited to asset accounts. Decreases in assets are credited to asset accounts.
2. Increases in liabilities are credited to liability accounts. Decreases in liabilities are debited to liability accounts.
3. Increases in owner's equity are credited to owner's equity accounts. Decreases in owner's equity are debited to owner's equity accounts.



CAUTION: We must guard against the error of thinking that the terms debit and credit mean increase or decrease. In an account where a *debit is an increase*, such as an asset, a credit is a decrease. *But* notice that in an account where a debit is a decrease, such as a liability, a *credit is an increase*.

We explained in Chapter 2 how owner's equity increases with owner investments and revenues and decreases with expenses and owner withdrawals. We can therefore expand the accounting equation and debit and credit effects as shown in Exhibit 3.8.



Increases in owner's capital or revenues *increase* owner's equity. Increases in owner's withdrawals or expenses *decrease* owner's equity. These important relations are reflected in the following four additional rules:

4. Investments by the owner are credited to owner's capital because they increase equity.
5. Revenues are credited to revenue accounts because they increase equity.
6. Expenses are debited to expense accounts because they decrease equity.
7. Withdrawals made by the owner are debited to owner's withdrawals because they decrease equity.

Our understanding of these diagrams and rules is crucial to analyzing and recording transactions. This also helps us to prepare and analyze financial statements.⁴

Notice in Exhibit 3.8 that the debit or credit side of each T-account is shaded. The shaded areas highlight the *normal balance* of each type of account. The **normal balance** of each account refers to the debit or credit side where increases are recorded. For example, the normal balance for an asset account would be a debit because debits cause assets to increase. The normal balance for a revenue account would be a credit because revenues are increased by credits.

Chart of Accounts

Recall that the collection of all accounts for an electronic or manual information system is called a *ledger*. The number of accounts needed in the ledger is affected by a company's size and diversity of operations. A small company may have as few as 20 accounts, while a large company may need several thousand.

The **chart of accounts** is a list of all accounts used in the ledger by a company. The chart includes an identification number assigned to each account. The chart of accounts in Appendix III of the text uses the following numbering system for its accounts:

101–199	Asset accounts
201–299	Liability accounts
301–399	Owner capital and withdrawals accounts
401–499	Revenue accounts
501–599 ⁵	Cost of sales expense accounts
601–699	Operating expense accounts

The numbers provide a three-digit code that is useful in recordkeeping. In this case, the first digit assigned to asset accounts is 1, while the first digit assigned to liability accounts is 2, and so on. The first digit of an account's number also shows whether the account appears on the balance sheet or the income statement. The second and subsequent digits may also relate to the accounts' categories. The



Describe a chart of accounts and its relationship to the ledger.

⁴ We can use good judgement to our advantage in applying double-entry accounting. For example, revenues and expenses normally (but not always) accumulate in business. This means they increase and rarely decrease during an accounting period. Accordingly, we should be alert to decreases in these accounts (debit revenues or credit expenses) to be certain that this is our intent.

⁵ Finlay Interiors does not use accounts 501–599. These accounts are used by merchandisers (like Leon's Furniture or The Bay), a topic discussed in Chapter 6.

numerical basis of a chart of accounts is a fundamental component of a computerized accounting system. A partial chart of accounts for Finlay Interiors follows.

Account Number	Account Name	Account Number	Account Name
101	Cash	301	Carol Finlay, Capital
106	Accounts Receivable	302	Carol Finlay, Withdrawals
125	Supplies	403	Consulting Revenue
128	Prepaid Insurance	406	Rental Revenue
167	Furniture	641	Rent Expense
201	Accounts Payable	622	Salaries Expense
236	Unearned Consulting Revenue	690	Utilities Expense
240	Notes Payable		



4. What is the relationship of an account to the ledger and chart of accounts?
5. What determines the quantity and types of accounts used in the ledger by a company?



Mid-Chapter Demonstration Problem

Indicate whether the following transactions increase or decrease the relevant account.

- a. A liability account is debited for \$500.
- b. A revenue account is credited for \$1,000.
- c. An asset account is debited for \$300.
- d. An expense account is credited for \$75.
- e. Owner's capital is credited for \$1,000.

SOLUTION TO Mid-Chapter Demonstration Problem

- a. decrease; b. increase; c. increase; d. decrease; e. increase

Analyzing Transactions

We return to the activities of Finlay Interiors to show how debit and credit rules and double-entry accounting are useful in analyzing and processing transactions. We analyze Finlay Interiors' transactions in two steps. *Step One* analyzes a transaction and its source document(s). *Step Two* applies double-entry accounting to identify the effect of a transaction on account balances.

We should study each transaction thoroughly before proceeding to the next transaction. The first 11 activities are familiar to us from Chapter 2. We expand our analysis of these items and consider four new transactions (numbered 12 through 15) of Finlay Interiors that were omitted earlier.

LO⁵ Analyze the impact of transactions on accounts.

Extend Your Knowledge



3-1

1. Investment by owner.

Cash		101
(1)	10,000	
Carol Finlay, Capital		302
	10,000	(1)

Transaction. Carol Finlay invested \$10,000 in Finlay Interiors on January 1, 2005.

Analysis. Assets increase. Owner's equity increases.

Double-entry. Debit the Cash asset account for \$10,000. Credit the Carol Finlay, Capital account in owner's equity for \$10,000.

$$A = L + E$$

↑ ↑

2. Purchase supplies for cash.

Supplies		125
(2)	2,500	
Cash		101
(1)	10,000	2,500 (2)

Transaction. Finlay Interiors purchases supplies by paying \$2,500 cash.

Analysis. Assets increase. Assets decrease. This changes the composition of assets, but does not change the total amount of assets.

Double-entry. Debit the Supplies asset account for \$2,500. Credit the Cash asset account for \$2,500.

$$A = L + E$$

↑ ↓

3. Purchase furniture and supplies on credit.

Supplies		125
(2)	2,500	
(3)	1,100	
Furniture		167
(3)	6,000	
Accounts Payable		201
	1,100	(3)
Notes Payable		240
	6,000	(3)

Transaction. Finlay Interiors purchases \$1,100 of supplies and \$6,000 of furniture on credit. Finlay Interiors signs a promissory note for the \$6,000 of furniture.

Analysis. Assets increase. Liabilities increase.

Double-entry. Debit two asset accounts: Supplies for \$1,100 and Furniture for \$6,000. Credit two liability accounts: Accounts Payable for \$1,100 and Notes Payable for \$6,000.

$$A = L + E$$

↑ ↑

4. Services rendered for cash.

Cash		101
(1)	10,000	2,500 (2)
(4)	2,200	
Consulting Revenue		403
	2,200	(4)

Transaction. Finlay Interiors provided consulting services to a customer and immediately collected \$2,200 cash.

Analysis. Assets increase. Owner's equity increases from Revenue.

Double-entry. Debit the Cash asset account for \$2,200. Credit the Consulting Revenue account for \$2,200 (this increases owner's equity).

$$A = L + E$$

↑ ↑

5. Payment of expense in cash.

Rent Expense		641
(5)	1,000	
Cash		101
(1)	10,000	2,500 (2)
(4)	2,200	1,000 (5)

Transaction. Finlay Interiors pays \$1,000 cash for January rent.

Analysis. Assets decrease. Owner's equity decreases from Expense.

Double-entry. Debit the Rent Expense account for \$1,000 (this decreases owner's equity). Credit the Cash asset account for \$1,000.

$$A = L + E$$

↓ ↓

⁶ The effect of each transaction on the accounting equation is repeated here from Chapter 2 to help you transition to debits and credits.

6. Payment of expense in cash.

Salaries Expense		622	
(6)	700		

Cash		101	
(1)	10,000	2,500	(2)
(4)	2,200	1,000	(5)
		700	(6)

Transaction. Finlay Interiors pays \$700 cash for employee's salary for the pay period ending on January 14.

Analysis. Assets decrease. Owner's equity decreases from Expense.

Double-entry. Debit the Salaries Expense account for \$700 (this decreases owner's equity). Credit the Cash asset account for \$700.

$$A = L + E$$

↓ ↓

7. Service contract signed for February and March.

Event. Finlay Interiors signed a contract to perform \$5,000 of services during February and March.

Analysis. There has been no economic exchange between two parties (the services have not been provided and Finlay Interiors did not receive any assets), therefore this is an event and has no effect on the accounting equation.

8. Services and rental revenues rendered on credit.

Accounts Receivable		106	
(8)	1,900		

Consulting Revenue		403	
		2,200	(4)
		1,600	(8)

Rental Revenue		406	
		300	(8)

Transaction. Finlay Interiors provided consulting services of \$1,600 and rented furniture for \$300 to a customer. The customer is billed \$1,900 for the services and Finlay Interiors expects to collect this money in the near future.

Analysis. Assets increase. Owner's equity increases from Revenue.

Double-entry. Debit the Accounts Receivable asset account for \$1,900. Credit two revenue accounts: Consulting Revenue for \$1,600 (this increases owner's equity) and Rental Revenue for \$300 (this increases owner's equity).

$$A = L + E$$

↑ ↑

9. Receipt of cash on account.

Cash		101	
(1)	10,000	2,500	(2)
(4)	2,200	1,000	(5)
(9)	1,900	700	(6)

Accounts Receivable		106	
(8)	1,900	1,900	(9)

Transaction. On January 25, an amount of \$1,900 is received from the client in Transaction 8.

Analysis. Assets increase. Assets decrease. This changes the composition of assets, but does not change the total amount of assets.

Double-entry. Debit the Cash asset account for \$1,900. Credit Accounts Receivable asset account for \$1,900.

$$A = L + E$$

↑ ↓

10. Partial payment of accounts payable.

Accounts Payable		201	
(10)	900	1,100	(3)

Cash		101	
(1)	10,000	2,500	(2)
(4)	2,200	1,000	(5)
(9)	1,900	700	(6)
		900	(10)

Transaction. Finlay Interiors pays CanTech Supply \$900 cash toward the account payable of \$1,100 owed from the purchase of supplies in Transaction 4.

Analysis. Assets decrease. Liabilities decrease.
Double-entry. Debit the Accounts Payable liability account for \$900. Credit the Cash asset account for \$900.

$$A = L + E$$

↓ ↓

11. Withdrawal of cash by owner.

Carol Finlay, Withdrawals		302	
(11)	600		
Cash		101	
(1)	10,000	2,500	(2)
(4)	2,200	1,000	(5)
(9)	1,900	700	(6)
		900	(10)
		600	(11)

Transaction. Carol Finlay withdraws \$600 from Finlay Interiors for personal living expenses.

Analysis. Assets decrease. Owner's equity decreases.

Double-entry. Debit the Carol Finlay, Withdrawals account in owner's equity for \$600. Credit the Cash asset account for \$600.

$$A = L + E$$

↓ ↓

12. Receipt of cash for future services.

Cash		101	
(1)	10,000	2,500	(2)
(4)	2,200	1,000	(5)
(9)	1,900	700	(6)
(12)	3,000	900	(10)
		600	(11)
Unearned Consulting Revenue		236	
		3,000	(12)

Transaction. Finlay Interiors enters into (signs) a contract with a customer to provide future consulting. Finlay Interiors receives \$3,000 cash in advance of providing these consulting services.

Analysis. Assets increase. Liabilities increase. Accepting the \$3,000 cash obligates Finlay Interiors to perform future services, and is a liability. No revenue is earned until services are provided.

Double-entry. Debit the Cash asset account for \$3,000. Credit the Unearned Consulting Revenue liability account for \$3,000.

$$A = L + E$$

↑ ↑

13. Payment of cash for future insurance coverage.

Prepaid Insurance		128	
(13)	2,400		
Cash		101	
(1)	10,000	2,500	(2)
(4)	2,200	1,000	(5)
(9)	1,900	700	(6)
(12)	3,000	900	(10)
		600	(11)
		2,400	(13)

Transaction. Finlay Interiors pays \$2,400 cash (premium) for a two-year insurance policy. Coverage begins on January 1.

Analysis. Assets increase. Assets decrease. This changes the composition of assets from cash to a "right" of insurance coverage. This does not change the total amount of assets. Expense will be incurred as insurance coverage is provided.

Double-entry. Debit the Prepaid Insurance asset account for \$2,400. Credit the Cash asset account for \$2,400.

$$A = L + E$$

↑↓

14. Payment of expense in cash.

Utilities Expense		690	
(14)	230		
Cash		101	
(1)	10,000	2,500	(2)
(4)	2,200	1,000	(5)
(9)	1,900	700	(6)
(12)	3,000	900	(10)
		600	(11)
		2,400	(13)
		230	(14)

Transaction. Finlay Interiors pays \$230 cash for January utilities.

Analysis. Assets decrease. Owner's equity decreases from Expense.

Double-entry. Debit the Utilities Expense account for \$230 (this decreases owner's equity). Credit the Cash asset account for \$230.

$$A = L + E$$

↓ ↓

15. Payment of expense in cash.

Salaries Expense		622
(6)	700	
(15)	700	

Cash		101
(1)	10,000	2,500
(4)	2,200	1,000
(9)	1,900	700
(12)	3,000	900
		600
		2,400
		230
		700
		(15)

Transaction. Finlay Interiors pays \$700 cash for employee's salary for the two-week pay period ending on January 28.

Analysis. Assets decrease. Owner's equity decreases from Expense.

Double-entry. Debit the Salaries Expense account for \$700 (this decreases owner's equity). Credit the Cash asset account for \$700.

$$A = L + E$$

↓ ↓

Accounting Equation Analysis

Exhibit 3.9 shows Finlay Interiors' accounts in the ledger after all 15 transactions are recorded and the balances computed. For emphasis, the accounts are grouped into three major columns representing the terms in the accounting equation: assets, liabilities, and owner's equity.

Exhibit 3.9 highlights several important points. First, as with each transaction, the totals for the three columns show that the accounting equation is in balance:

Assets \$20,070	=	Liabilities \$9,200	+	Owner's Equity \$10,870
---------------------------	---	-------------------------------	---	-----------------------------------

Second, the owner's investment is recorded in the capital account and the withdrawals, revenue, and expense accounts reflect the events that change owner's equity. Their ending balances make up the statement of owner's equity. Third, the revenue and expense account balances are summarized and reported in the income statement.

6. Does debit always mean increase and credit always mean decrease?
7. What kinds of transactions increase owner's equity? What kinds decrease owner's equity?
8. Why are most accounting systems called *double-entry*?
9. Double-entry accounting requires that (select the best answer):
 - a. All transactions that create debits to asset accounts must create credits to liability or owner's equity accounts.
 - b. A transaction that requires a debit to a liability account also requires a credit to an asset account.
 - c. Every transaction must be recorded with total debits equal to total credits.



Answers—p. 108

Recording and Posting Transactions

In the previous section, we analyzed transactions, *Step One* of the accounting cycle, and recorded their effects directly in T-accounts to help you understand the double-entry accounting system. Yet accounting systems rarely record transactions directly in accounts. Instead, *Step Two* of the accounting cycle requires that we record transactions in a record called a **journal** before recording them in accounts. This is to avoid the potential for error and the difficulty in tracking mistakes. A journal gives us a complete record of each transaction in one place. It also directly links the debits and credits for each transaction. The process of recording transactions in a journal is called **journalizing**.

Step Three of the accounting cycle is to **post**, or transfer, entries from the journal to the ledger. **Posting occurs after debits and credits for each transaction are entered into a journal.** This process leaves a helpful trail that can be followed in checking for accuracy. It also helps us avoid errors. This section describes both journalizing and posting of transactions. *Step Four* of the accounting cycle, preparing a *trial balance*, is explained in the next section. Each of these steps in processing transactions is shown in Exhibit 3.10.

The Journal Entry

The **General Journal** is flexible in that it can be used to record any economic transaction. A General Journal entry includes the following information about each transaction:

1. Date of transaction
2. Titles of affected accounts
3. Dollar amount of each debit and credit
4. Explanation of transaction

Exhibit 3.11 shows how the first three transactions of Finlay Interiors are recorded in a General Journal. A journal is often referred to as the *book of original entry*. The accounting process is similar for manual and computerized systems. Many computer programs even copy the look of a paper journal.

The third entry in Exhibit 3.11 uses four accounts. There are debits to the two assets purchased, Supplies and Furniture. There are also credits to the two sources of payment, Accounts Payable and Notes Payable. A transaction affecting three or more accounts is called a **compound journal entry**.

LO⁶ Record transactions in a journal and post entries to a ledger.

Exhibit 3.10

First Four Steps of the Accounting Cycle

Step 1: Analyze transactions based on source documents.

Bank Statement Finlay Interiors January 2005	
1	Deposit 10,000
TOTAL	

Step 2: Record journal entry.

2005 General Journal			
Jan. 1	Cash	10,000	
	Carol Finlay, Capital		10,000
1	Supplies	2,500	
	Cash		2,500

Step 3: Post entry to ledger.

Step 4: Prepare trial balance.

Finlay Interiors Trial Balance January 31, 2005		
	Debit	Credit
Cash	\$8,070	
Accounts receivable	-0-	
Prepaid insurance	\$2,400	

Exhibit 3.11

Partial General Journal
for Finlay Interiors



General Journal				Page 1	
Date	Account Titles and Explanation	PR	Debit	Credit	
2005					
Jan. 1	Cash.....		10,000		
	Carol Finlay, Capital			10,000	
	<i>Investment by owner.</i>				
1	Supplies		2,500		
	Cash			2,500	
	<i>Purchased store supplies for cash.</i>				
1	Supplies		1,100		
	Furniture		6,000		
	Accounts Payable			1,100	
	Notes Payable			6,000	
	<i>Purchased supplies and furniture on credit.</i>				

Journalizing Transactions

We can identify nine steps in journalizing entries in a General Journal. Review the entries in Exhibit 3.11 when studying these steps.

1. Enter the year on the first line at the top of the first column.
2. Enter the month in Column One on the first line of the journal entry. Later entries for the same month and year on the same page of the journal do not require re-entering the same month and year.
3. Enter the day of the transaction in Column Two on the first line of each entry. Transactions are journalized in date order.
4. Enter the titles of accounts debited. Account titles are taken from the chart of accounts and are aligned with the left margin of the Account Titles and Explanation column.
5. Enter the debit amounts in the Debit column on the same line as the accounts to be debited.
6. Enter the titles of accounts credited. Account titles are taken from the chart of accounts and are indented from the left margin of the Account Titles and Explanation column to distinguish them from debited accounts (an indent of 1 cm is common).
7. Enter the credit amounts in the Credit column on the same line as the accounts to be credited.
8. Enter a brief explanation of the transaction on the line below the entry. This explanation is indented about half as far as the credited account titles to avoid confusing an explanation with accounts. For illustrative purposes, the textbook italicizes explanations so they stand out. This is not normally done.
9. Skip a line after each journal entry for clarity.

A complete journal entry gives us a useful description of the transaction and its effects on the organization.

The **posting reference (PR) column** is left blank when a transaction is initially recorded. Individual account numbers are later entered into the PR column when entries are posted to the ledger. The PR column is also called the *folio column*. This follows from past recordkeeping procedures where each account took up a page in a book, and an old word for page is *folio*.

Computerized Journals

Journals in computerized and manual systems serve the same purposes. Computerized journals are often designed to look like a manual journal page (as in Exhibit 3.11). Computerized systems include error-checking routines that ensure that debits equal credits for each entry. Shortcuts often allow recordkeepers to enter account numbers instead of names, and to enter account names and numbers with pull-down menus.

Balance Column Ledger

T-accounts are a simple and direct learning tool to show how the accounting process works. They allow us to omit less relevant details and concentrate on main ideas. Accounting systems in practice need more structure and use **balance column ledger accounts**. Exhibit 3.12 is an example.

Cash			Account No. 101		
Date	Explanation	PR	Debit	Credit	Balance
2005					
Jan. 1		G1	10,000		10,000
1		G1		2,500	7,500
10		G1	2,200		9,700

Exhibit 3.12

Cash Account in Balance Column Ledger



The T-account was derived from the balance column ledger account format and it too has a column for debits and a column for credits. Look at the imaginary T-account superimposed over Exhibit 3.12. The balance column ledger account is different from a T-account because it includes a transaction's date and explanation and has a third column with the balance of the account after each entry is posted. This means that the amount on the last line in this column is the account's current balance. For example, Finlay Interiors' Cash account in Exhibit 3.12 is debited on January 1 for the \$10,000 investment by Finlay. The account then shows a \$10,000 debit balance. The account is also credited on January 1 for \$2,500, and its new \$7,500 balance is shown in the third column. The Cash account is debited for \$2,200 on January 10, and its balance increases to \$9,700.

When a balance column ledger is used, the heading of the Balance column does not show whether it is a debit or credit balance. This omission is no problem because every account has a normal balance, as previously highlighted in Exhibit 3.8.

Abnormal Balance

Unusual events can sometimes give an abnormal balance to an account. An *abnormal balance* refers to a balance on the side where decreases are recorded. For example, a customer might mistakenly overpay a bill. This gives that customer's account receivable an abnormal credit balance.

Zero Balance

A zero balance for an account is usually shown by writing zeros or a dash in the Balance column. This practice avoids confusion between a zero balance and one omitted in error.

Posting Journal Entries

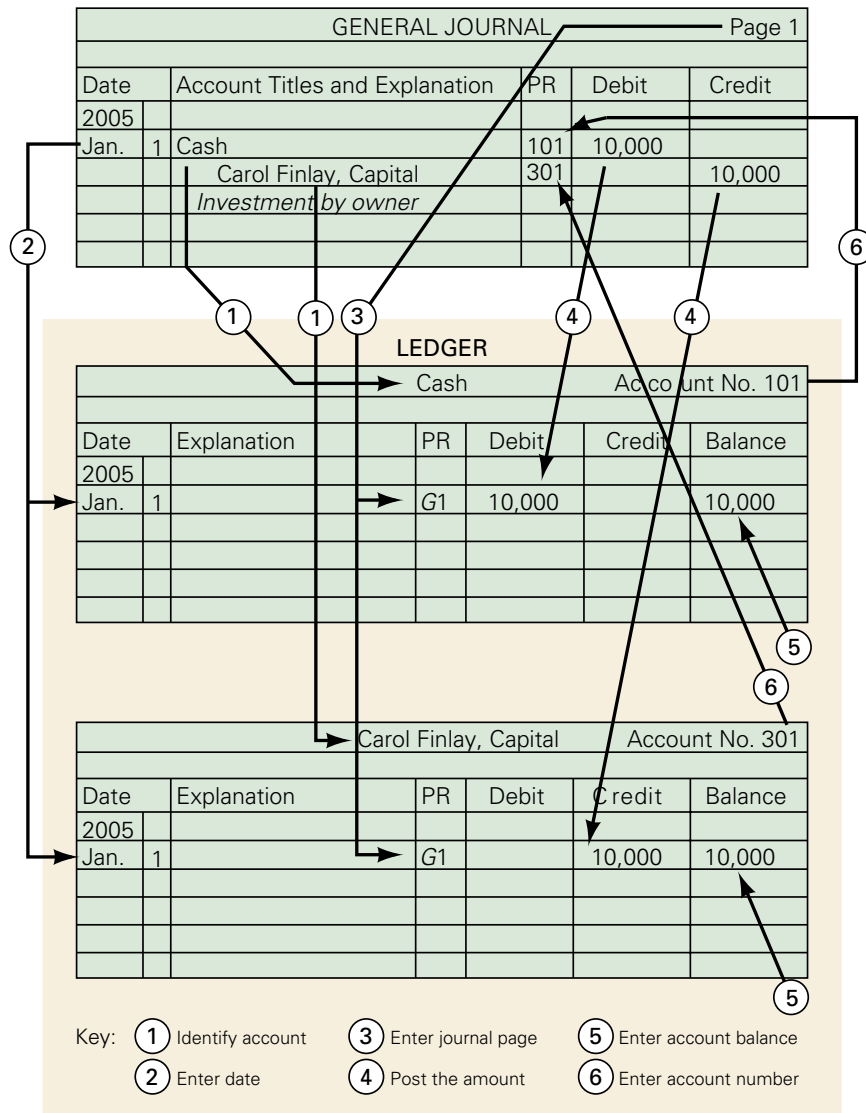
To ensure that the ledger is up to date, entries are posted as soon as possible. This might be daily, weekly, or when time permits. All entries must be posted to the ledger by the end of a reporting period. This is so that account balances are current when financial statements are prepared. Because the ledger is the final destination for individual transactions, it is referred to as the *book of final entry*.

When posting entries to the ledger, the debits in journal entries are copied into ledger accounts as debits, and credits are copied into the ledger as credits. Exhibit 3.13 lists six steps of manual systems to post each debit and credit from a journal entry.

Exhibit 3.13

Posting an Entry to the Ledger

Extend Your Knowledge



For each journal entry, the usual process is to post debit(s) and then credit(s). The steps in posting are:

1. Identify the ledger account that was debited in the journal entry.
2. Enter the date of the journal entry in this ledger account.
3. Enter the source of the debit in the PR column, both the journal and page. The letter *G* shows it came from the General Journal.⁷
4. Enter the amount debited from the journal entry into the Debit column of the ledger account.
5. Compute and enter the account's new balance in the Balance column.
6. Enter the ledger account number in the PR column of the journal entry.

Repeat the six steps for credit amounts and Credit columns. Notice that posting does not create new information; posting simply transfers (or copies) information from the General Journal to the appropriate account in the ledger.

Step Six in the posting process for both debit and credit amounts of an entry inserts the account number in the journal's PR column. This creates a cross-reference between the ledger and the journal entry for tracing an amount from one record to another. It also readily shows the stage of completion in the posting process. This permits one to start and stop the posting process easily without losing one's place.

Posting in Computerized Systems

Computerized systems require no added effort to post journal entries to the ledger. These systems automatically transfer debit and credit entries from the journal to the ledger database. Journal entries are posted directly to ledger accounts. Many systems have programs that test the reasonableness of a journal entry and the account balance when recorded. For example, a payroll program might alert a preparer to hourly wage rates that are greater than \$100.

10. Assume Maria Sanchez, the owner of a new business called RecordLink, invested \$15,000 cash and equipment with a market value of \$23,000. Assume that RecordLink also took responsibility for an \$18,000 note payable issued to finance the purchase of equipment. Prepare the journal entry to record Sanchez's investment.
11. Explain what a compound journal entry is.
12. Why are posting reference numbers entered in the journal when entries are posted to accounts?



Trial Balance

We know that double-entry accounting records every transaction with equal debits and credits. We also know that an error exists if the sum of debit entries in the ledger does not equal the sum of credit entries. This also means that the sum of debit account balances must equal the sum of credit account balances.

Step Four of the accounting cycle shown in Exhibit 3.1 requires the preparation of a trial balance to check whether debit and credit account balances are

LO⁷ Prepare and explain the use of a trial balance.

⁷ Other journals are identified by their own letters. We discuss other journals later in the book.

equal. A **trial balance** is a list of accounts and their balances at a point in time. Account balances are reported in the debit or credit column of the trial balance. Exhibit 3.14 shows the trial balance for Finlay Interiors after the entries described earlier in the chapter are posted to the ledger.

Another use of the trial balance is as an internal report for preparing financial statements. Preparing statements is easier when we can take account balances from a trial balance instead of searching the ledger. The preparation of financial statements using a trial balance is illustrated in the demonstration problem at the end of the chapter. We expand on this process in Chapter 4.

Exhibit 3.14

Trial Balance

FINLAY INTERIORS Trial Balance January 31, 2005			
Acct. No.	Account	Debit	Credit
101	Cash.....	\$ 8,070	
106	Accounts receivable.....	–0–	
125	Supplies.....	3,600	
128	Prepaid insurance.....	2,400	
167	Furniture.....	6,000	
201	Accounts payable.....		\$ 200
236	Unearned consulting revenue.....		3,000
240	Notes payable.....		6,000
301	Carol Finlay, capital.....		10,000
302	Carol Finlay, withdrawals.....	600	
403	Consulting revenue.....		3,800
406	Rental revenue.....		300
622	Salaries expense.....	1,400	
641	Rent expense.....	1,000	
690	Utilities expense.....	230	
	Totals.....	<u>\$23,300</u>	<u>\$23,300</u>

Preparing a Trial Balance

Preparing a trial balance involves five steps:

Extend Your Knowledge



3-3

1. Identify each account balance from the ledger.
2. List each account and its balance (in the same order as the Chart of Accounts). Debit balances are entered in the Debit column and credit balances in the Credit column.⁸
3. Compute the total of debit balances.
4. Compute the total of credit balances.
5. Verify that total debit balances equal total credit balances.

Notice that the total debit balance equals the total credit balance for the trial balance in Exhibit 3.14. If these two totals were not equal, we would know that one or more errors exist. Equality of these two totals does **not** guarantee the absence of errors.

⁸ If an account has a zero balance, it can be listed in the trial balance with a zero in the column for its normal balance.

Using a Trial Balance

We know that one or more errors exist when a trial balance does not *balance* (when its columns are not equal). When one or more errors exist, they often arise from one of the following steps in the accounting process:

1. Preparing journal entries
2. Posting entries to the ledger
3. Computing account balances
4. Copying account balances to the trial balance
5. Totalling the trial balance columns

When a trial balance does balance, the accounts are likely free of the kinds of errors that create unequal debits and credits. Yet errors can still exist. One example is when a debit or credit of a correct amount is made to a wrong account. This can occur when either journalizing or posting. The error would produce incorrect balances in two accounts but the trial balance would balance. Another error is to record equal debits and credits of an incorrect amount. This error produces incorrect balances in two accounts but again the debits and credits are equal. We give these examples to show that when a trial balance does balance, it does not prove that all journal entries are recorded and posted correctly.

In a computerized accounting system, the trial balance would *always* balance. Accounting software is such that unbalanced entries would not be accepted by the system. However, errors as described in the last paragraph can still exist in a computerized system.

Searching for Errors

In a manual accounting system, if the trial balance does not balance, the error (or errors) must be found and corrected before financial statements are prepared. To search for the error, we check the journalizing, posting, and trial balance preparation process in *reverse order*. Otherwise we would need to look at every transaction until the error is found.

The steps involved are:

1. Verify that the trial balance columns are correctly added. If this fails to show the error, then
2. Verify that account balances are accurately copied from the ledger.
3. Determine if a debit or credit balance is mistakenly listed in the trial balance as a credit or debit. A clue pointing to this kind of error is when the difference between total debits and total credits in the trial balance equals twice the amount of the incorrect account balance. If the error is still undiscovered, then
4. Recalculate each account balance. If the error remains, then
5. Verify that each journal entry is properly posted to ledger accounts.
6. Verify that the original journal entry has equal debits and credits.

One frequent error is called a **transposition error**, in which two digits are switched or transposed within a number (e.g., 619 instead of 691). If transposition is the only error, then the difference between the totals of the trial balance columns will be *evenly divisible by nine*. For example:

- Subtract total debits in the trial balance from total credits.
Based on the transposition given above, the difference between total debits and credits is 72 (\$691 – \$619).
- Divide the difference by 9.
 $\$72 \div 9 = 8$
- The quotient equals the difference between the two transposed numbers.
8 is the difference between ‘9’ and ‘1’ in both ‘91’ of ‘691’ and ‘19’ of ‘619’.
- The number of digits in the quotient tells us the location of the transposition.
The quotient of 8 is only one digit, so the transposition can be found by checking the first digit from the right in each number.⁹

Formatting Conventions

Dollar signs are *not* used in journals and ledgers. They *do* appear in financial statements and other reports, including trial balances, to identify the kind of currency being used. This book follows the usual practice of putting a dollar sign beside the first amount in each column of numbers and the first amount appearing after a ruled line that indicates that an addition or subtraction has been performed. The financial statements in Exhibit 2.11 on page 51 demonstrate how dollar signs are used in this book. Different companies use various conventions for dollar signs.

When amounts are entered manually in a formal journal, ledger, or trial balance, commas are not needed to indicate thousands, millions, and so forth. Also, decimal points are not needed to separate dollars and cents. If an amount consists of even dollars without cents, a convenient shortcut uses a dash in the cents column instead of two zeros. However, commas and decimal points are used in financial statements and other reports. An exception is when this detail is not important to users.

It is common for companies to round amounts to the nearest dollar, and to an even higher level for certain accounts. WestJet is typical of many companies in that it rounds its financial statement amounts to the nearest thousand dollars.



13. If a \$4,000 debit to Equipment in a journal entry is incorrectly posted to the ledger as a \$4,000 credit, and the ledger account has a resulting debit balance of \$20,000, what is the effect of this error on the trial balance column totals, assuming no other errors?

14. When are dollar signs typically used in accounting reports?

⁹ Consider another example where a transposition error involves posting \$961 instead of the correct \$691. The difference in these numbers is \$270, and its quotient is \$30 (\$270/9). Because the quotient has two digits, it tells us to check the second digits from the right for a transposition of two numbers that have a difference of 3.

Summary

LO1 Explain the accounting cycle. The accounting cycle includes the steps in preparing financial statements for users that are repeated each reporting period.

LO2 Describe an account, its use, and its relationship to the ledger. An account is a detailed record of increases and decreases in a specific asset, liability, or equity item. Information is taken from accounts, analyzed, summarized, and presented in useful reports and financial statements for users.

LO3 Define debits and credits and explain their role in double-entry accounting. Debit refers to left, and credit refers to right. The following table summarizes debit and credit effects by account type:

Assets		= Liabilities		+ Owner's Equity			
				Owner's Capital	Owner's Withdrawals	Revenues	Expenses
Increases	Debits	Credits		Credits	Debits	Credits	Debits
Decreases	Credits	Debits		Debits	Credits	Debits	Credits

Double-entry accounting means that every transaction affects at least two accounts. The total amount debited must equal the total amount credited for each transaction. The system for recording debits and credits follows from the accounting equation. The debit side is the normal balance for assets, owner's withdrawals, and expenses, and the credit side is the normal balance for liabilities, owner's capital, and revenues.

LO4 Describe a chart of accounts and its relationship to the ledger. A ledger is a record that contains all accounts used by a company. This is what is referred to as *the books*. The chart of accounts is a listing of all accounts and usually includes an identification number that is assigned to each account.

LO5 Analyze the impact of transactions on accounts. We analyze transactions using the concepts of double-entry accounting. This analysis is performed by determining a transaction's effects on accounts. These effects are recorded in journals and posted to accounts in the ledger.

LO6 Record transactions in a journal and post entries to a ledger. We record transactions in a journal to give a record of their effects. Each entry in a journal is posted to the accounts in the ledger. This provides information in accounts that is used to produce financial statements. Balance column ledger accounts are widely used and include columns for debits, credits, and the account balance after each entry.

LO7 Prepare and explain the use of a trial balance. A trial balance is a list of accounts in the ledger showing their debit and credit balances in separate columns. The trial balance is a convenient summary of the ledger's contents and is useful in preparing financial statements. It reveals errors of the kind that produce unequal debit and credit account balances.

GUIDANCE ANSWERS TO Judgement Call



Accounting Clerk

The Business Entity Principle is being violated because it requires that the owner's personal expenses be recorded separately from those of his business. By debiting the entire amount to Office Supplies, assets will be overstated on the balance sheet. By crediting Accounts Payable for the whole

amount, liabilities will also be overstated. At the end of the accounting period when the amount of supplies used is recorded, Office Supplies Expense will be overstated on the income statement, causing net income to be understated. When net income is too low, owner's equity is also understated.

GUIDANCE ANSWERS TO Flashback

1. The accounting cycle represents the steps followed each reporting period for the purpose of preparing financial statements.

2. Assets	Liabilities	Equity
1, 3, 6	2, 5	4

3. The difference between the three accounts is in the name only; they are variations of a revenue account for rent.
4. An account is a record in the ledger where increases and decreases in a specific asset, liability, or equity item are recorded and stored. A ledger is a collection of all accounts used by a business. A chart of accounts is a numerical list of the accounts in the ledger. The numbers represent whether the account is an asset, liability, or type of equity.
5. A company's size and diversity affect the number of accounts needed in its ledger. The types of accounts used by a business depend on information that the business needs to both effectively operate and report its activities in financial statements.
6. No. Debit and credit both can mean increase or decrease. The particular meaning depends on the type of account.
7. Owner's equity is increased by revenues and owner's investments in the company. Owner's equity is decreased by expenses and owner's withdrawals.
8. The name *double-entry* is used because all transactions affect and are recorded in at least two accounts. There must be at least one debit in one account and at least one credit in another.
9. Answer is (c).

10. The entry is:

Cash	15,000	
Equipment	23,000	
Notes Payable.....		18,000
Maria Sanchez, Capital.....		20,000

11. A compound journal entry is one that affects three or more accounts.
12. Posting reference numbers are entered in the journal when posting to the ledger as a control over the posting process. They provide a cross-reference that allows the bookkeeper or auditor to trace debits and credits from journals to ledgers and vice versa. They also create a marker in case the posting process is interrupted.
13. The effect of this error is to understate the trial balance's debit column total by \$8,000.
14. Dollar signs are used in financial statements and other reports to identify the kind of currency being used in the reports. At a minimum, they are placed beside the first and last numbers in each column. Some companies place dollar signs beside any amount that appears after a ruled line to indicate that an addition or subtraction has taken place.

Demonstration Problem

This demonstration problem is based on the same facts as the demonstration problem at the end of Chapter 2 except for two additional items: (b) August 1 and (k) August 18. The following activities occurred during the first month of Barbara Schmidt's new haircutting business called The Cutlery:

- a. On August 1, Schmidt put \$3,000 cash into a chequing account in the name of The Cutlery. She also invested \$15,000 of equipment that she already owned.
- b. On August 1, Schmidt paid \$600 for six months of insurance effective immediately.
- c. On August 2, she paid \$600 cash for furniture for the shop.
- d. On August 3, she paid \$900 cash to rent space in a strip mall for August.
- e. On August 4, she furnished the shop by installing the old equipment and some new equipment that she bought on credit for \$1,200. This amount is to be repaid in three equal payments at the end of August, September, and October.
- f. On August 5, The Cutlery opened for business. Cash receipts from haircutting services provided in the first week and a half of business (ended August 15) were \$225.
- g. On August 15, Schmidt provided haircutting services on account for \$100.
- h. On August 17, Schmidt received a \$100 cheque in the mail for services previously rendered on account.
- i. On August 17, Schmidt paid \$125 to an assistant for working during the grand opening.

- j. On August 18, Schmidt interviewed a job applicant. The applicant was successful in getting the position and will receive \$750 per week for part-time work starting in September.
- k. On August 18, a regular customer paid \$500 for services to be provided over the next three months.
- l. Cash receipts from haircutting services provided during the second half of August were \$530.
- m. On August 31, Schmidt paid an instalment on the accounts payable.
- n. On August 31, the August hydro bill for \$75 was received. It will be paid on September 14.
- o. On August 31, she withdrew \$200 cash for her personal use.

Required

1. Prepare General Journal entries for the preceding transactions.
2. Open the following accounts: Cash, 101; Accounts Receivable, 106; Prepaid Insurance, 128; Furniture, 161; Store Equipment, 165; Accounts Payable, 201; Unearned Haircutting Services Revenue, 236; Barbara Schmidt, Capital, 301; Barbara Schmidt, Withdrawals, 302; Haircutting Services Revenue, 403; Wages Expense, 623; Rent Expense, 640; and Hydro Expense, 690.
3. Post the journal entries to the ledger accounts.
4. Prepare a trial balance as of August 31, 2005.
5. Prepare an income statement and a statement of owner's equity for the month ended August 31, 2005, and a balance sheet at August 31, 2005.

Planning the Solution

- o Analyze each activity to determine if it is a transaction.
- o For each transaction, identify the accounts affected and the amount of each effect.
- o Use the debit and credit rules to prepare a journal entry for each transaction.
- o Post each debit and each credit in the journal entries to the appropriate ledger accounts and cross-reference each amount in the Posting Reference columns in the journal and account.
- o Calculate each account balance and list the accounts with their balances on a trial balance.
- o Verify that the total debits in the trial balance equal total credits.
- o Prepare an income statement, statement of owner's equity, and balance sheet using the information in the trial balance.

SOLUTION TO **Demonstration Problem**

1. General Journal entries:

General Journal				
Date	Account Titles and Explanations	PR	Debit	Page G1 Credit
2005				
Aug. 1	Cash	101	3,000	
	Store Equipment	165	15,000	
	Barbara Schmidt, Capital	301		18,000
	<i>Owner's initial investment.</i>			
1	Prepaid Insurance	128	600	
	Cash	101		600
	<i>Purchased six months of insurance.</i>			
2	Furniture	161	600	
	Cash	101		600
	<i>Purchased furniture for cash.</i>			
3	Rent Expense	640	900	
	Cash	101		900
	<i>Paid rent for August.</i>			
4	Store Equipment	165	1,200	
	Accounts Payable	201		1,200
	<i>Purchased additional equipment on credit.</i>			
15	Cash	101	225	
	Haircutting Services Revenue	403		225
	<i>Cash receipts from 10 days of operations.</i>			
15	Accounts Receivable	106	100	
	Haircutting Services Revenue	403		100
	<i>To record revenue for services provided on account.</i>			
17	Cash	101	100	
	Accounts Receivable	106		100
	<i>To record cash received as payment on account.</i>			
17	Wages Expense	623	125	
	Cash	101		125
	<i>Paid wages to assistant.</i>			
18	No entry required since a transaction has not occurred.			
18	Cash	101	500	
	Unearned Haircutting Services Revenue	236		500
	<i>To record payment in advance.</i>			
31	Cash	101	530	
	Haircutting Services Revenue	403		530
	<i>Cash receipts from second half of August.</i>			
31	Accounts Payable	201	400	
	Cash	101		400
	<i>Paid an instalment on accounts payable.</i>			
31	Hydro Expense	690	75	
	Accounts Payable	201		75
	<i>August hydro to be paid by Sept. 14.</i>			
31	Barbara Schmidt, Withdrawals	302	200	
	Cash	101		200
	<i>Owner withdrew cash from the business.</i>			

2. & 3. Accounts in the ledger:

Cash			Account No. 101		
Date	Explanation	PR	Debit	Credit	Balance
2005 Aug.	1	G1	3,000		3,000
	1	G1		600	2,400
	2	G1		600	1,800
	3	G1		900	900
	15	G1	225		1,125
	17	G1	100		1,225
	17	G1		125	1,100
	18	G1	500		1,600
	31	G1	530		2,130
	31	G1		400	1,730
	31	G1		200	1,530

Accounts Receivable			Account No. 106		
Date	Explanation	PR	Debit	Credit	Balance
2005 Aug.	15	G1	100		100
	17	G1		100	-0-

Prepaid Insurance			Account No. 128		
Date	Explanation	PR	Debit	Credit	Balance
2005 Aug.	1	G1	600		600

Furniture			Account No. 161		
Date	Explanation	PR	Debit	Credit	Balance
2005 Aug.	2	G1	600		600

Store Equipment			Account No. 165		
Date	Explanation	PR	Debit	Credit	Balance
2005 Aug.	1	G1	15,000		15,000
	4	G1	1,200		16,200

Accounts Payable			Account No. 201		
Date	Explanation	PR	Debit	Credit	Balance
2005 Aug.	4	G1		1,200	1,200
	31	G1	400		800
	31	G1		75	875

Note: The T-account has been superimposed on each balance column ledger account for illustrative purposes only. It emphasizes that using T-accounts will produce identical balances to the balance column ledger account but in a shortened form. This shortened form is what makes the T-account a convenient tool.

Unearned Haircutting Services Revenue					Account No. 236	
Date	Explanation		PR	Debit	Credit	Balance
2005 Aug. 18			G1		500	500

Barbara Schmidt, Capital					Account No. 301	
Date	Explanation		PR	Debit	Credit	Balance
2005 Aug. 1			G1		18,000	18,000

Barbara Schmidt, Withdrawals					Account No. 302	
Date	Explanation		PR	Debit	Credit	Balance
2005 Aug. 31			G1	200		200

Haircutting Services Revenue					Account No. 403	
Date	Explanation		PR	Debit	Credit	Balance
2005 Aug. 15			G1		225	225
	15		G1		100	325
	31		G1		530	855

Wages Expense					Account No. 623	
Date	Explanation		PR	Debit	Credit	Balance
2005 Aug. 17			G1	125		125

Rent Expense					Account No. 640	
Date	Explanation		PR	Debit	Credit	Balance
2005 Aug. 3			G1	900		900

Hydro Expense					Account No. 690	
Date	Explanation		PR	Debit	Credit	Balance
2005 Aug. 31			G1	75		75

4.

THE CUTLERY Trial Balance August 31, 2005			
Acct. No.	Account	Debit	Credit
101	Cash	\$ 1,530	
106	Accounts receivable	-0-	
128	Prepaid insurance	600	
161	Furniture	600	
165	Store equipment	16,200	
201	Accounts payable		\$ 875
236	Unearned haircutting services revenue		500
301	Barbara Schmidt, capital		18,000
302	Barbara Schmidt, withdrawals	200	
403	Haircutting services revenue		855
623	Wages expenses	125	
640	Rent expense	900	
690	Hydro expense	75	
	Totals	<u>\$20,230</u>	<u>\$20,230</u>

5.

THE CUTLERY Income Statement For Month Ended August 31, 2005	
Revenues:	
Haircutting services revenue	\$ 855
Operating expenses:	
Rent expense	\$900
Wages expense	125
Hydro expense	75
Total operating expenses	<u>1,100</u>
Net loss	<u>\$ 245</u>

THE CUTLERY Statement of Owner's Equity For Month Ended August 31, 2005	
Barbara Schmidt, capital, August 1	\$ -0-
Add: Investments by owner	18,000
Total	<u>\$18,000</u>
Less: Withdrawals by owner	\$200
Net loss	<u>245</u>
Barbara Schmidt, capital, August 31	<u>\$17,555</u>

THE CUTLERY Balance Sheet August 31, 2005	
Assets	
Cash	\$ 1,530
Prepaid insurance	600
Furniture	600
Store equipment	16,200
Total assets	<u>\$18,930</u>
Liabilities	
Accounts payable	\$875
Unearned haircutting services revenue	500
Total liabilities	<u>\$ 1,375</u>
Owner's Equity	
Barbara Schmidt, capital	<u>17,555</u>
Total liabilities and owner's equity	<u>\$18,930</u>

Glossary

Account A place or location within an accounting system in which the increases and decreases in a specific asset, liability, or equity are recorded and stored. (p. 86)

Account balance The difference between the increases (including the beginning balance) and decreases recorded in an account. (p. 89)

Accounting cycle The steps repeated each reporting period for the purpose of preparing financial statements for users. (p. 86)

Accounts payable Obligations that arise when a promise to pay later is made in connection with purchases of merchandise, supplies, or equipment. (p. 87)

Accounts receivable When services are performed for or goods are sold to customers in return for promises to pay in the future, an *account receivable* is recorded. These transactions are said to be *on credit* or *on account*. Accounts receivable are *increased* by services performed or goods sold on credit and *decreased* by customer payments. (p. 87)

Balance column ledger account An account with debit and credit columns for recording entries and a third column showing the balance of the account after each entry is posted. (p. 101)

Chart of accounts A list of all accounts used by a company; includes the identification number assigned to each account. (p. 92)

Compound journal entry A journal entry that affects at least three accounts. (p. 99)

Credit An entry that decreases asset, expense, and owner's withdrawals accounts or increases liability, owner's capital, and revenue accounts; recorded on the right side of a T-account. (p. 90)

Debit An entry that increases asset, expense, and owner's withdrawals accounts or decreases liability, owner's capital, and revenue accounts; recorded on the left side of a T-account. (p. 90)

Double-entry accounting An accounting system where every transaction affects and is recorded in at least two accounts; the sum of the debits for all entries must equal the sum of the credits for all entries. (p. 90)

General Journal The most flexible type of journal; can be used to record any kind of transaction. (p. 99)

Journal A record where transactions are recorded before they are recorded in accounts; amounts are posted from the journal to the ledger; also called the *book of original entry*. (p. 99)

Journalizing Recording transactions in a journal. (p. 99)

Ledger A record containing all accounts used by a business. (p. 87)

Normal balance The debit or credit side on which an account increases. For example, assets increase with debits, therefore the normal balance for an asset is a debit. Revenues increase with credits, therefore a credit is the normal balance for a revenue account. (p. 92)

Note receivable An unconditional written promise to pay a definite sum of money on demand or on a defined future date(s); also called a *promissory note*. (p. 87)

Notes payable Obligations that arise when an organization formally recognizes a promise to pay by signing a promissory note. (p. 87)

Post(ing) Transfer journal entry information to ledger accounts. (p. 99)

Posting reference (PR) column A column in *journals* where individual account numbers are entered when entries are posted to the ledger. A column in *ledgers* where journal page numbers are entered when entries are posted. (p. 101)

Prepaid Expenses An asset account containing payments made for assets that are not to be used until later. (p. 87)

Promissory note An unconditional written promise to pay a definite sum of money on demand or on a defined future date(s); also called a *note receivable*. (p. 87)

T-account A simple characterization of an account form used as a helpful tool in showing the effects of transactions and events on specific accounts. (p. 89)

Transposition error Error due to two digits being switched or transposed within a number. (p. 106)

Trial balance A list of accounts and their balances at a point in time; the total debit balances should equal the total credit balances. (p. 104)

Unearned revenues Liabilities created when customers pay in advance for products or services; created when cash is received before revenues are earned; satisfied by delivering the products or services in the future. (p. 87)



For more study tools, quizzes, and problem material,

refer to the Online Learning Centre at

www.mcgrawhill.ca/college/larson

Questions

- Describe the fundamental steps in the accounting process.
- What is the difference between a note receivable and an account receivable?
- Reread the chapter's opening scenario describing Rethink Advertising. Rethink's expenses are about 75% of total revenues. Suggest appropriate account titles for 15 possible expense accounts.
- Review the Leon's Furniture balance sheet for fiscal year-end December 31, 2002, in Appendix I. Identify four different asset accounts and four different liability accounts.
- If assets are valuable resources and asset accounts have debit balances, why do expense accounts have debit balances?



6. Review the WestJet balance sheet for fiscal year-end December 31, 2002, in Appendix I. Identify three accounts on the balance sheet that would carry debit balances and three accounts on the balance sheet that would carry credit balances.
7. What kinds of transactions can be recorded in a General Journal?



8. Are debits or credits listed first in General Journal entries? Are the debits or the credits indented?
9. Should a transaction be recorded first in a journal or the ledger? Why?
10. Why does the bookkeeper prepare a trial balance?

Quick Study

Identify the account as an asset, liability, or equity by entering the letter of the account type beside the account name. If the item is an equity account, indicate the type of equity account.

QS 3-1

Identifying accounts

LO²

A = Asset
L = Liability
E = Owner's Capital (Equity)

W = Owner's Withdrawals (Equity)
R = Revenues (Equity)
E = Expenses (Equity)

- | | |
|----------------------------------|--------------------------------------|
| _____ 1. Buildings | _____ 10. Interest Earned |
| _____ 2. Building Repair Expense | _____ 11. Earned Subscription Fees |
| _____ 3. Wages Expense | _____ 12. Unearned Subscription Fees |
| _____ 4. Wages Payable | _____ 13. Prepaid Subscription Fees |
| _____ 5. Notes Receivable | _____ 14. Supplies |
| _____ 6. Notes Payable | _____ 15. Supplies Expense |
| _____ 7. Prepaid Advertising | _____ 16. Rent Revenue |
| _____ 8. Advertising Expense | _____ 17. Unearned Rent Revenue |
| _____ 9. Jan Sted, Withdrawals | _____ 18. Service Fees Earned |

Calculate the account balance for each of the following:

QS 3-2

Calculating account balances

LO³

Accounts Receivable		Accounts Payable		Service Revenue	
1,000	650	250	250		13,000
400	920	900	1,800		2,500
920	1,500	650	1,400		810
3,000			650		3,500

Utilities Expense		Cash		Notes Payable	
610		3,900	2,400	4,000	50,000
520		17,800	3,900	8,000	
390		14,500	21,800		
275		340			

Indicate whether the normal balance of each of the following accounts is a debit or a credit:

QS 3-3

Identifying normal balance as a debit or credit

LO³

- | | |
|-------------------------|------------------------|
| a. Equipment | f. Prepaid Rent |
| b. Land | g. Accounts Receivable |
| c. Al Tait, Withdrawals | h. Office Supplies |
| d. Rent Expense | i. Notes Receivable |
| e. Interest Revenue | j. Notes Payable |

Identify whether a debit or credit entry would be made to record the indicated change in each of the following accounts:

QS 3-4

Analyzing debit or credit by account

LO³

- | | |
|------------------------------------|-----------------------------------|
| a. To increase Notes Payable | f. To decrease Cash |
| b. To decrease Accounts Receivable | g. To increase Utilities Expense |
| c. To increase Owner, Capital | h. To increase Fees Earned |
| d. To decrease Unearned Fees | i. To increase Store Equipment |
| e. To decrease Prepaid Insurance | j. To increase Owner, Withdrawals |

QS 3-5

Linking credit or debit with normal balance

LO³

Indicate whether a debit or credit is necessary to *decrease* the normal balance of each of the following accounts:

- a. Buildings
- b. Interest Revenue
- c. Bob Norton, Withdrawals
- d. Bob Norton, Capital
- e. Prepaid Insurance
- f. Interest Payable
- g. Accounts Receivable
- h. Salaries Expense
- i. Office Supplies
- j. Repair Services Revenue

QS 3-6

Developing a chart of accounts

LO⁴

Using the numbering system on page 93, develop a chart of accounts that assigns an account number to each of the following accounts:

- a. Buildings
- b. Interest Revenue
- c. Bob Norton, Withdrawals
- d. Bob Norton, Capital
- e. Prepaid Insurance
- f. Interest Payable
- g. Accounts Receivable
- h. Salaries Expense
- i. Office Supplies
- j. Repair Services Revenue

QS 3-7

Recording directly into T-accounts

LO⁵

Record the following transactions directly in the T-accounts provided:

- a. Del Martin invested \$15,000 cash into his new business.
- b. Purchased \$2,000 of furniture on account.
- c. Purchased \$500 of furniture, paying cash.
- d. Did \$1,000 of work for a customer; collected cash.
- e. Did \$700 of work for a customer on account.

Cash 101	Accounts Receivable 106	Furniture 161
Accounts Payable 201	Del Martin, Capital 301	Revenue 403

QS 3-8

Preparing journal entries

LO^{3,5,6}

Prepare journal entries for the following transactions that occurred during January 2005:

- a. On January 15, Stan Adams opened a landscaping business by investing \$60,000 cash and equipment having a \$40,000 fair value.
- b. On January 20, purchased office supplies on credit for \$340.
- c. On January 28, received \$5,200 in return for providing landscaping services to a customer.

QS 3-9

Recording in T-accounts

LO^{5,6}

Post the journal entries from QS 3-8 into the following T-accounts:

Cash 101	Office Supplies 124	Equipment 163
Accounts Payable 201	Stan Adams, Capital 301	Landscaping Services Revenue 403

Using your account balances from QS 3-9, prepare a trial balance at January 31, 2005.

QS 3-10

Preparing a trial balance

LO⁷

A trial balance has total debits of \$21,000 and total credits of \$25,500. Which one of the following errors would create this imbalance? Explain.

- A \$4,500 debit to Salaries Expense in a journal entry was incorrectly posted to the ledger as a \$4,500 credit, leaving the Salaries Expense account with a \$750 debit balance.
- A \$2,250 credit to Consulting Fees Earned in a journal entry was incorrectly posted to the ledger as a \$2,250 debit, leaving the Consulting Fees Earned account with a \$6,300 credit balance.
- A \$2,250 debit to Rent Expense in a journal entry was incorrectly posted to the ledger as a \$2,250 credit, leaving the Rent Expense account with a \$3,000 debit balance.

QS 3-11

Identifying a posting error

LO^{3,5,6,7}

Identify the transposition error in the following trial balance, assuming this is the only error.

QS 3-12

Identifying a transposition error

LO⁷

SunFlowers Trial Balance September 30, 2005			
Acct. No.	Account	Debit	Credit
101	Cash.....	\$ 9,800	
106	Accounts receivable.....	2,200	
165	Equipment	7,000	
201	Accounts payable.....		\$ 750
301	Tracy Rumanko, Capital.....		3,800
403	Consulting revenue.....		17,000
623	Wages expense	1,150	
640	Rent expense.....	4,100	
	Totals	<u>\$24,250</u>	<u>\$21,550</u>

Exercises

Set up the following T-accounts: Cash; Accounts Receivable; Office Supplies; Office Equipment; Accounts Payable; Steve Moore, Capital; Steve Moore, Withdrawals; Fees Earned; and Rent Expense. Next, record these transactions of the Moore Company by recording the debit and credit entries directly in the T-accounts. Use the letters beside each transaction to identify the entries. Finally, determine the balance of each account.

- Steve Moore invested \$12,750 cash in the business.
- Purchased \$375 of office supplies for cash.
- Purchased \$7,050 of office equipment on credit.
- Received \$1,500 cash as fees for services provided to a customer.
- Paid for the office equipment purchased in transaction (c).
- Billed a customer \$2,700 as fees for services.
- Paid the monthly rent with \$525 cash.
- Collected \$1,125 of the account receivable created in transaction (f).
- Steve Moore withdrew \$1,000 cash from the business.

Exercise 3-1

Recording the effects of transactions directly in T-accounts

LO^{3,5}

Check figure:
Total cash = \$6,425

Exercise 3-2

Recording the effects of transactions directly in T-accounts

LO 3.5

Check figure:

Total cash = \$370

Della's Accounting Services began operations on January 1, 2005. Set up the following T-accounts, which show balances at January 31: Cash (\$700), Accounts Receivable (\$1,200); Prepaid Insurance (\$0); Computer Equipment (\$450); Accounts Payable (\$30); Notes Payable (\$0); Della Morris, Capital (\$800); Della Morris, Withdrawals (\$0); Service Revenue (\$2,600); Wages Expense (\$1,080). The activities below occurred during February. Identify the transactions and record them directly in the T-accounts. Use the dates beside each transaction to identify the entries. Also, determine the balance of each account.

- Feb. 2 Della provided services to a customer and collected cash of \$1,400.
- 10 \$3,800 of new computer equipment was purchased for the business by signing a note.
- 12 \$7,500 of accounting services were performed for a client on account.
- 14 Paid the \$2,000 annual insurance premium covering the next 12 months.
- 18 Billed a client \$950 for work performed today.
- 20 Collected \$1,200 from a credit customer.
- 21 Della ordered \$800 in new accounting software from a local vendor; it will be paid for when it arrives in about two weeks.
- 23 Paid the outstanding accounts payable.
- 25 Della withdrew \$500 cash.
- 26 A part-time employee was paid wages of \$400.

Exercise 3-3

Recording the effects of transactions directly in T-accounts

LO 3.5

Check figure:

Total cash = \$2,880

On March 1, 2005, Nels Sigurdson opened an automotive repair shop called Nels Car Repairs. Set up the following T-accounts that show balances at March 31, 2005: Cash (\$1,800); Accounts Receivable (\$4,800); Repair Supplies (\$1,400); Equipment (\$7,400); Accounts Payable (\$500); Nels Sigurdson, Capital (\$2,350); Nels Sigurdson, Withdrawals (\$500); Repair Revenue (\$14,000); Rent Expense (\$950). The activities below occurred during April. Identify the transactions and record them directly in the T-accounts. Use the dates beside each transaction to identify the entries. Also, determine the balance of each account.

- Apr. 2 Nels did some repairs on a car today and immediately collected \$780.
- 5 Nels hired a tune-up specialist who will start next month and get paid \$3,000 per month.
- 9 Repair supplies were purchased on credit; \$890.
- 10 Paid \$400 regarding the supplies purchased on April 9.
- 15 Bought a small piece of equipment, paying cash of \$300.
- 18 Did work for a customer on account; \$1,200.
- 19 Collected \$2,000 regarding a customer's account.
- 25 Rented some specialized equipment from Ace Rentals; \$250 on account.
- 29 Nels withdrew \$1,000 cash.

Exercise 3-4

Journalizing, posting, preparing a trial balance, and financial statements

LO 3.5, 6, 7

Check figure:

5. Total assets = \$30,500

NorthCo incurred the following transactions during July 2005, its first month of operations:

- July 1 The owner, Greg Duggan, invested \$10,000 cash.
- 10 Purchased \$5,000 worth of equipment on credit.
- 12 Performed services for a client and received \$20,000 cash.
- 14 Paid for expenses; \$7,000.
- 15 Completed services for a client and sent a bill for \$3,000.
- 31 The owner withdrew \$500 cash.

Required

1. Create a General Ledger by setting up the following accounts: Cash, 101; Accounts Receivable, 106; Equipment, 150; Accounts Payable, 201; Greg Duggan, Capital, 301; Greg Duggan, Withdrawals, 302; Revenue, 401; Expenses, 501.
2. Journalize the July transactions in the General Journal.
3. Post the July transactions from your General Journal into your General Ledger accounts.
4. Prepare a trial balance based on the balances in your General Ledger accounts.
5. Prepare an income statement, statement of owner's equity and balance sheet based on your trial balance.

You have been given the following guide regarding the chart of accounts for EastCo:

100–199	Assets	400–499	Revenues
200–299	Liabilities	500–599	Expenses
300–399	Owner's Equity		

Exercise 3-5

Chart of accounts

LO⁴

Using the account information from Exercise 3-6, develop a chart of accounts for EastCo.

EastCo showed the following account balances in its General Ledger accounts as at January 31, 2005.

Cash	23,000	Accounts Receivable	12,000
Office Equipment	25,000	Accounts Payable	6,000
Unearned Revenue	1,000	Bill Evans, Capital	19,000
Bill Evans, Withdrawals	4,000	Consulting Revenues	75,000
Salaries Expense	20,000	Rent Expense	15,000
Utilities Expense	2,000		

Exercise 3-6

Journalizing, posting, preparing a trial balance, and financial statements

LO^{3, 5, 6, 7}

During February, the following transactions occurred:

- Feb. 1 Performed work for a client and received cash of \$17,000.
- 5 Paid \$4,000 regarding outstanding accounts payable.
- 10 Received cash of \$5,000 for work to be done in March.
- 12 Called FasCo Rentals to book the use of some equipment next month. It will be paid in full when the equipment is returned.
- 17 The owner withdrew cash of \$1,000.
- 28 Paid salaries of \$20,000.

Required

1. Journalize the February transactions in the General Journal.
2. Post the transactions from your General Journal to the General Ledger (T-accounts above).
3. Prepare a trial balance based on the balances in your General Ledger.
4. Prepare the balance sheet as at February 28, 2005.

Check figure:
4. Total assets = \$57,000

Exercise 3-7

Analyzing transactions from T-accounts

LO^{3,5}

Seven transactions were posted to the following T-accounts. Provide a short description of each transaction. Include the amounts in your descriptions. The first one is done as an example.

(a) *The owner invested a total of \$23,600, including cash of \$7,000, an automobile valued at \$11,000, and equipment worth \$5,600.*

Cash			
(a)	7,000	3,600	(b)
(e)	2,500	600	(c)
		2,400	(f)
		700	(g)

Automobiles	
(a)	11,000

Accounts Payable			
(f)	2,400	9,600	(d)

Office Supplies	
(c)	600
(d)	200

Jerry Steiner, Capital	
	23,600 (a)

Delivery Services Revenue			
		2,500	(e)

Prepaid Insurance	
(b)	3,600

Equipment	
(a)	5,600
(d)	9,400

Gas and Oil Expense	
(g)	700

Exercise 3-8

General Journal entries

LO¹

Use the information in the T-accounts in Exercise 3-7 to prepare General Journal entries for the seven transactions.

Exercise 3-9

General Journal entries

LO^{3,5,6}

TLC Laser Eye Centres showed the following selected activities during the month of April 2005. Journalize the transactions in your General Journal.

- April 5 Performed surgery on a customer today and collected \$1,500 cash.
- 8 Purchased surgical supplies on credit; \$3,000.
- 15 Paid salaries; \$57,000.
- 20 Paid for the surgical supplies purchased on April 8.
- 22 Contacted a client's lawyer today regarding a complaint about the surgery. The client is planning to sue for \$100,000.
- 27 Performed six surgeries today, all on credit; \$1,500 each.
- 30 Paid the April utilities bill today; \$1,800.

Exercise 3-10

Analyzing and journalizing revenue transactions

LO^{3,5,6}

Examine the following transactions and identify those that created revenues for Jarrell Services, a sole proprietorship owned by John Jarrell. Prepare General Journal entries to record those transactions and explain why the other transactions did not create revenues.

- a. John Jarrell invested \$38,250 cash in the business.
- b. Provided \$1,350 of services on credit.
- c. Received \$1,575 cash for services provided to a client.
- d. Received \$9,150 from a client in payment for services to be provided next year.
- e. Received \$4,500 from a client in partial payment of an account receivable.
- f. Borrowed \$150,000 from the bank by signing a promissory note.

Examine the following transactions and identify those that created expenses for Jarrell Services. Prepare General Journal entries to record those transactions and explain why the other transactions did not create expenses.

- Paid \$14,100 cash for office supplies purchased 30 days previously.
- Paid the \$1,125 salary of the receptionist.
- Paid \$45,000 cash for equipment.
- Paid utility bill with \$930 cash.
- John Jarrell withdrew \$5,000 from the business account for personal use.

Exercise 3-11
Analyzing and journalizing
expense transactions

LO 3, 5, 6

Hay's Landscape Consultants is in its second month of operations. You have been given the following journal entries regarding its January 2005 transactions.

Required

- Set up the following accounts (use the balance column format) entering the opening balances brought forward from the end of last month, December 31, 2004: Cash (101) \$1,700; Accounts Receivable (106) \$600; Equipment (167) \$3,000; Accounts Payable (201) \$650; Alice Hay, Capital (301) \$4,650; Alice Hay, Withdrawals (302) \$600; Fees Earned (401) \$3,600; and Salaries Expense (622) \$3,000.
- Post the journal entries to the accounts and enter the balance after each posting.

Exercise 3-12
Posting from the General
Journal to the ledger

LO 4, 6

Check figure:
b. Jan. 31/05 Cash
balance = \$7,200

General Journal				Page 1	
Date	Account Titles and Explanation	PR	Debit	Credit	
2005					
Jan. 1	Cash		7,000		
	Alice Hay, Capital			7,000	
	<i>Additional owner investment.</i>				
12	Accounts Receivable		18,000		
	Fees Earned			18,000	
	<i>Performed work for a customer on account.</i>				
20	Equipment		24,000		
	Accounts Payable			20,000	
	Cash			4,000	
	<i>Purchased equipment by paying cash and the balance on credit.</i>				
31	Cash		10,000		
	Accounts Receivable			10,000	
	<i>Collected cash from credit customer.</i>				
31	Salaries Expense		6,000		
	Cash			6,000	
	<i>Paid month-end salaries.</i>				
31	Alice Hay, Withdrawals		1,500		
	Cash			1,500	
	<i>Alice Hay withdrew cash for personal use.</i>				

Follow the instructions in Exercise 3-12, but instead of using a balance column format for the accounts, use T-accounts.

Exercise 3-13
Posting from the General
Journal to T-accounts

LO 4, 6

Exercise 3-14

General Journal entries

LO^{3,5,6}

Prepare General Journal entries to record the following August 2005 transactions of a new business called PhotoFinish Co.

- Aug. 1 Hannah Young, the owner, invested \$7,500 cash and photography equipment with a fair value of \$32,500.
 - 1 Rented a studio, paying \$3,000 for the next three months in advance.
 - 5 Purchased office supplies for \$1,400 cash.
 - 20 Received \$2,650 in photography fees.
 - 31 Paid \$875 for August utilities.

Exercise 3-15

Ledger accounts and the trial balance

LO^{3,5,6,7}

Set up the following accounts (use the balance column format): Cash (101); Office Supplies (124); Prepaid Rent (131); Photography Equipment (167); Hannah Young, Capital (301); Photography Fees Earned (401); and Utilities Expense (690). Then, using your General Journal entries from Exercise 3-14, post to the ledger. Finally, prepare the August 31, 2005, trial balance.

Check figure:

Trial balance
total debits = \$42,650

Exercise 3-16

T-accounts and the trial balance

LO^{3,5,6,7}

Follow the instructions in Exercise 3-15, but instead of using a balance column format for the accounts, use T-accounts.

Exercise 3-17

Preparation of financial statements from a trial balance

LO⁷

Check figure:

Total assets = \$2,950

JenCo showed the following trial balance information (in alphabetical order) for its first month just ended March 31, 2005:

Account	Debit	Credit
Accounts payable		\$ 260
Accounts receivable	\$ 950	
Cash	1,000	
Equipment	700	
Interest expense	10	
Marie Jensen, capital		2,050
Marie Jensen, withdrawals	1,500	
Notes payable		800
Prepaid insurance	300	
Salaries expense	800	
Service revenue		1,900
Unearned service revenue		250
Totals	<u>\$5,260</u>	<u>\$5,260</u>

Required

Use the information provided to complete an income statement, statement of owner's equity, and balance sheet.

XYZ Co. showed the following trial balance information (in alphabetical order) for its second month just ended March 31, 2005:

Account	Debit	Credit
Accounts payable.....		\$ 23,000
Accounts receivable.....	\$ 7,000	
Building.....	40,000	
Cash.....	15,000	
Fees earned.....		85,000
John Biggs, capital*.....		61,000
John Biggs, withdrawals.....	9,000	
Land.....	58,000	
Machinery.....	25,000	
Notes payable.....		73,000
Office supplies.....	1,500	
Office supplies expense.....	3,500	
Wages expense.....	83,000	
Totals.....	<u>\$242,000</u>	<u>\$242,000</u>

*The \$61,000 balance includes \$5,000 invested by the owner during March.

Required

Using the information provided, prepare an income statement and a statement of owner's equity for the month ended March 31, 2005, and a balance sheet at March 31, 2005.

Exercise 3-18

Preparation of financial statements from a trial balance

LO7

Check figure:
Total assets = \$146,500

Complete the following table by filling in the blanks. For each of the listed posting errors:

- Enter in column (1) the amount of the difference that the error would create between the two trial balance columns (show a zero if the columns would balance).
- Identify if there would be a difference between the two columns, identify in column (2) the trial balance column that would be larger.
- Identify the account(s) affected in column (3).
- Identify the amount by which the account(s) is under- or overstated in column (4). The answer for the first error is provided as an example.

Exercise 3-19

Effects of posting errors on the trial balance

LO3,5,6,7

	Description	(1) Difference Between Debit and Credit Columns	(2) Column with the Larger Total	(3) Identify Account(s) Incorrectly Stated	(4) Amount That Account(s) Is Over- or Understated
a.	A \$2,400 debit to Rent Expense was posted as a \$1,590 debit.	\$810	Credit	Rent Expense	Rent Expense is understated by \$810
b.	A \$42,000 debit to Machinery was posted as a debit to Accounts Payable.				
c.	A \$4,950 credit to Services Revenue was posted as a \$495 credit.				
d.	A \$1,440 debit to Store Supplies was not posted at all.				
e.	A \$2,250 debit to Prepaid Insurance was posted as a debit to Insurance Expense.				
f.	A \$4,050 credit to Cash was posted twice as two credits to the Cash account.				
g.	A \$9,900 debit to the owner's withdrawals account was debited to the owner's capital account.				

Exercise 3-20

Analyzing trial balance

LO^{3,5,6,7}

During March, Shawna Cameron, the owner of Cameron Cleaning Services, had trouble keeping her debits and credits equal. The following errors were noted:

- Shawna did not post the entry to record \$7,000 of services performed on account.
- In posting a \$600 payment on account, Shawna debited Cash and credited Accounts Payable.
- In posting a cash payment, Shawna correctly debited Accounts Payable for \$850 but incorrectly credited Cash for \$580.
- In posting a cash receipt, Shawna debited Cash but forgot to post the credit to Accounts Receivable.
- In posting the purchase of \$2,000 of equipment on credit, Shawna debited Accounts Payable and credited Equipment.

Required

For each of the errors described, indicate:

- Whether debits equal credits on the trial balance, and
- Which account(s) have incorrect balances.

Exercise 3-21

Transposition errors on the trial balance

LO⁷**Required**

Identify the single transposition error in each of the following independent trial balances.

	Case A	Case B	Case C			
Cash.....	120	3,900	59			
Accounts receivable.....	260	1,900	46			
Equipment	3,170	12,900	791			
Accounts payable.....	190	2,350	72			
Capital.....	1,100	16,150	229			
Withdrawals.....	850	700	-0-			
Revenue.....	3,000	9,600	641			
Wages expense.....	610	4,200	10			
Totals	5,010	4,290	23,600	28,100	906	942

Problems

Problem 3-1A

Recording transactions in T-accounts

LO^{3,5}

Following are business activities completed by Kevin Smith during the month of November 2005:

- Invested \$80,000 cash and office equipment with a \$30,000 fair value in a new sole proprietorship named Apex Consulting.
- Purchased land and a small office building. The land was worth \$30,000, and the building was worth \$170,000. The purchase price was paid with \$40,000 cash and a long-term note payable for \$160,000.
- Purchased \$2,400 of office supplies on credit.
- Transferred title of his personal automobile to the business. The automobile had a value of \$18,000 and was to be used exclusively in the business.
- Purchased \$6,000 of additional office equipment on credit.
- Paid \$1,500 salary to an assistant.
- Provided services to a client and collected \$6,000 cash.
- Paid \$800 for the month's utilities.
- Signed an equipment rental agreement to commence in January. A deposit of \$500 must be paid by December 15.
- Paid account payable created in transaction (c).
- Purchased \$20,000 of new office equipment by paying \$18,600 cash and trading in old equipment with a recorded cost of \$1,400.
- Completed \$5,200 of services for a client. This amount is to be paid within 30 days.
- Paid \$1,500 salary to an assistant.
- Received \$3,800 payment on the receivable created in transaction (l).
- Withdrew \$6,400 cash from the business for personal use.

Required

1. Set up the following T-accounts: Cash; Accounts Receivable; Office Supplies; Automobiles; Office Equipment; Building; Land; Accounts Payable; Long-Term Notes Payable; Kevin Smith, Capital; Kevin Smith, Withdrawals; Fees Earned; Salaries Expense; and Utilities Expense.
2. Record the effects of the transactions by entering debits and credits directly in the T-accounts. Use the transaction letters to identify each debit and credit entry.

Spin Master Toys showed the following selected transactions for the month ended May 31, 2005:

- May 1 Purchased new equipment, paying cash of \$50,000 and signing a 90-day note payable for the balance of \$175,000.
- 2 Purchased 12 months of insurance to begin May 2; paid \$3,600.
- 3 Completed a toy design for a customer today and received \$12,000.
- 4 Purchased office supplies on account; \$7,500.
- 6 Returned to the supplier \$1,000 of defective office supplies purchased on May 4.
- 10 Provided services to a client today on account; \$23,000.
- 15 Paid for the May 4 purchase less the return of May 6.
- 20 Received payment from the client of May 10.
- 25 Received cash of \$1,200 from a client for work to be done in June.
- 31 Paid month-end salaries of \$94,000.
- 31 Paid the May telephone bill today; \$4,500.
- 31 Received the May electrical bill today; \$1,800. It will be paid on June 15.

Required

Prepare General Journal entries for each of the above transactions.

Carrie Ford opened a new accounting practice called Carrie Ford, Public Accountant, and completed these activities during March 2005:

- Mar. 1 Invested \$25,000 in cash and office equipment that had a fair value of \$6,000.
- 1 Prepaid \$1,800 cash for three months' rent for an office.
- 3 Made credit purchases of office equipment for \$3,000 and office supplies for \$600.
- 5 Completed work for a client and immediately received \$500 cash.
- 9 Completed a \$2,000 project for a client, who will pay within 30 days.
- 11 Paid the account payable created on March 3.
- 15 Paid \$1,500 cash for the annual premium on an insurance policy.
- 20 Received \$1,600 as partial payment for the work completed on March 9.
- 22 Placed an order with a supplier for \$2,400 of supplies to be delivered April 7. They must be paid for within 15 days of being received.
- 23 Completed work for another client for \$660 on credit.
- 27 Carrie Ford withdrew \$1,800 cash from the business to pay some personal expenses.
- 30 Purchased \$200 of additional office supplies on credit.
- 31 Paid \$175 for the month's utility bill.

Required

Prepare General Journal entries to record the transactions.

Required

Using the General Journal entries prepared in Problem 3-3A, complete the following:

1. Set up the following accounts (use the balance column format): Cash (101); Accounts Receivable (106); Office Supplies (124); Prepaid Insurance (128); Prepaid Rent (131); Office Equipment (163); Accounts Payable (201); Carrie Ford, Capital (301); Carrie Ford, Withdrawals (302); Accounting Fees Earned (401); and Utilities Expense (690).
2. Post the entries to the accounts and enter the balance after each posting.
3. Prepare a trial balance as of the end of the month.

Problem 3-2A

Preparing General Journal entries

LO^{3,5,6}

Problem 3-3A

Preparing General Journal entries

LO^{3,5,6}

Problem 3-4A

Posting, preparing a trial balance

LO^{4,6,7}

Check figure:
3. Total Dr = \$34,360

Problem 3-5A

Posting, preparing a trial balance

Follow the instructions in Problem 3-4A, but instead of using a balance column format for the accounts in Part 1, use T-accounts.

LO^{4,6,7}**Check figure:**

3. Total Dr = \$34,360

Problem 3-6A

Preparing and posting
General Journal entries and
preparing a trial balance

Hector Mendez opened a computer consulting business called Capital Consultants and completed the following transactions during May 2005:

LO^{3,4,5,6,7}

- May 1 Mendez invested \$100,000 in cash and office equipment that had a fair value of \$24,000 in the business.
- 1 Prepaid \$7,200 cash for three months' rent for an office.
 - 2 Made credit purchases of office equipment for \$12,000 and office supplies for \$2,400.
 - 6 Completed services for a client and immediately received \$2,000 cash.
 - 9 Completed an \$8,000 project for a client, who will pay within 30 days.
 - 10 Paid the account payable created on May 2.
 - 19 Paid \$6,000 cash for the annual premium on an insurance policy.
 - 22 Received \$6,400 as partial payment for the work completed on May 9.
 - 25 Completed work for another client for \$2,640 on credit.
 - 31 Mendez withdrew \$6,200 cash from the business for personal use.
 - 31 Purchased \$800 of additional office supplies on credit.
 - 31 Paid \$700 for the month's utility bill.

Check figure:

4. Total Dr = \$137,440

Required

1. Prepare General Journal entries to record the transactions. Use page 1 for the journal.
2. Set up the following accounts (use the balance column format): Cash (101); Accounts Receivable (106); Office Supplies (124); Prepaid Insurance (128); Prepaid Rent (131); Office Equipment (163); Accounts Payable (201); Hector Mendez, Capital (301); Hector Mendez, Withdrawals (302); Services Revenue (403); and Utilities Expense (690).
3. Post the entries to the accounts and enter the balance after each posting.
4. Prepare a trial balance at May 31, 2005.

Problem 3-7A

Posting, preparing a trial balance

Follow the instructions in Problem 3-6A, but instead of using a balance column format for the accounts in Part 2, use T-accounts.

LO^{3,4,5,6,7}**Check figure:**

4. Total Dr = \$137,440

CAPITAL CONSULTANTS			
Trial Balance			
May 31, 2005			
Acct. No.	Account Title	Debit	Credit
101	Cash.....	\$ 73,900	
106	Accounts receivable.....	4,240	
124	Office supplies.....	3,200	
128	Prepaid insurance	6,000	
131	Prepaid rent	7,200	
163	Office equipment.....	36,000	
201	Accounts payable.....		\$ 800
301	Hector Mendez, capital.....		124,000
302	Hector Mendez, withdrawals	6,200	
403	Services revenue		12,640
690	Utilities expense	700	
	Totals	<u>\$137,440</u>	<u>\$137,440</u>

Problem 3-8A

Preparing financial statements from a trial balance

LO7

Required

Using the trial balance provided above, prepare an income statement and statement of owner's equity for the first month ended May 31, 2005, and a balance sheet at May 31, 2005.

Check figures:
 Net income = \$11,940
 Total assets = \$130,540

Jamil Engineering, a sole proprietorship, completed the following transactions during July 2005, the third month of operations:

- July 1 Jamil Alsuwaidi, the owner, invested \$150,000 cash, office equipment with a value of \$6,000, and \$45,000 of drafting equipment in the business.
- 2 Purchased land for an office. The land was worth \$54,000, which was paid with \$5,400 cash and a long-term note payable for \$48,600.
- 3 Purchased a portable building with \$75,000 cash and moved it onto the land.
- 5 Paid \$6,000 cash for the premiums on two one-year insurance policies.
- 7 Completed and delivered a set of plans for a client and collected \$700 cash.
- 9 Purchased additional drafting equipment for \$22,500. Paid \$10,500 cash and signed a long-term note payable for the \$12,000 balance.
- 10 Completed \$2,000 of engineering services for a client. This amount is to be paid within 30 days.
- 12 Purchased \$2,250 of additional office equipment on credit.
- 15 Completed engineering services for \$3,500 on credit.
- 16 Received a bill for rent on equipment that was used on a completed job. The \$6,900 rent must be paid within 30 days.
- 17 Collected \$200 from the client of July 10.
- 19 Paid \$6,000 wages to the drafting assistants.
- 22 Paid the account payable created on July 12.
- 25 Paid \$675 cash for some repairs to an item of drafting equipment.
- 26 Jamil Alsuwaidi withdrew \$400 cash from the business for personal use.
- 30 Paid \$6,000 wages to the drafting assistants.
- 31 Paid \$3,000 cash for advertising in the local newspaper during July.

Problem 3-9A

Journalizing, posting, preparing a trial balance

LO3, 4, 5, 6, 7

Required

1. Prepare General Journal entries to record the transactions. Use page 1 for the journal.
2. Set up the following accounts (use the balance column format), entering the balances brought forward from June 30, 2005: Cash (101) \$13,000; Accounts Receivable (106) \$1,500; Prepaid Insurance (128) \$250; Office Equipment (163) \$850; Drafting Equipment (167) \$600; Building (173) \$21,000; Land (183) \$14,000; Accounts Payable (201) \$870; Long-Term Notes Payable (251) \$12,000; Jamil Alsuwaidi, Capital (301) \$27,000; Jamil Alsuwaidi, Withdrawals (302) \$500; Engineering Fees Earned (401) \$14,800; Wages Expense (623) \$2,000; Equipment Rental Expense (645) \$500; Advertising Expense (655) \$320; and Repairs Expense (684) \$150.
3. Post the entries to the accounts and enter the balance after each posting.
4. Prepare a trial balance at July 31, 2005.

Check figure:
 4. Total Dr = \$329,370

Problem 3-10A

Posting, preparing a trial balance

Follow the instructions in Problem 3-9A, but instead of using a balance column format for the accounts in Part 2, use T-accounts.

LO^{3,4,5,6,7}

Check figure:

4. Total Dr = \$329,370

Problem 3-11A

Preparing financial statements from a trial balance

LO⁷

JAMIL ENGINEERING Trial Balance July 31, 2005			
Acct. No.	Account Title	Debit	Credit
101	Cash.....	\$ 48,675	
106	Accounts receivable.....	6,800	
128	Prepaid insurance	6,250	
163	Office equipment.....	9,100	
167	Drafting equipment.....	68,100	
173	Building.....	96,000	
183	Land.....	68,000	
201	Accounts payable.....		\$ 7,770
251	Long-term notes payable		72,600
301	Jamil Alsuwaidi, capital.....		228,000
302	Jamil Alsuwaidi, withdrawals.....	900	
401	Engineering fees earned.....		21,000
623	Wages expense	14,000	
645	Equipment rental expense	7,400	
655	Advertising expense	3,320	
684	Repairs expense	825	
	Totals	<u>\$329,370</u>	<u>\$329,370</u>

Check figures:

Net loss = \$4,545

Total assets = \$302,925

Required

Using the trial balance provided above, prepare an income statement and statement of owner's equity for the first three months ended July 31, 2005, and a balance sheet at July 31, 2005.

Problem 3-12A

Analyzing trial balance errors

During January, Dallas Glynn, the owner of Glynn's Window Washing Services, had difficulty getting the debits to equal credits on the January 31, 2005, trial balance.

LO^{3,5,6,7}

Glynn's Window Washing Services Trial Balance January 31, 2005		
	Debit	Credit
Cash	\$ 5,800	
Accounts receivable	4,620	
Prepaid insurance.....	1,200	
Equipment.....	12,000	
Accounts payable.....		\$ 2,700
Dallas Glynn, capital		22,500
Dallas Glynn, withdrawals.....	4,100	
Service revenues.....		30,200
Salaries expense	18,000	
Insurance expense	2,600	
Maintenance expense.....	6,500	
Utilities expense.....	2,600	
Totals	<u>\$57,420</u>	<u>\$55,400</u>

The following errors were discovered:

- a. Glynn did not post a \$2,000 purchase of Equipment on credit.
- b. In posting a \$700 collection from a credit customer, Glynn debited Accounts Receivable and credited Cash.
- c. In journalizing a cash receipt, Glynn correctly debited Cash for \$350 but incorrectly credited Accounts Receivable for \$530.
- d. In posting a \$2,200 payment on account, Glynn debited Accounts Payable but forgot to post the credit to Cash.
- e. In posting the entry for services of \$1,800 performed for a customer on credit, Glynn debited Accounts Receivable but credited Maintenance Expense.

Required

Prepare a corrected trial balance.

Check figure:
Total Dr = \$59,200

Alternate Problems

West Consulting completed these transactions during June 2005:

- a. Susan West, the sole proprietor, invested \$23,000 cash and office equipment with a \$12,000 fair value in the business.
- b. Purchased land and a small office building. The land was worth \$8,000 and the building was worth \$33,000. The purchase price was paid with \$15,000 cash and a long-term note payable for \$26,000.
- c. Purchased \$600 of office supplies on credit.
- d. Susan West transferred title of her personal automobile to the business. The automobile had a value of \$7,000 and was to be used exclusively in the business.
- e. Purchased \$1,100 of additional office equipment on credit.
- f. Paid \$800 salary to an assistant.
- g. Provided services to a client and collected \$2,700 cash.
- h. Paid \$430 for the month's utilities.
- i. Paid account payable created in transaction (c).
- j. Purchased \$4,000 of new office equipment by paying \$2,400 cash and trading in old equipment with a recorded cost of \$1,600.
- k. Completed \$2,400 of services for a client. This amount is to be paid within 30 days.
- l. Paid \$800 salary to an assistant.
- m. Received \$1,000 payment on the receivable created in transaction (k).
- n. Susan West withdrew \$1,050 cash from the business for personal use.

Required

1. Set up the following T-accounts: Cash; Accounts Receivable; Office Supplies; Automobiles; Office Equipment; Building; Land; Accounts Payable; Long-Term Notes Payable; Susan West, Capital; Susan West, Withdrawals; Fees Earned; Salaries Expense; and Utilities Expense.
2. Record the effects of the listed transactions by entering debits and credits directly in the T-accounts. Use the transaction letters to identify each debit and credit entry.

Problem 3-1B
Recording transactions in
T-accounts

LO 3, 5

Problem 3-2B

Preparing General Journal entries

LO^{3,5,6}

SunBlush Technologies showed the following selected transactions for the month ended March 31, 2005:

- Mar. 1 Purchased a new building, paying cash of \$250,000 and signing a note payable for the balance of \$500,000.
- 1 Purchased six months of insurance to begin March 1; paid \$7,200.
- 3 Provided consulting services to the local botanical garden society; collected \$5,000.
- 4 Purchased cleaning supplies on account; \$750.
- 10 Performed work for a client today on account; \$55,000.
- 11 Made a hotel reservation by phone regarding a business meeting to be held on March 28. The full payment of \$180 will be required upon arrival at the hotel.
- 15 Paid for the March 4 purchase.
- 20 Collected cash of \$10,000 from a customer. The consulting work will be done in April.
- 28 Registered at the hotel booked on March 11 and paid the \$180 bill. Attended the out-of-town business meeting and returned to the office the next day.
- 30 Paid month-end salaries of \$49,000.
- 30 Received the March telephone bill today; \$1,300. It will be paid April 14.
- 30 Collected half of the amount owed by the customer of March 10.

Required

Prepare General Journal entries for each of the above transactions.

Problem 3-3B

Preparing General Journal entries

LO^{3,5,6}

Adam Uppe, Public Accountant, completed these activities during September 2005, the first month of operations:

- Sept. 1 Began a public accounting practice by investing \$4,200 in cash and office equipment having a \$4,800 fair value.
- 1 Prepaid two months' rent in advance on suitable office space, \$1,800.
- 2 Purchased on credit office equipment, \$420, and office supplies, \$75.
- 4 Completed accounting work for a client and immediately received payment of \$180 cash.
- 8 Completed accounting work on credit for Frontier Bank, \$700.
- 10 Paid for the items purchased on credit on September 2.
- 14 Paid the annual \$750 premium on an insurance policy.
- 15 Paid \$250 to attend an all-day seminar on September 20 regarding ethical accounting practices.
- 18 Received payment in full from Frontier Bank for the work completed on September 8.
- 20 Attended the seminar paid for on September 15.
- 24 Completed accounting work on credit for Travis Realty, \$500.
- 28 Adam Uppe withdrew \$300 cash from the practice to pay personal expenses.
- 29 Purchased additional office supplies on credit, \$45.
- 30 Paid the September utility bills, \$165.

Required

Prepare General Journal entries to record the transactions.

Problem 3-4B

Posting, preparing a trial balance

LO^{4,6,7}**Check figure:**

3. Total Dr = \$10,425

Required

Using the General Journal entries prepared in Problem 3-3B, complete the following:

1. Set up the following accounts (use the balance column format): Cash (101); Accounts Receivable (106); Office Supplies (124); Prepaid Insurance (128); Prepaid Rent (131); Office Equipment (163); Accounts Payable (210); Adam Uppe, Capital (301); Adam Uppe, Withdrawals (302); Accounting Fees Earned (401); Professional Development Expense (680); and Utilities Expense (690).
2. Post the entries to the accounts and enter the balance after each posting.
3. Prepare a trial balance as of September 30, 2005.

Follow the instructions in Problem 3-4B, but instead of using a balance column format for the accounts in Part 1, use T-accounts.

Problem 3-5B

Posting, preparing a trial balance

LO 4, 6, 7

Check figure:

3. Total Dr = \$10,425

Leonard Management Services completed these transactions during November 2005:

- Nov. 1 Arthur Leonard, the owner, invested \$48,000 cash and office equipment that had a fair value of \$25,000 in the business.
 2 Prepaid \$10,500 cash for three months' rent for an office.
 4 Made credit purchases of office equipment for \$9,000 and office supplies for \$1,200.
 8 Completed work for a client and immediately received \$2,600 cash.
 12 Completed a \$3,400 project for a client, who will pay within 30 days.
 13 Paid the account payable created on November 4.
 19 Paid \$5,200 cash as the annual premium on an insurance policy.
 22 Received \$1,800 as partial payment for the work completed on November 12.
 24 Completed work for another client for \$1,900 on credit.
 28 Arthur Leonard withdrew \$5,300 from the business for personal use.
 29 Purchased \$1,700 of additional office supplies on credit.
 30 Paid \$8,000 in wages.
 30 Paid \$1,460 for the month's utility bill.

Problem 3-6B

Preparing and posting General Journal entries; preparing a trial balance

LO 3, 4, 5, 6, 7

Required

1. Prepare General Journal entries to record the transactions. Use General Journal page 1.
2. Set up the following accounts (use the balance column format): Cash (101); Accounts Receivable (106); Office Supplies (124); Prepaid Insurance (128); Prepaid Rent (131); Office Equipment (163); Accounts Payable (201); Arthur Leonard, Capital (301); Arthur Leonard, Withdrawals (302); Service Fees Earned (401); Wages Expense (680); and Utilities Expense (690).
3. Post the entries to the accounts, and enter the balance after each posting.
4. Prepare a trial balance at November 30, 2005.

Check figure:

4. Total Dr = \$82,600

Follow the instructions in Problem 3-6B, but instead of using a balance column format for the accounts in Part 2, use T-accounts.

Problem 3-7B

Posting, preparing a trial balance

LO 3, 4, 5, 6, 7

Check figure:

4. Trial balance Dr = \$82,600

Problem 3-8B

Preparing financial statements from a trial balance

LO⁷**Check figures:**

Net loss = \$1,560

Total assets = \$67,840

LEONARD MANAGEMENT SERVICES			
Trial Balance			
November 30, 2005			
Acct. No.	Account Title	Debit	Credit
101	Cash.....	\$11,740	
106	Accounts receivable.....	3,500	
124	Office supplies.....	2,900	
128	Prepaid insurance	5,200	
131	Prepaid rent	10,500	
163	Office equipment.....	34,000	
201	Accounts payable.....		\$ 1,700
301	Arthur Leonard, capital.....		73,000
302	Arthur Leonard, withdrawals.....	5,300	
401	Service fees earned		7,900
680	Wages expense	8,000	
690	Utilities expense	1,460	
	Totals	<u>\$82,600</u>	<u>\$82,600</u>

Use the trial balance provided above to prepare an income statement and statement of owner's equity for the first month ended November 30, 2005, and a balance sheet at November 30, 2005.

Problem 3-9B

Journalizing, posting, preparing a trial balance

LO^{3, 4, 5, 6, 7}

At the beginning of June 2005, Avery Wilson created a custom computer programming company called Softouch Co. The company had the following transactions during July, its second month of operations:

- July 1 Purchased on credit office equipment for \$4,500 and computer equipment for \$28,000.
- 2 Purchased land for an office. The land was worth \$24,000, which was paid with \$4,800 cash and a long-term note payable for \$19,200.
- 3 Purchased a portable building with \$21,000 cash and moved it onto the land.
- 5 Paid \$6,600 cash for the premiums on two one-year insurance policies.
- 9 Provided services to a client and collected \$3,200 cash.
- 12 Purchased additional computer equipment for \$3,500. Paid \$700 cash and signed a long-term note payable for the \$2,800 balance.
- 15 Completed \$3,750 of services for a client. This amount is to be paid within 30 days.
- 16 Purchased \$750 of additional office equipment on credit.
- 20 Completed another software job for \$9,200 on credit.
- 21 Received a bill for rent on a computer that was used on the completed job. The \$320 rent must be paid within 30 days.
- 22 Collected \$4,600 from the client described in the transaction on July 20.
- 23 Paid \$1,600 wages to an assistant.
- 24 Paid the account payable created in the transaction of July 16.
- 25 Paid \$425 cash for some repairs to an item of computer equipment.
- 26 Avery Wilson withdrew \$3,875 in cash from the business for personal use.
- 27 Paid \$1,600 wages to an assistant.
- 28 Paid \$800 cash for advertising in the local newspaper during July.
- 29 Received \$1,400 from a client for services to be performed in August.

Check figure:

4. Total Dr = \$148,495

Required

1. Prepare General Journal entries to record the transactions. Use page 1 for the journal.
2. Set up the following accounts (use the balance column format), entering the balances brought forward from June 30, 2005: Cash (101) \$51,175; Accounts Receivable (106) \$950; Prepaid Insurance (128) \$275; Office Equipment (163) \$1,200; Computer Equipment (167) \$800; Building (173) \$14,000; Land (183) \$6,000; Accounts Payable (201) \$725; Unearned Fees (233) \$-0-; Long-Term Notes Payable (251) \$7,000; Avery Wilson, Capital (301) \$60,000; Avery Wilson, Withdrawals (302) \$600; Fees Earned (401) \$8,400; Wages Expense (623) \$780; Computer Rental Expense (645) \$230; Advertising Expense (655) \$75; and Repairs Expense (684) \$40.
3. Post the entries to the accounts and enter the balance after each posting.
4. Prepare a trial balance as of the end of the month.

Follow the instructions in Problem 3-9B, but instead of using a balance column format for the accounts in Part 2, use T-accounts.

Problem 3-10B

Posting, preparing a trial balance

LO 3, 4, 5, 6, 7

Check figure:

4. Total Dr = \$148,495

SOFTOUCH CO. Trial Balance July 31, 2005			
Acct. No.	Account Title	Debit	Credit
101	Cash.....	\$ 18,225	
106	Accounts receivable.....	9,300	
128	Prepaid insurance	6,875	
163	Office equipment.....	6,450	
167	Computer equipment.....	32,300	
173	Building.....	35,000	
183	Land.....	30,000	
201	Accounts payable.....		\$ 33,545
233	Unearned fees		1,400
251	Long-term notes payable		29,000
301	Avery Wilson, capital.....		60,000
302	Avery Wilson, withdrawals.....	4,475	
401	Fees earned.....		24,550
623	Wages expense	3,980	
645	Computer rental expense	550	
655	Advertising expense	875	
684	Repairs expense	465	
	Totals	<u>\$148,495</u>	<u>\$148,495</u>

LO 7

Problem 3-11B

Preparing financial statements
from a trial balance

Required

Using the trial balance provided above, prepare an income statement and a statement of owner's equity for the first two months ended July 31, 2005, and a balance sheet at July 31, 2005.

Check figures:

Net income = \$18,680

Total assets = \$138,150

On January 1, 2005, Jan Taylor started a new business called The Party Place. Near the end of the year, she hired a new bookkeeper without making a careful reference check. As a result, a number of mistakes have been made in preparing the following trial balance:

Problem 3-12B

Analyzing trial balance errors

LO 3, 5, 6, 7

THE PARTY PLACE Trial Balance December 31		
	Debit	Credit
Cash	\$ 5,500	
Accounts receivable		\$ 7,900
Office supplies	2,650	
Office equipment	20,500	
Accounts payable		9,465
Jan Taylor, capital.....	16,745	
Services revenue.....		22,350
Wages expense.....		6,000
Rent expense		4,800
Advertising expense.....		1,250
Totals	<u>\$45,395</u>	<u>\$52,340</u>

Taylor's analysis of the situation has uncovered these errors:

- a. The sum of the debits in the Cash account is \$37,175 and the sum of the credits is \$30,540.
- b. A \$275 payment from a credit customer was posted to Cash but was not posted to Accounts Receivable.
- c. A credit purchase of office supplies for \$400 was not posted at all.
- d. A transposition error occurred in copying the balance of the Services Revenue account to the trial balance. The correct amount was \$23,250.

Other errors were made in placing account balances in the wrong trial balance columns and in taking the totals of the columns.

Check figure:

Total Dr = \$49,860

Required

Prepare a corrected trial balance.

Analytical and Review Problems

A & R Problem 3-1

Carlos Young started an engineering firm called Young Engineering. He began operations in March 2005 and completed seven transactions, including his initial investment of \$17,000 cash. After these transactions, the ledger included the following accounts with their normal balances:

Cash.....	\$26,660
Office Supplies	660
Prepaid Insurance	3,200
Office Equipment.....	16,500
Accounts Payable	16,500
Carlos Young, Capital.....	17,000
Carlos Young, Withdrawals	3,740
Engineering Fees Earned	24,000
Rent Expense	6,740

Required

Preparation component:
Prepare a trial balance for the business.

Analysis component:
Analyze the accounts and balances and prepare narratives that describe each of the seven most likely transactions and their amounts.

Ethics Challenge

EC 3-1



You are a cashier at a retail convenience store. When you were hired, the manager explained to you the policy of immediately ringing up each sale. Recently, lunch hour traffic has increased dramatically and the assistant manager asks you to take customers' cash and make change without ringing up sales to avoid delays. The assistant manager says she will add up cash and ring up sales equal to the cash amount after lunch. She says that in this way the register will always be accurate when the owner arrives at 3:00 p.m.

Required

1. Identify the advantages and disadvantages of the assistant manager's suggestion.
2. Identify the ethical dilemma and evaluate at least two courses of action you might consider and why.

Serial Problem

Echo Systems

(This comprehensive problem starts in this chapter and continues in Chapters 4, 5, and 6. Because of its length, this problem is most easily solved if you use the Working Papers that accompany this text.)

On October 1, 2005, Mary Graham organized a computer service company called Echo Systems. Echo is organized as a sole proprietorship and will provide consulting services, computer system installations, and custom program development. Graham has adopted the calendar year for reporting, and expects to prepare the company's first set of financial statements as of December 31, 2005. The initial chart of accounts for the accounting system includes these items:

Account Number	Account Name	Account Number	Account Name
101	Cash	301	Mary Graham, Capital
106	Accounts Receivable	302	Mary Graham, Withdrawals
126	Computer Supplies	403	Computer Services Revenue
128	Prepaid Insurance	623	Wages Expense
131	Prepaid Rent	655	Advertising Expense
163	Office Equipment	676	Mileage Expense
167	Computer Equipment	684	Repairs Expense, Computer
201	Accounts Payable	699	Charitable Donations Expense

Part A**Required**

1. Set up balance column accounts based on the chart of accounts provided.
2. Prepare journal entries to record each of the following October transactions.
3. Post the October entries.
4. Prepare a trial balance at October 31, 2005.
5. Prepare an income statement and a statement of owner's equity for the month ended October 31, 2005, as well as a balance sheet at October 31, 2005.

- Oct. 1 Mary Graham invested \$45,000 cash, an \$18,000 computer system, and \$9,000 of office equipment in the business.
- 2 Paid rent in advance of \$4,500.
- 3 Purchased computer supplies on credit for \$1,320 from Abbott Office Products.
- 5 Paid \$2,160 cash for one year's premium on a property and liability insurance policy.
- 6 Billed Capital Leasing \$3,300 for installing a new computer.
- 8 Paid for the computer supplies purchased from Abbott Office Products.
- 10 Hired Carly Smith as a part-time assistant for \$100 per day, as needed.
- 12 Billed Capital Leasing another \$1,200 for computer services rendered.
- 15 Received \$3,300 from Capital Leasing on its account.
- 17 Paid \$705 to repair computer equipment damaged when moving into the new office.
- 20 Paid \$1,860 for an advertisement in the local newspaper.
- 22 Received \$1,200 from Capital Leasing on its account.
- 28 Billed Decker Company \$3,225 for services.
- 31 Paid Carly Smith for seven days' work.
- 31 Mary Graham withdrew \$3,600 cash from the business for personal use.

Part B**Required**

6. Prepare journal entries to record each of the following November transactions.
7. Post the November entries.
8. Prepare a trial balance at November 30, 2005.
9. Prepare an income statement and a statement of owner's equity for the two months ended November 30, 2005, as well as a balance sheet at November 30, 2005.

- Nov. 1 Reimbursed Mary Graham's business automobile expense for 1,000 kilometres at \$0.50 per kilometre.
- 2 Received \$4,650 cash from Elite Corporation for computer services rendered.
- 5 Purchased \$960 of computer supplies for cash from Abbott Office Products.
- 8 Billed Fostek Co. \$4,350 for computer services rendered.
- 13 Notified by Alamo Engineering Co. that Echo's bid of \$3,750 for an upcoming project was accepted.
- 18 Received \$1,875 from Decker Company against the bill dated October 28.
- 22 Donated \$750 to the United Way in the company's name.
- 24 Completed work for Alamo Engineering Co. and sent a bill for \$3,750.
- 25 Sent another bill to Decker Company for the past due amount of \$1,350.
- 28 Reimbursed Mary Graham's business automobile expense for 1,200 kilometres at \$0.50 per kilometre.
- 30 Paid Carly Smith for 14 days' work.
- 30 Mary Graham withdrew \$1,800 cash from the business for personal use.