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Chapter 2: Transaction Analysis

Learning Objective 1: Explain what a transaction is

1. What is a transaction? Listed below are some events. Indicate which of the following events would be considered a transaction of Baskin Real Estate Services, Inc. Explain youranswers.

   A transaction is any event that has a financial impact on the business and can be measured reliably.

   a. Richard Baskin inherited $100,000 from his crazy uncle Fred. **Not a transaction of the business**

   b. Richard invested the $100,000 inheritance in his business, Baskin Real Estate Services Inc., and received common stock in exchange. **Impacts business and can bemeasured**

   c. Richard hired an office manager. The office manager will receive a salary of $1,800 every two weeks. **Impacts business, but not financially**

   d. Richard paid the office manager, $1,800. **Impacts business and can be measured**

   e. Richard met with a client who agreed to pay Richard $1,000 a month for managing some rental property. **Impacts business, but no money has changed hands and Richard hasn't done anything yet.**

   f. Richard billed the client $1,000 for January services on January 31. **Impacts business and can be measured**

   g. Richard received a check from the client on February 15. **Impacts business and can be measured**

***Learning Objective 2: Define "account," and list and differentiate between different types of* accounts**

1. What is an account?
   An account is the record of all the changes in a particular asset, liability, or stockholders' equity during a period.
2. Every account contains the information on the left.

	Cash	Accounts Payable
Beg. Balance		
+ Increases	**Cash receipts**	**Purchases on credit**

- Decreases	**Cash payments**	**Payments of accounts payable**
= End. Balance		

a. What transactions cause Cash to increase? Which transactions cause Cash to decrease? Enter your answers in the table above.
b. What transactions cause Accounts Payable to increase? Which transactions cause Accounts Payable to decrease? Enter your answers in the table above.

3. Choose a company whose product that you buy (such as Prentice Hall, the publisher of this textbook). List two asset accounts, two liability accounts, two stockholders' equity accounts, two revenue accounts, and two expense accounts that your company might have. **Answers will vary. Instructors can use this question to compare the similarities and differences of companies.**

Learning Objective 3: Show the impact of business transactions on the accounting equation

Indicate the effect of the following transactions on the accounting equation in the chart below. Transaction (a) has been provided as an example.

a. Received $500,000 from the owners as an investment in the company in exchange for common stock. (pg 63)
b. Purchased $2,000 of supplies on account. (pg 64)
c. Purchased land for $60,000, paying $10,000 down and the balance on a note payable.
d. Performed services on account, $4,000. (pg 64)
e. Paid $5,000 for salaries.(pg 65)

	Cash	Accounts Receivable	Supplies	Land	Notes Payable	Accounts Payable	Common Stock	Retained Earnings
a.	**+500,000**						**+500,000**	
b.			**+ 2,000**			**+ 2,000**		
c.	**(10,000)**			**+ 60,000**	**+50,000**			
d.		**+ 4,000**						**+ 4,000**

e.	**(5,000)**														**(5,000)**

IN-CLASS EXAMPLE

Analyze the effects of the transactions given below as illustrated in transaction 1.

	ASSETS				=	LIABILITIES		+	STOCKHOLDERS' EQUITY	
	Cash	Accounts Receivable	Supplies	Truck		Notes Payable	Accounts Payable		Common Stock	Retained Earnings
Bal	$ 10,000	$ 2,000	$ 500				$ 2,500		$ 4,000	$ 6,000
1.	210,000								+210,000	
2.			+ 1,000				+ 1,000			
3.	(1,500)			+ 12,000		+ 10,500				
4.	5,000									+ 5,000
5.		+ 1,000								+1,000
6.	(1,200)									(1,200)
7.	500	(500)								
8.	(700)									(700)
9.	(1,000)						(1,000)			(1,000)
10.	(800)									(800)
	$20,300	$2,500	$1,500	$12,000		$10,500	$2,500		$214,000	$9,300

1. Boring invested $210,000 in exchange for common stock.
2. Purchased $1,000 of supplies on account.
3. Purchased a truck for $12,000, terms $1,500 down andthe balance on a 2-year note payable.
4. Provided $5,000 of services for cash.
5. Provided $1,000 of services on account.
6. Paid an employee salary of $1,200.
7. Collected $500 on account
8. Paid a $700 dividend.
9. Paid $1,000 on account for the supplies purchased in transaction 2.
10. Paid $800 rent.

Learning Objective 4: Analyze the impact of business transactions on accounts

1. Enter the words *debit, credit, increase or decrease* on the appropriate sides of the T-accounts shown below. Refer to page 73for guidance. What is the same? What is different?

Assets		Liabilities		Owners' Equity	
Debit	**Credit**	**Debit**	**Credit**	**Debit**	**Credit**
Increase	**Decrease**	**Decrease**	**Increase**	**Decrease**	**Increase**

Debit and credit is the same for all types of accounts; increases and decreases are on different sides.

2. Certain T-accounts are listed below. Indicate if the account is an asset, liability, or stockholders' equity account. Enter the words *debit, credit, increase or decrease* on the appropriate sides of the T-accounts. Then, draw a circle around those accounts where increase are recorded on the left side of the account. An example is provided for you.

Cash (A)		Accounts Receivable (A)		Supplies (A)	
Debit	Credit	***Debit***	***Credit***	***Debit***	***Credit***
Increase	Decrease	***Increase***	***Decrease***	***Increase***	***Decrease***

Truck (A)		Note payable (L)		Accounts Payable (L)	
Debit	***Credit***	***Debit***	***Credit***	***Debit***	***Credit***
Increase	***Decrease***	***decrease***	***increase***	***Decrease***	***Increase***

Service Revenue (SE)		Salary Expense (SE)	
Debit	***Credit***	***Debit***	***Credit***
Decrease	***Increase***	***Decrease***	***Increase***

Common Stock (SE)		Dividends (SE)		Retained Earnings (SE)	
Debit	***Credit***	***Debit***	***Credit***	***Debit***	***Credit***
Decrease	***Increase***	***Increase***	***Decrease***	***Decrease***	***Increase***

3. Refer to question 1 under *Objective 3*. Indicate (1) the accounts involved in each transaction, (2) if the account is an asset (A), liability (L), stockholders' equity (SE), revenue (R), or expense (E), (3) if the account increases or decreases, and (4) if the accounts are debited or credited. The first one is provided as an example

Account	A, L, SE, R or E	Increase/Decrease	Debit/ Credit
a. Cash	A	Increase	Debit
Common Stock	SE	Increase	Credit
b. Supplies	A	Increase	Debit

Accounts Payable	L	Increase	Credit
c. Land	A	Increase	Debit
Cash	A	Decrease	Credit
Notes Payable	L	Increase	Credit
d. Accounts Receivable	A	Increase	Debit
Service Revenue	R	Increase	Credit
e. Salaries Expense	E	Increase	Debit
Cash	A	Decrease	Credit

Learning Objective 5: Record (journalize and post) transactions in the books

1. What information is recorded in the journal? Why is it helpful to have information recorded in this way?

   The journal is a chronological record of each transaction. The journal records the debit and the credit together to ensure the equality of the accounting equation as well as a memo for each entry. If an accountant needed to look up a transaction that occurred on a particular date, it would be easy to find that information in the journal.

2. Using the information from the IN-CLASS EXAMPLE in *Learning Objective 4,* prepare the journal entries for first two transactions. The remaining items will be reviewed in class.

IN-CLASS EXAMPLE

Date	Account Name		Debit	Credit
1	**Cash**		**210,000**	
	Common Stock			**210,000**
	Issued common stock.			
2	**Supplies**		**1,000**	
	Accounts Payable			**1,000**
	Purchased supplies on credit.			
3	**Truck**		**12,000**	
	Cash			**1,500**
	Notse Payable			**10,500**

	Purchased truck for cash and a note.			
4	Cash		5,000	
	Service Revenue			5,000
	Provided services for cash.			
5	Accounts Receivable		1,000	
	Service Revenue			1,000
	Provided services on account.			
6	Salary Expense		1,200	
	Cash			1,200
	Paid salaries.			
7	Cash		500	
	Accounts Receivable			500
	Collected cash on account.			
8	Dividends		700	
	Cash			700
	Paid dividends.			
9	Accounts Payable		1,000	
	Cash			1,000
	Paid cash on account.			
10	Rent Expense		800	
	Cash			800
	Paid rent.			

3. What information is recorded in the general ledger? Why is it helpful to have information recorded in this way? How is this information different than the information in the journal?

   The journal organizes information by *date* while the ledger organizes information by *account.* The ledger shows the beginning balance of an account, the increases and decreases (debits and credits), and the ending balance. The ending balance is reported on the financial statements. Without the journal, the equality of debits and credits would be very difficult to verify and without the ledger, the balances of the accounts would be difficult to compute.

4. Using the information in the journal above, post the first two transactions to the general ledger. The remaining items will be reviewed in class.

IN-CLASS EXAMPLE

Cash	
Bal. 10,000	**3. 1,500**
1. 210,000	**6. 1,200**
4. 5,000	**8. 700**
7. 500	**9. 1,000**
	10. 800
Bal. 220,300	

Accounts Receivable	
Bal. 2,000	**7. 500**
5. 1,000	
Bal. 2,500	

Supplies	
Bal 500	
2. 1,000	
Bal. 1,500	

Truck	
4. 12,000	
Bal. 12,000	

Accounts Payable	
	Bal. 2,500
9. 1,000	**2. 1,000**
	Bal. 2,500

Notes Payable	
	3. 10,500
	Bal. 10,500

Common Stock	
	Bal 4,000
	1. 210,000
	Bal. 214,000

Retained Earnings	
	Bal. 6,000
	Bal. 6,000

Dividends	
8. 700	
Bal. 700	

Revenues	
	4 5,000
	5. 1,000
	Bal. 6,000

Salary Expense	
6. 1,200	
Bal. 1,200	

Rent Expense	
10. 800	
Bal. 800	

Learning Objective 6: Construct and use a trial balance

1. What is a trial balance? When is it prepared?

A trial balance is a listing of all of the balances from the accounts. In a real accounting system, you couldn't see all of the accounts at the same time, so the trial balance allows you to see all of the account balances in one place. A trial balance can be prepared at any time.

2. Using the information from the T-accounts above, fill in the trial balance.

Trial Balance
Boring Company
12/31/x1

	Debit	Credit
Cash	**$ 220,300**	
Accounts Receivable	**2,500**	
Supplies	**1,500**	
Truck	**12,000**	
Accounts Payable		**$ 2,500**
Notes Payable		**10,500**
Common Stock		**214,000**
Retained Earnings		**6,000**
Dividends	**700**	
Revenues		**6,000**
Salary Expense	**1,200**	
Rent Expense	**800**	
	$ **239,000**	$ **239,000**

IN-CLASS EXAMPLE

A. What would the totals of the trial balance be the debit to *Accounts Receivable* had not been posted in transaction 5? Would Accounts Receivable be overstated, understated, correctly stated?

The debit column total would be $1,000 (understated) because the Accounts Receivable account is understated by $1,000. The credit column totals would still be $239,000. To find this error, compute the difference between the columns and look for an entry for that amount.

B. What would the totals of the trial balance be if transaction 5 had been posted as a debit to *Cash* and a credit to *Service Revenue.* Would Accounts Receivable, Cash, and Service Revenue be overstated, understated, correctly stated?

The debit and credit column totals would still be $239,000. Cash would be overstated $1,000 and Accounts Receivable would be understated by $1,000. Since both of these accounts are on the debit side of the trial balance, the trial balance total is not affected. Service Revenue is correct.

C. What would the totals of the trial balance be if transaction 5 had been posted as a *credit* to *Accounts Receivable* and a credit to *Service Revenue.* Would Accounts Receivable, Cash, and Service Revenue be overstated, understated, correctly stated?

The debit column would be understated by $2,000 because Accounts Receivable is understated by $2,000. The credit column total would still be $239,000. Service Revenue is correct. To find this error, compute the difference between the column totals ($2,000) and divide by 2. Cash is correct.

D. What would the totals of the trial balance be if transaction 5 had been posted as a debit to Accounts Receivable for $1,000 and credit to Service Revenue for *$100.* Would Accounts Receivable, Cash, and Service Revenue be overstated, understated, correctly stated?

The debit column and Accounts Receivable would be correctly stated. The credit column would be understated by $900 because Service Revenue is understated by $900. To find this error, compute the difference between the two columns and if the difference is divisible by 9, then the error might either be a slide (adding too many or too few zeros) or a transposition error (rearranging the digits in a number). Cash is correct.

3. Using the following information, compute the missing information. Prepare T-accounts to help. How does the *normal* balance of the account affect your solution?

	Cash		**Accounts Receivable**
Beginning balance	$ 10,000	Beginning balance	$ 25,000
Receipts	***160,000***	Revenue on account	240,000
Payments	150,000	Collections on account	***244.000***
Ending balance	$ 20,000	Ending balance	$ 21,000

Cash

Bal.	**10,000**	
Receipts	***160,000***	**Payments 150,000**
Bal.	**20,000**	

Accounts Receivable

Bal.	**25,000**	
Revenue	**240,000**	**Collections *244,000***
Bal.	**21,000**	

The normal balance of an account is on the side on which increases are recorded. Cash and Accounts Receivable are both assets and have a normal debit balance.