CHAPTER 2: ACCOUNTING FOR TRANSACTIONS

I. FINANCIAL STATEMENTS

A. Income Statement

- Describes a company’s revenues and expenses along with the resulting net income or loss over a period of time due to earnings activities.

- Examples of accounts on form: Consulting revenue, rental revenue, advertising expense, rent expense, salaries expense

B. Statement of Retained Earnings

- Explains changes in retained earnings from net income (or loss) and from any dividends over a period of time.

- Examples of accounts on form: Retained earnings for April 1, 2009, Net Income or (net loss), Dividends, retained earnings for April 30, 2009
C. Balance Sheet

- Describes a company’s financial position (types and amounts of assets, liabilities, and equity) at a point in time.
- Examples of accounts on form: assets like cash, accounts receivable, supplies, equipment; liabilities like accounts payable; equity like common stock and retained earnings

D. Statement of Cash Flows

- Identifies cash inflows (receipts) and cash outflows (payments) over a period of time.
- Has three sections: 1st section on cash flows from Operating Activities, 2nd section reports Investing Activities, and the 3rd section shows cash flows from Financing Activities.
- Examples of accounts on form: cash from operating activities, purchase of equipment, investments by stockholder, dividends to stockholder
II. TRANSACTION ANALYSIS AND THE ACCOUNTING EQUATION

A. Accounting Equation

1. Assets

- Resources owned or controlled by a company.
- **Examples**: cash, accounts receivable, supplies, equipment, and land
- These resources are expected to yield future benefits
- **Examples**: musical instruments for a rock band, land for a vegetable grower
- **Receivable**—is an asset that promises a future inflow of resources.
- A company that provides a service or product “on credit’ is said to have an account receivable from that customer.

2. Liabilities

- What a company owes to its creditors in future payments, products, or services.
- **Payable**—means a liability that promises a future outflow of resources.
- **Examples**: wages payable to workers, accounts payable to suppliers, notes payable to banks, taxes payable to the government

3. Equity

- Is the owner’s claim on assets.
- It is the owner’s actual interest in the business.
- Also called “net assets” or “residual equity”.
- Can be found by subtracting total assets from total liabilities.
Corporation’s equity is called stockholders’ equity or shareholders’ equity.

**Revenues**—increase in company resources from the sale of goods or services.

**Examples**: consulting services provided, sales of products, facilities rented to others, commissions from services

**Expense**—costs encountered in the normal course of business.

**Examples**: costs of employee time, use of supplies, advertising from others, utilities from others

**Net Income**—an overall measure of performance for the period which equals revenues less expenses.

4. **Equation**

   a. **Basic Accounting Equation**

   **Assets** = **Liabilities** + **Equity**

   Assets must be equal to the claims against those assets.

   If you have an asset, we can have two broad categories of claims against that asset.

   First, we may have claims by creditors, liabilities.

   Secondly, after all creditor claims are satisfied, owners and stockholders have a claim on those assets.
Expanded Accounting Equation

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

**Common stock**—when an owner invests in a company in exchange for common stock.

**Dividends**—a corporation’s distribution of assets to its owners; it reduces the equity account.

### B. Transaction Analysis

- Business activities can be described in terms of transactions and events.
- **Events**—are happenings that affect an entity’s accounting equation AND can be reliably measured.
- **Examples**: changes in the market value of certain assets and liabilities, natural events such as floods and fires that destroy assets and create losses
- During the process of recording business transactions, it is IMPORTANT to always keep the accounting equation in balance. We can’t let our books get out of balance.

### III. ANALYZING AND RECORDING PROCESS

- The accounting process identifies business transactions and events, analyzes and records their effects, and summarizes and presents information in reports and financial statements.
- **External transactions**—where external parties like creditors, customers, financial institutions and owners have exchanges of value between the two entities.
**Internal transactions**—transactions that may involve exchanges between divisions within a company or payments to employees.

**The analyzing and recording process consists of:**

1. Analyze each transaction and event from source documents
2. Record relevant transactions and events in a journal
3. Post journal information to ledger accounts
4. Prepare and analyze the trial balance

**A. Source Documents**

- Identify and describe transactions and events entering the accounting process.
- Provide objective and reliable evidence about transactions and events and their amounts.
- Can be in hard copy form or in electronic form.
- **Examples:** sales tickets, checks, purchase orders, bills from suppliers, employee earnings records, and bank statements

**B. The Account and Its Analysis**

- **Account**—a record of increases and decreases in a specific asset, liability, equity, revenue, or expense item.
- Account information is analyzed, summarized, and presented in reports and financial statements.

- **General Ledger (or ledger)**—is a record containing all accounts used by a company.
- Accounts are arranged in three general categories based on the accounting equation: 1. Assets, 2. Liabilities, 3. Equity
1. **Asset Accounts**

- **Assets**—are resources owned or controlled by a company and that have expected future benefits.

- **Examples**: cash, accounts receivable, note receivable (or promissory note), prepaid accounts, supplies, equipment, buildings, land

a. **Cash**

- Reflects a company’s cash balance.
- All increases and decreases in cash are recorded in this account.
- **Examples**: money and any medium of exchange that a bank accepts for deposit (coins, checks, money orders, and checking account balances)

b. **Accounts Receivable**

- Also called **credit sales** or **sales on account** (or on credit).
- Are promises of payment from customers to sellers.
- Customers charge the item with the seller, get to take the item home and pay for it later.
- Account receivables are increased by credit sales.
- Account receivables are decreased when customers make payments.

c. **Note Receivable (or Promissory Note)**

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

- Are assets that represent prepayments of FUTURE expenses (NOT current expenses).

- When the expense finally happens through the passage of time or are used up, the amounts in prepaid accounts are transferred to expense accounts.

- **Examples:** prepaid insurance, prepaid rent, prepaid services (such as club memberships)

- Prepaid accounts are adjusted when the financial statements are prepared so that: (1) all expired and used prepaid accounts are recorded as regular expenses and (2) all unexpired and unused prepaid accounts are recorded as assets.

- **Example:** a *premium* is an insurance fee that is paid in advance for a certain length of time (i.e. one year). It is listed as Prepaid Insurance and is an asset for the insurance coverage that we have paid for in advance but haven’t used yet. Once we use up a month’s worth of insurance, it is deducted from the worth of Prepaid Insurance (an asset) and is recorded as an expense.

e. **Supplies**

- Are considered assets until they are used.

- When used up, their costs are reported as expenses.

- Are grouped by purpose—Office Supplies, Store Supplies

- Office Supplies includes stationery, paper, toner, pens.

- Store Supplies includes packaging materials, plastic and paper bags, gift boxes and cartons, cleaning materials.

f. **Equipment**

- Is an asset.

- Are grouped by purpose—Office Equipment, Store Equipment

- Office Equipment includes computers, printers, desks, chairs, and shelves.
Store Equipment includes counters, showcases, ladders, hoists, and cash registers.

g. **Buildings**  
- Are assets because they provide expected future benefits to those who control or own them.  
- **Examples:** stores, offices, warehouses, and factories  
- Separate accounts are sometimes kept when a business owns several buildings.

h. **Land**  
- The cost of land owned by a business is recorded in a Land account.  
- Buildings on that land are recorded in a Building account.

2. **Liability Accounts**  
- Are claims by creditors against assets; obligations to transfer assets or provide products or services to other entities/companies.

- **Creditors**—individuals and organizations that own the right to receive payments from a company.

- It’s when your business charges items with another company and still owes the money.

- If your business fails to pay the company (creditor) money when it is due, the creditor has a legal right to take your assets, sell them and pay for your debt.

- **Examples:** Accounts Payable, Note Payable, Accrued Liabilities

a. **Accounts Payable**  
- Oral or implied promises to pay later, which usually happens from purchases of merchandise on account.
It can also happen from purchases of supplies, equipment, and services.

b. Notes Payable

- A formal promise, usually indicated by the signing of a promissory note, to pay a future amount.

- Depending on when it is to be paid, it can be recorded either to a short-term Note Payable account or a long-term Note Payable account.

c. Unearned Revenue

- **Revenue**—also called sales

- Is when the cash has been received but the product or service has not been delivered.

- **Example:** you subscribe to a magazine, you pay a one-year subscription in advance. The publishing company has received cash but nothing has been done to earn that revenue. As the magazine is delivered to you, the publishing company recognizes a portion of the money received as revenue. At the end of the year, all the revenue will be earned and the liability no longer exists.

d. Accrued Liabilities

- Amounts owed that are not yet paid.

- **Examples:** Wages Payable, Taxes Payable, Interest Payable

3. Equity Accounts

- Also called stockholders’ equity, or shareholders’ equity

- Is the owner’s claim on a corporation’s assets.

- Equity is the owners’ remaining interest in the assets of a business after deducting liabilities.
Equity is affected by four accounts: common stock, dividends, revenues, and expenses.

a. **Common Stock**

- When an owner invest in a company in exchange for a share/stock in the company.
- Increases equity.

b. **Dividends**

- Opposite of owner investment and decreases equity.
- It’s the distribution of assets to the stockholders.
- Is an account used in recording asset distribution to stockholders/owners.

c. **Revenues**

- When products and services are sold or provided to customers.
- Increases equity.
- **Examples:** Sales, Commissions Earned, Professional Fees Earned, Rent Earned, Interest Revenue

d. **Expenses**

- Result from assets and services used in a company’s operation.
- Decreases equity.
- **Examples:** Advertising Expense, Store Supplies Expense, Office Salaries Expense, Office Supplies Expense, Rent Expense, Utilities Expense, Insurance Expense
IV. ANALYZING AND PROCESSING TRANSACTIONS

A. Ledger and Chart of Accounts

Ledger (or General Ledger)—a record containing all the accounts and their amounts for a business.

A small company may have 20 to 30 accounts.

A large company may have several thousand accounts.

Chart of Accounts—is a list of all accounts a company uses and includes an identification number assigned to each account.

The identification number is a 3-digit code.

The first digit refers to the type of account it is—asset, liability, etc.

The second and third digits relate to the accounts’ subcategories.

B. Debits and Credits

T-account—represents a ledger account; it is used as a tool to understand the effects of one or more transactions.

t-account is in the shape of a capital T.

Debit (Dr.)—is the left side of an account.

Credit (Cr.)—is the right side of an account.

When you enter an amount on the left side of an account, you debit the account.

When you enter an amount on the right side of an account, you credit the account.

Account balance—is the difference between total debits and total credits for an account including any beginning balance.
Debit balance—when the sum of the debits exceeds the sum of the credits.

Credit balance—when the sum of the credits exceeds the sum of the debits.

Zero balance—when the sum of debits equals the sum of credits.

C. Double-Entry Accounting

Double-entry accounting—requires that each transaction affects at least two accounts and is recorded in two accounts.

It also means that the total debits of a transaction must equal the total credits.

With transactions, if you increase one side of the accounting equation, you must increase the other side.

If you decrease one side of the accounting equation, you must decrease the other side.

If the transaction affects only one side of the accounting equation, then one account is increased and one account is decreased.

Dividends, Expenses, Assets (DEA) have Normal Balances on the Debit side OR on the side that you increase.

Liabilities, Equity, Common Stock, Revenues (LECR) have Normal Balances on the Credit side OR on the side that you increase.

Equity has 4 sub-categories: Common Stock, Dividends, Revenue, Expenses.

Common Stock and Revenues INCREASE Equity on the Credit side.

Dividends and Expenses DECREASE Equity on the Debit side.

D. Journalizing and Posting Transactions

Journal—gives a complete record of each transaction in one place.
Journalizing—is the process of recording transactions in a journal.

Posting—the process of transferring journal entry information to the ledger.

Steps in Processing Transactions:

1) Analyze transactions and source documents.

2) Apply double-entry accounting by putting it into T-accounts.

3) Record each transaction in a journal as a journal entry.

4) Post journal entry to the ledger.

1. Journalizing Transactions

General Journal—an all-purpose journal for recording the debits and credits of transactions and events.

Posting Reference (PR) column—is left blank in a manual system when entering a transaction in the General Journal. Later this column will be filled in with a number when you post to the Ledgers.

The General Journal can be used to record any transaction and includes the following information:

1) date of transaction

2) titles of affected accounts

3) dollar amount of each debit and credit

4) explanation of the transaction
To record entries (transactions) into a General Journal, follow these steps:

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

2) On the same line as the month and day, enter titles of accounts debited aligned with the left margin of the column. Then enter amounts in the Debit column on the same line.

3) On the line below, indent and enter titles of accounts credited. Then enter amounts in the Credit column on the same line.

4) Indent half as far as the credited account title on the next line below. It is italicized. Then enter a brief explanation of the transaction. It references a source document. Then leave a blank line in between transactions for clarity purposes.

2. Balance Column Account

- Is similar to a T-account in that it has columns for debits and credits.

- It also has columns for the Date, Explanation, PR (post reference), and Balance.

- The heading of the Balance column does not show whether it is a debit or a credit balance.

3. Posting Journal Entries

- To make sure that the ledger is up-to-date, entries are posted as soon as possible.

- It could be daily, weekly, or when time permits.
Posting creates a link and a cross-reference between the ledger and the General Journal entry.

All entries must be posted to the ledgers before financial statements can be prepared.

If it is a debit in the General Journal, then it is a debit in the Ledger.

Steps to post a journal entry:

1) Identify the ledger account that is debited in the entry; then, in the ledger, enter the entry date, the journal and page in its PR column, the debit amount, and the new balance of the ledger.

2) Enter the ledger account number in the PR column of the General Journal.

3) and 4) Repeat the first two steps for credit entries and amounts.

E. Analyzing Transactions—An Illustration

<table>
<thead>
<tr>
<th>ANALYSIS</th>
<th>Identify</th>
<th>1. Determine what accounts are affected.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Classify</td>
<td>2. Determine what kind of account it is (i.e. asset, liability, etc.)</td>
</tr>
<tr>
<td></td>
<td>+/-</td>
<td>3. Determine if each account increases or decreases</td>
</tr>
<tr>
<td></td>
<td>Balance</td>
<td>4. Determine if the accounting equation is in balance.</td>
</tr>
<tr>
<td></td>
<td>Debit/Credit Rule</td>
<td>Which account is debited? ________________________________</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Which account is credited? ________________________________</td>
</tr>
<tr>
<td></td>
<td>T-Accounts</td>
<td></td>
</tr>
</tbody>
</table>
1. **Investment by Owner**

**TRANSACTION #1:** Shareholders invested $30,000 in FastForward on Dec. 1.

**ANALYSIS**

1. **Identify** 1. Cash; Common Stock

2. **Classify** 2. Cash → Asset; Common Stock → Equity

3. **+/−** 3. Cash +; Common Stock +

4. **Balance** 4. The equation is balanced

**Debit/Credit Rule** Which account is debited? **Cash**

Which account is credited? **Common Stock**

**T-Accounts**

<table>
<thead>
<tr>
<th></th>
<th>Cash</th>
<th>Common Stock</th>
</tr>
</thead>
<tbody>
<tr>
<td>+ 30,000</td>
<td>-</td>
<td>+ 30,000</td>
</tr>
</tbody>
</table>

**Assets** = **Liab** + **Equity**

<table>
<thead>
<tr>
<th>Cash</th>
<th>Accts Recev</th>
<th>Supp</th>
<th>Prepd Insur</th>
<th>Equipment</th>
<th>Accts Pay</th>
<th>Commo n Stock</th>
<th>Dividends</th>
<th>Reven ue</th>
<th>Exp</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bal.</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>1</td>
<td>+30,000</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>+30,000</td>
</tr>
</tbody>
</table>

Bal. 30,000 + 0 + 0 + 0 + 0 + 0 = 0 + 30,000 - 0 + 0 - 0

**Double Entry:**

<table>
<thead>
<tr>
<th></th>
<th>Cash</th>
<th>30,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1)</td>
<td>Common Stock</td>
<td></td>
</tr>
</tbody>
</table>
2. **Purchase Supplies for Cash**

**TRANSACTION #2**: FastForward purchases supplies by paying $2,500 cash.

**ANALYSIS**

1. **Identify** Cash; Supplies

2. **Classify** Cash → Asset; Supplies → Asset

3. **+/-** Cash - ; Supplies +

4. **Balance** The equation is balanced

**Debit/Credit Rule**

Which account is debited? **Supplies**

Which account is credited? **Cash**

**T-Accounts**

<table>
<thead>
<tr>
<th>Supplies</th>
<th>Cash</th>
</tr>
</thead>
<tbody>
<tr>
<td>+ 2,500</td>
<td>- 2,500</td>
</tr>
</tbody>
</table>

**Assets** = **Liab** + **Equity**

<table>
<thead>
<tr>
<th>Cash + Accts Recv + Supp + Prep + Prepd Insur + Equipment = Accts Pay + Commo + Dividends + Revenue - Expenses</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bal. 30,000 0 0 0 0 0 = 0 30,000 0 0 0 0</td>
</tr>
<tr>
<td>2 -2,500 +2,500</td>
</tr>
<tr>
<td>Bal. 27,500 + 0 + 2,500 + 0 + 0 = 0 + 30,000 - 0 + 0 - 0</td>
</tr>
</tbody>
</table>

**Double Entry:**

<table>
<thead>
<tr>
<th>(2) Supplies</th>
<th>Cash</th>
<th>2,500</th>
<th>2,500</th>
</tr>
</thead>
</table>
3. **Purchase Equipment for Cash**

TRANSACTION #3: FastForward purchases equipment by paying $26,000 cash.

**ANALYSIS**

1. **Identify**  
   Equipment; Cash

2. **Classify**  
   Equipment → Asset; Cash → Asset

3. **+/−**  
   Equipment +; Cash −

4. **Balance**  
   The equation is balanced

**Debit/Credit Rule**  
*Which account is debited? Equipment*

*Which account is credited? Cash*

**T-Accounts**

<table>
<thead>
<tr>
<th></th>
<th>Equipment</th>
<th></th>
<th>Cash</th>
</tr>
</thead>
<tbody>
<tr>
<td>+</td>
<td>26,000</td>
<td>-</td>
<td>26,000</td>
</tr>
<tr>
<td>Bal.</td>
<td>1,500</td>
<td>0</td>
<td>2,500</td>
</tr>
</tbody>
</table>

**Assets** = **Liab** + **Equity**

<table>
<thead>
<tr>
<th>Cash</th>
<th>AcctsRecv</th>
<th>Supp</th>
<th>Prepdp</th>
<th>Insur</th>
<th>Equipment</th>
<th>=</th>
<th>AcctsPay</th>
<th>CommoStock</th>
<th>Dividends</th>
<th>Reven</th>
<th>Exp</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bal.</td>
<td>27,500</td>
<td>0</td>
<td>2,500</td>
<td>0</td>
<td>0</td>
<td>=</td>
<td>0</td>
<td>30,000</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
</tbody>
</table>

3  ·26,000

+26,000

Bal. 1,500  +  0  +  2,500  +  0  +  26,000  =  0  +  30,000  -  0  +  0  -  0

**Double Entry:**

<table>
<thead>
<tr>
<th>(3)</th>
<th>Equipment</th>
<th>26,000</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Cash</td>
<td>26,000</td>
</tr>
</tbody>
</table>
4. **Purchase Supplies on Credit**

**TRANSACTION #4:** FastForward purchases $7,100 of supplies on credit.

**ANALYSIS**

1. **Identify**
   - Supplies; Accounts Payable

2. **Classify**
   - Supplies → Asset; Accounts Payable → Liability

3. **+/−**
   - Supplies +; Accounts Payable +

4. **Balance**
   - The equation is balanced

**Debit/Credit Rule**

Which account is debited? **Supplies**

Which account is credited? **Accounts Payable**

**T-Accounts**

<table>
<thead>
<tr>
<th>Supplies</th>
<th>Accounts Payable</th>
</tr>
</thead>
<tbody>
<tr>
<td>+ 7,100</td>
<td>- 7,100</td>
</tr>
</tbody>
</table>

**Assets** = **Liab** + **Equity**

<table>
<thead>
<tr>
<th>Cash</th>
<th>Accts Receivable</th>
<th>Supp</th>
<th>Prep</th>
<th>Equipment</th>
<th>Accts Pay</th>
<th>Commo Stock</th>
<th>Dividends</th>
<th>Revenue</th>
<th>Exp</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bal.</td>
<td>1,500</td>
<td>0</td>
<td>2,500</td>
<td>0</td>
<td>26,000</td>
<td>0</td>
<td>30,000</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>4</td>
<td>+7,100</td>
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<td></td>
</tr>
<tr>
<td>Bal.</td>
<td>1,500</td>
<td>0</td>
<td>9,600</td>
<td>0</td>
<td>26,000</td>
<td>7,100</td>
<td>30,000</td>
<td>0</td>
<td>0</td>
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</table>

**Double Entry:**

<table>
<thead>
<tr>
<th>(4) Supplies</th>
<th>7,100</th>
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</thead>
<tbody>
<tr>
<td>Accounts Payable</td>
<td></td>
</tr>
<tr>
<td>7,100</td>
<td></td>
</tr>
<tr>
<td></td>
<td>7,100</td>
</tr>
</tbody>
</table>
5. **Provide Services for Cash**

TRANSACTION #5: FastForward provides consulting services and immediately collects $4,200 cash.

### ANALYSIS

**Identify** 1. Cash; Consulting Revenue

**Classify** 2. Cash → Asset; Consulting Revenue → Equity

**+/-** 3. Cash +; Consulting Revenue +

**Balance** 4. The equation is in balance.

**Debit/Credit Rule** Which account is debited? **Cash**

Which account is credited? **Consulting Revenue**

**T-Accounts**

<table>
<thead>
<tr>
<th>Cash</th>
<th>Consulting Revenue</th>
</tr>
</thead>
<tbody>
<tr>
<td>+4,200</td>
<td>-4,200</td>
</tr>
</tbody>
</table>

### Double Entry:

<table>
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</tr>
</thead>
<tbody>
<tr>
<td>1,500</td>
<td>+0</td>
<td>+9,600</td>
<td>0</td>
<td>26,000</td>
<td>=</td>
<td>7,100</td>
<td>30,000</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>5</td>
<td>+4,200</td>
<td></td>
<td></td>
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<td></td>
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<td></td>
</tr>
<tr>
<td>Bal.</td>
<td>5,700</td>
<td>+0</td>
<td>+9,600</td>
<td>0</td>
<td>+26,000</td>
<td>=</td>
<td>7,100</td>
<td>+30,000</td>
<td>-0</td>
<td>+4,200</td>
</tr>
</tbody>
</table>

**Cons. +4,200**
<table>
<thead>
<tr>
<th></th>
<th>Cash</th>
<th>Consulting Revenue</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>(5)</td>
<td>$4,200</td>
<td>$4,200</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

### 6. Payment of Expense in Cash

**TRANSACTION #6:** FastForward pays $1,000 for December rent to the landlord of the building where its facilities are located.

**ANALYSIS**

1. **Identify** 1. Cash; Rent Expense

2. **Classify** 2. Cash $\rightarrow$ Asset; Rent Expense $\rightarrow$ Equity

3. Pay $\rightarrow$ Expense

4. **Balance** The equation is in balance.

**Debit/Credit Rule**
- Which account is debited? Rent Expense
- Which account is credited? Cash

**T-Accounts**

<table>
<thead>
<tr>
<th>Rent Expense</th>
<th>Cash</th>
</tr>
</thead>
<tbody>
<tr>
<td>+ 1,000</td>
<td>-</td>
</tr>
<tr>
<td>-</td>
<td>+ 1,000</td>
</tr>
</tbody>
</table>

**Assets = Liab + Equity**

<table>
<thead>
<tr>
<th>Cash</th>
<th>Accts Receivables</th>
<th>Supplies</th>
<th>Prepaid Insurance</th>
<th>Equipment</th>
<th>Accts Payable</th>
<th>Common Stock</th>
<th>Dividends</th>
<th>Revenue</th>
<th>Expenses</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bal</td>
<td>5,700</td>
<td>0</td>
<td>9,600</td>
<td>0</td>
<td>26,000</td>
<td>7,100</td>
<td>30,000</td>
<td>4,200</td>
<td>0</td>
</tr>
<tr>
<td>6</td>
<td>-1,000</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bal</td>
<td>4,700</td>
<td>0</td>
<td>9,600</td>
<td>0</td>
<td>26,000</td>
<td>7,100</td>
<td>30,000</td>
<td>4,200</td>
<td>-1,000</td>
</tr>
</tbody>
</table>

**Double Entry:**
<table>
<thead>
<tr>
<th>(6)</th>
<th>Rent Expense</th>
<th>1,000</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Cash</td>
<td>1,000</td>
</tr>
</tbody>
</table>

7. Payment of Expense in Cash

TRANSACTION #7: FastForward pays the bi-weekly $700 salary of the company’s only employee.

ANALYSIS

Identify 1. Cash; Salaries Expense

Classify 2. Cash → Asset; Salaries Expense → Equity

+/- 3. Cash - ; Salaries Expense +

Balance 4. The equation is in balance.

Debit/Credit Rule Which account is debited? Salaries Expense

Which account is credited? Cash

T-Accounts

<table>
<thead>
<tr>
<th>Cash</th>
<th>Salaries Expense</th>
</tr>
</thead>
<tbody>
<tr>
<td>+</td>
<td>- 700</td>
</tr>
<tr>
<td></td>
<td>+ 700</td>
</tr>
</tbody>
</table>

Assets \[=\] Liab + Equity

<table>
<thead>
<tr>
<th>Cash +</th>
<th>Accts Recv +</th>
<th>Supp +</th>
<th>Prep +</th>
<th>Equipment +</th>
<th>Accts Pay +</th>
<th>Commo Stock −</th>
<th>Dividends +</th>
<th>Reven −</th>
<th>Exp</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bal.  4,700</td>
<td>0</td>
<td>9,600</td>
<td>0</td>
<td>26,000 = 7,100</td>
<td>30,000</td>
<td>0</td>
<td>4,200</td>
<td>-1,000</td>
<td></td>
</tr>
<tr>
<td>7 -700</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

| Bal.  4,000 | + 0 | + 9,600 | + 0 | + 26,000 = 7,100 | + 30,000 | - 0 | + 4,200 | - 1,700 |

Double Entry:

<table>
<thead>
<tr>
<th>(7)</th>
<th>Salaries Expense</th>
<th>700</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Cash</td>
<td>700</td>
</tr>
</tbody>
</table>

8. **Provide Consulting and Rental Services on Credit**

**TRANSACTION #8:** FastForward provides consulting services of $1,600 and rents its test facilities for $300 to an amateur sports club. The customer is billed $1,900 for these services.

**ANALYSIS**

1. **Identify**
   - Consulting Revenue; Rental Revenue; Accounts Receivable

2. **Classify**
   - Consult Rev → Revenue; Rent Rev → Rev; Accounts Receivable → Asset
   - +/− Consulting Revenue +; Rental Revenue +; Accounts Receivable +

3. **Balance**
   - The equation is in balance.

**Debit/Credit Rule**

- **Which account is debited?** Accounts Receivable
- **Which account is credited?** Consulting Revenue; Rental Revenue

**T-Accounts**

<table>
<thead>
<tr>
<th>Accounts Receivable</th>
<th>Consulting Revenue</th>
<th>Rental Revenue</th>
</tr>
</thead>
<tbody>
<tr>
<td>+ 1,600</td>
<td>−</td>
<td>+ 300</td>
</tr>
</tbody>
</table>

**Double Entry:**

<table>
<thead>
<tr>
<th>(8) Accounts Receivable</th>
<th>1,900</th>
</tr>
</thead>
<tbody>
<tr>
<td>Consulting Revenue</td>
<td>1,600</td>
</tr>
<tr>
<td>Rental Revenue</td>
<td>300</td>
</tr>
</tbody>
</table>
9. **Receipt of Cash on Account**

**TRANSACTION #9**: The client in Transaction #8 pays $1,900 to FastForward 10 days after it is billed for consulting services.

**ANALYSIS**

<table>
<thead>
<tr>
<th>Identify</th>
<th>Cash; Accounts Receivable</th>
</tr>
</thead>
<tbody>
<tr>
<td>Classify</td>
<td>Cash(\rightarrow) Asset; Accounts Receivable(\rightarrow) Asset</td>
</tr>
<tr>
<td>+/-</td>
<td>Cash - ; Accounts Receivable -</td>
</tr>
<tr>
<td>Balance</td>
<td>The equation is balanced.</td>
</tr>
</tbody>
</table>

**Debit/Credit Rule**

*Which account is debited? Cash*

*Which account is credited? Accounts Receivable*

**T-Accounts**

<table>
<thead>
<tr>
<th>Cash</th>
<th>Accounts Receivable</th>
</tr>
</thead>
<tbody>
<tr>
<td>+1,900</td>
<td>-1,900</td>
</tr>
</tbody>
</table>

**Assets**  \(=\) **Liab** + **Equity**

<table>
<thead>
<tr>
<th>Cash +</th>
<th>Accts Receivable +</th>
<th>Supp +</th>
<th>Prep +</th>
<th>Equipment +</th>
<th>Accts Pay +</th>
<th>Common +</th>
<th>Dividends +</th>
<th>Revenue +</th>
<th>Exp -</th>
</tr>
</thead>
<tbody>
<tr>
<td>B 4,000</td>
<td>1,900</td>
<td>9,600</td>
<td>0</td>
<td>26,000 = 7,100</td>
<td>30,000</td>
<td>0</td>
<td>6,100</td>
<td>-1,700</td>
<td></td>
</tr>
<tr>
<td>9 +1,900</td>
<td>-1,900</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bal. 5,900</td>
<td>0</td>
<td>9,600</td>
<td>0</td>
<td>26,000 = 7,100</td>
<td>30,000</td>
<td>0</td>
<td>6,100</td>
<td>-1,700</td>
<td></td>
</tr>
</tbody>
</table>

**Double Entry:**

<table>
<thead>
<tr>
<th></th>
<th>Cash</th>
<th>Accounts Receivable</th>
<th>1,900</th>
<th>1,900</th>
</tr>
</thead>
<tbody>
<tr>
<td>(9)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
10. Partial Payment of Accounts Payable

TRANSACTION #10: FastForward pays CalTech Supply $900 cash as partial payment for its earlier $7,100 purchase of supplies (Transaction #4), leaving $6,200 unpaid.

**ANALYSIS**

**Identify** 1. Cash; Accounts Payable

**Classify** 2. Cash → Asset; Accounts Payable → Liability

+/− 3. Cash - ; Accounts Payable -

**Balance** 4. The equation is balanced.

**Debit/Credit Rule** Which account is debited? Accounts Payable

Which account is credited? Cash

**T-Accounts**

<table>
<thead>
<tr>
<th>Cash</th>
<th>Accounts Payable</th>
</tr>
</thead>
<tbody>
<tr>
<td>+</td>
<td>-</td>
</tr>
<tr>
<td>900</td>
<td>900</td>
</tr>
</tbody>
</table>

**Assets** = **Liab** + **Equity**

<table>
<thead>
<tr>
<th>Cash</th>
<th>Accts Receiv</th>
<th>Supp</th>
<th>Prep</th>
<th>Equipment</th>
<th>Accts Pay</th>
<th>Commo Stock</th>
<th>Dividends</th>
<th>Revenue</th>
<th>Exp</th>
</tr>
</thead>
<tbody>
<tr>
<td>5,900</td>
<td>0</td>
<td>9,600</td>
<td>0</td>
<td>26,000</td>
<td>7,100</td>
<td>30,000</td>
<td>0</td>
<td>6,100</td>
<td>-1,700</td>
</tr>
</tbody>
</table>

Bal. 5,000 + 0 + 9,600 + 0 + 26,000 = 6,200 + 30,000 - 0 + 6,100 - 1,700

**Double Entry:**

<table>
<thead>
<tr>
<th>(10)</th>
<th>Accounts Payable</th>
<th>900</th>
<th>Cash</th>
<th>900</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
11. **Payment of Cash Dividend**

**TRANSACTION #11:** FastForward pays $200 cash for dividends.

### ANALYSIS

**Identify** 1. Cash; Dividends

**Classify** 2. Cash → Asset; Dividends → Equity

**+/-** 3. Cash - ; Dividends -

**Balance** 4. The equation is balanced.

**Debit/Credit Rule** Which account is debited? Dividends

Which account is credited? Cash

**T-Accounts**

<table>
<thead>
<tr>
<th>Cash</th>
<th>Dividends</th>
</tr>
</thead>
<tbody>
<tr>
<td>+</td>
<td>-</td>
</tr>
<tr>
<td>200</td>
<td>+</td>
</tr>
<tr>
<td></td>
<td>200</td>
</tr>
</tbody>
</table>

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

<table>
<thead>
<tr>
<th>Cash</th>
<th>Accts Recv</th>
<th>Supp</th>
<th>Prep</th>
<th>Insur</th>
<th>Equipment</th>
<th>Accts Pay</th>
<th>Common Stock</th>
<th>Dividends</th>
<th>Reven</th>
<th>Exp</th>
</tr>
</thead>
<tbody>
<tr>
<td>+</td>
<td>+</td>
<td>+</td>
<td>+</td>
<td>+</td>
<td>=</td>
<td>-</td>
<td>-</td>
<td>+</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>5,000</td>
<td>0</td>
<td>9,600</td>
<td>0</td>
<td>26,000</td>
<td>= 6,200</td>
<td>30,000</td>
<td>0</td>
<td>6,100</td>
<td>-1,700</td>
<td></td>
</tr>
<tr>
<td>11</td>
<td>-200</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4,800</td>
<td>+</td>
<td>+</td>
<td>+</td>
<td>+</td>
<td>= 6,200</td>
<td>+ 30,000</td>
<td>-200</td>
<td>+ 6,100</td>
<td>-1,700</td>
<td></td>
</tr>
</tbody>
</table>

### Double Entry:

<table>
<thead>
<tr>
<th>Dividends</th>
<th>Cash</th>
<th>200</th>
<th>200</th>
</tr>
</thead>
</table>
12. **Receipt of Cash for Future Services**

TRANSACTION #12: FastForward receives $3,000 cash in advance of providing consulting services to a customer.

**ANALYSIS**

Identify 1. Cash; Unearned Consulting Revenue  

Classify 2. Cash $\rightarrow$ Asset; Unearned Consulting Revenue $\rightarrow$ Liability  

+/− 3. Cash + ; Unearned Consulting Revenue +  

Balance 4. The equation is balanced.

**Debit/Credit Rule** Which account is debited? Cash

Which account is credited? Unearned Consulting Revenue

**T-Accounts**

<table>
<thead>
<tr>
<th></th>
<th>Cash</th>
<th>Unearned Consulting Revenue</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>+ 3,000</td>
<td>-</td>
</tr>
<tr>
<td></td>
<td>-</td>
<td>+ 3,000</td>
</tr>
</tbody>
</table>

**Assets** = **Liab** + **Equity**

<table>
<thead>
<tr>
<th>Cash</th>
<th>Accts Recv</th>
<th>Supp</th>
<th>Prep</th>
<th>Insur</th>
<th>Equipment</th>
<th>Accts Pay</th>
<th>Commo Stock</th>
<th>Dividends</th>
<th>Reven - Exp</th>
</tr>
</thead>
<tbody>
<tr>
<td>4,800</td>
<td>0</td>
<td>9,600</td>
<td>0</td>
<td>0</td>
<td>26,000</td>
<td>6,200</td>
<td>30,000</td>
<td>-200</td>
<td>6,100</td>
</tr>
<tr>
<td>+3,000</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>7,800</td>
<td>0</td>
<td>9,600</td>
<td>0</td>
<td>0</td>
<td>26,000</td>
<td>9,200</td>
<td>30,000</td>
<td>-200</td>
<td>6,100</td>
</tr>
</tbody>
</table>

**Double Entry:**

<table>
<thead>
<tr>
<th></th>
<th>Cash</th>
<th>Accounts Payable</th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>(12)</td>
<td>3,000</td>
<td>3,000</td>
<td>3,000</td>
<td>3,000</td>
<td>3,000</td>
</tr>
</tbody>
</table>
13. Pay Cash for Future Insurance Coverage

TRANSACTION #13: FastForward pays $2,400 cash (insurance premium) for a 24-month insurance policy. Coverage begins on December 1.

ANALYSIS

1. Identify
   Cash; Prepaid Insurance

2. Classify
   Cash → Asset; Prepaid Insurance → Asset

3. +/- Cash - ; Prepaid Insurance +

4. Balance
   The equation is balanced.

Debit/Credit Rule
Which account is debited? Prepaid Insurance

Which account is credited? Cash

T-Accounts

<table>
<thead>
<tr>
<th>Cash</th>
<th>Prepaid Insurance</th>
</tr>
</thead>
<tbody>
<tr>
<td>+</td>
<td>- 2,400</td>
</tr>
<tr>
<td>- 2,400</td>
<td>+</td>
</tr>
</tbody>
</table>

Assets = Liab + Equity

| Cash + Accts Receiv + Supp + Prepd Insur + Equipment = Accts Pay + Common Stock - Dividends + Revenue - Expense |
|---|---|---|---|---|---|---|---|---|
| Cash | 7,800 | 0 | 9,600 | 0 | 26,000 | 9,200 | 30,000 | -200 | 6,100 | -1,700 |
| Bal. | 5,400 | +0 | +9,600 | +2,400 | +26,000 | +9,200 | +30,000 | -200 | +6,100 | -1,700 |

Double Entry:

(13) Prepaid Insurance
    Cash                     2,400
    Cash                     2,400
14. **Purchase Supplies for Cash**

**TRANSACTION #14:** FastForward pays $120 cash for supplies.

**ANALYSIS**

1. **Identify**
   - Cash; Supplies

2. **Classify**
   - Cash → Asset; Supplies → Asset

3. **+/-**
   - Cash - ; Supplies +

4. **Balance**
   - The equation is balanced.

**Debit/Credit Rule**
- Which account is debited? **Supplies**
- Which account is credited? **Cash**

**T-Accounts**

<table>
<thead>
<tr>
<th>Supplies</th>
<th>Cash</th>
</tr>
</thead>
<tbody>
<tr>
<td>+ 120</td>
<td>- 120</td>
</tr>
</tbody>
</table>

**Assets** = **Liab** + **Equity**

<table>
<thead>
<tr>
<th>Cash</th>
<th>Accts Recev</th>
<th>Supp</th>
<th>Prepd</th>
<th>Equipment</th>
<th>Accts Pay</th>
<th>Commo Stock</th>
<th>Dividends</th>
<th>Reven</th>
<th>Exp</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bal.</td>
<td>5,400</td>
<td>0</td>
<td>9,600</td>
<td>2,400</td>
<td>26,000</td>
<td>30,000</td>
<td>- 200</td>
<td>6,100</td>
<td>- 1,700</td>
</tr>
<tr>
<td>14</td>
<td>-120</td>
<td></td>
<td>+120</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Bal. 5,280 + 0 + 9,720 + 2,400 + 26,000 = 9,200 + 30,000 - 200 + 6,100 - 1,700

**Double Entry:**

| (14) | Supplies       | Cash       | 120 | 120 |
15. Payment of Expense in Cash

TRANSACTION #15: FastForward pays $230 cash for December utilities expense.

ANALYSIS

Identify 1. Cash; Utilities Expense

Classify 2. Cash → Asset; Utilities Expense → Equity

+- 3. Cash - ; Utilities Expense +

Balance 4. The equation is balanced.

Debit/Credit Rule Which account is debited? Utilities Expense
Which account is credited? Cash

T-Accounts

<table>
<thead>
<tr>
<th>Cash</th>
<th>Utilities Expense</th>
</tr>
</thead>
<tbody>
<tr>
<td>+</td>
<td>-</td>
</tr>
<tr>
<td>230</td>
<td>230</td>
</tr>
</tbody>
</table>

Assets = Liab + Equity

<table>
<thead>
<tr>
<th>Cash +</th>
<th>Accts Recv +</th>
<th>Supp +</th>
<th>Prep -</th>
<th>Insur +</th>
<th>Equipment =</th>
<th>Accts Pay +</th>
<th>Commo Stock -</th>
<th>Dividends +</th>
<th>Revenue -</th>
<th>Exp -</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bal.</td>
<td>5,280</td>
<td>0</td>
<td>9,720</td>
<td>2,400</td>
<td>26,000</td>
<td>9,200</td>
<td>30,000</td>
<td>-200</td>
<td>6,100</td>
<td>-1,700</td>
</tr>
<tr>
<td>15</td>
<td>-230</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Utility</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>-230</td>
</tr>
<tr>
<td>Bal.</td>
<td>5,050</td>
<td>0</td>
<td>9,720</td>
<td>2,400</td>
<td>26,000</td>
<td>9,200</td>
<td>30,000</td>
<td>-200</td>
<td>6,100</td>
<td>-1,930</td>
</tr>
</tbody>
</table>

Double Entry:

| (15) | Utilities Expense | 230 | 230 |
III. TRIAL BALANCE

GLOSSARY

Trial balance— is a list of accounts and their balances at a point in time.

Account balances are reported in the appropriate debit or credit column of a trial balance.

A. Preparing a Trial Balance

Involves 3 steps:

1) List each account title and its amount (from ledger) in the trial balance. A zero balance is listed with a zero in its normal balance column.

2) Compute the total of debit balances and the total of credit balances.

3) Verify (prove) total debit balances equal total credit balances.

1. Searching for and Correcting Errors

If the trial balance doesn’t balance, the error(s) must be found and corrected.

Three Ways to Check for Errors:

a) REVERSE ORDER.
   i. Verify that the trial balance columns are correctly added.
   ii. Verify that account balances are accurately entered from the ledger.
   iii. See whether a debit (or credit) balance is mistakenly listed in the trial balance as a credit (or debit). CLUE: when the difference between total
debits and total credits equals twice the amount of the incorrect account balance.

iv. Recompute each account balance in the ledger.

v. Verify that each journal entry is properly posted.

vi. Verify that the original journal entry has equal debits and credits

b) **IF THE ERROR IS DISCOVERED BEFORE YOU POST:**

- **Manual System:** it can be corrected by drawing a line through the incorrect information. Then write the correct information above it to create a record of change for the auditor.

- **Computer System:** allows the person to replace the incorrect information directly.

c) **ERROR IS DISCOVERED AFTER YOU POST:**

- DON'T draw a line through it. It looks suspicious.

- You have to create a CORRECTING ENTRY that removes the amount from the wrong account and records it to the correct account.

**B. Using a Trial Balance to Prepare Financial Statements**

- These statements are also called **unadjusted statements** because we need to make some further accounting adjustments.

1. **Income Statement**

- Reports the Revenues earned less the Expenses incurred by a business over a period of time.

- Information is taken from the Trial Balance.

- Owner investments and dividends are NOT part of income.
2. Statement of Retained Earnings

- Reports information about how Retained Earnings changes over the reporting period.
- It shows the beginning-of-period balance, Net Income, Dividends, and the end-of-period balance.

3. Balance Sheet

- Reports the financial position of a company at a point in time.
- Usually at the end of a month, quarter, or year.
- **ACCOUNT FORM**: the left side lists its Assets, the upper right side lists its Liabilities, and the bottom right side lists its Equity.
- Think of the accounting equation: assets on the left, liabilities and equity on the right.
- **REPORT FORM**: Assets on the top, followed below by Liabilities and then Equity

4. Presentation Issues

- Dollar signs are NOT used in journals and ledgers.
- They appear in financial statements and other reports, like the trial balance.
- When you have a column of numbers, only put a dollar sign beside the first and last numbers.
- Commas are optional to indicate thousands, millions, etc., when amounts are entered in a journal, ledger, or trial balance.
- Companies also commonly round amounts in reports to the nearest dollar, or even to a higher level.