

# Accounting Fundamentals



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# UNIT 2

## The Basic Accounting Cycle

### A Look Back

Unit 1 described different types of accounting careers and the three forms of business organization.

### A Look Ahead

In Unit 2, you will analyze transactions and prepare financial records for a business.

### Keys to Success

- Q** Why are effective reading skills important for an accounting career?
- A** You may not think reading skills are important to an accountant who spends a lot of time crunching numbers and detailing costs. But without effective reading skills, an accountant would not be able to analyze important financial documents, make important financial recommendations, or stay up-to-date on current events and changes in laws that affect the accounting field. Whether you plan to go to a two- or four-year college or find a job after graduation, effective reading skills are among your most important keys to success.

### English Language Arts

**Reading** Keeping up with current events will help you stay competitive in the workplace. Read two financial news articles online or in a newspaper or magazine. Compare the two texts in a one-page paper. *What companies are involved? Are they sole proprietorships, partnerships, or corporations? How can you tell?*

### Focus on the Photo

The accounting cycle translates economic events into useful information. ***What economic events can you think of that might occur in a bicycle shop like this one?***



# Business Transactions and the Accounting Equation

## Chapter Topics

- 3-1 Property and Financial Claims
- 3-2 Transactions that Affect Owner's Investment, Cash, and Credit
- 3-3 Transactions that Affect Revenue, Expense, and Withdrawals by the Owner
- Visual Summary
- Review and Activities
- Standardized Test Practice
- Computerized Accounting
- Problems
- Real-World Accounting
- Careers



## Essential Question

**As you read this chapter, keep this question in mind:**

*Why is understanding the accounting equation crucial to understanding the condition of any business?*

## Main Idea

Any item of property has at least one financial claim against it. Accounts are used to analyze business transactions. Owner's equity is changed by revenue, expenses, and withdrawals.

## Chapter Objectives

### Concepts

- C1** Describe the relationship between property and financial claims.
- C2** Explain the meaning of the term *equities* as it is used in accounting.
- C3** List and define each part of the accounting equation.

### Analysis

- A1** Learn how businesses use accounts.
- A2** Demonstrate the effects of transactions on the accounting equation.

### Procedures

- P1** Check the balance of the accounting equation after a business transaction has been analyzed and recorded.



## Hulu

Have you ever missed a crucial episode of your favorite TV show? Have you ever sat at the library with nothing to do? Then Hulu might be a site you want to check out. Hulu lets you watch television shows, clips, and movies online—anytime. You can also use Hulu to embed video on your blog or Web page, or just email a clip to your friends. Since Hulu was founded in 2007, it has become hugely successful. Within its first year of operation, it was one of the top five online video sites in the United States.

### Connect to the Business

Hulu employs about 150 people, which is a much smaller staff than companies that generate similar revenues, and so is able to keep its payroll costs to a minimum. Lower operating cost is a big advantage in business because it helps increase profitability.

### Analyze

*How do technology companies like Hulu use technology to keep their operating costs down?*

### Focus on the Photo

Hulu's main assets are virtual in the world of streaming video, but producing its "product" requires technological equipment and real space in which staff develops Hulu's innovative media distribution. **What types of assets would a business like Hulu have?**



## SECTION 3.1

# Property and Financial Claims

In Chapter 2 you learned that accounting is the language of business. In this chapter you will learn how to apply basic accounting concepts and terminology. You will also learn how the accounting equation expresses the relationship between property and the rights, or claims, to the property.

United Parcel Service (UPS), a corporation that provides global delivery services, uses accounting reports to communicate with its managers, employees, and investors. The UPS financial reports identify the property used in the business, such as airplanes, trucks, and computers. The reports also show how the company obtained the property, either from loans or from **funds** provided by investors.

## Property

### What Is Property?

The right to own property is basic to a free enterprise system. **Property** is anything of value that a person or business owns and therefore controls. When you own an item of property, you have a legal right to that item. For example, suppose you paid \$600 for a mountain bike. As a result of the payment, you own the bike. If you had rented the bike for the weekend instead of buying it, you would pay a much smaller amount of money, but you would have the bike for only a limited time. You would have the right to use the bike for the weekend, but you would not own it.

Businesses also own property. One of the purposes of accounting is to provide financial information about property and financial claims to that property. A **financial claim** is a legal right to property. In accounting, property and financial claims are measured in dollar amounts. Dollar amounts measure both the cost of the property and the financial claims to the property. In our mountain bike example, since you paid \$600 cash to buy the bike, you have ownership and a financial claim of \$600 to the bike. This relationship between property and financial claims is shown in the following equation.

| Property (Cost) | = | Financial Claims       |
|-----------------|---|------------------------|
| Bike            | = | Your Claim to the Bike |
| \$600           | = | \$600                  |

When you buy property with cash, you **acquire** all of the financial claims to that property at the time of purchase. What happens to the financial claim, however, when you don't pay for the property right away?

When you buy something and agree to pay for it later, you are buying on **credit**. The business or person selling the item on credit is called a **creditor**. A creditor can be any person or business to which you owe money.

### Section Vocabulary

- property
- financial claim
- credit
- creditor
- assets
- equities
- owner's equity
- liabilities
- accounting equation
- owner
- acquire

When you buy property on credit, you do not have the only financial claim to the property. You share the financial claim to that property with your creditor. For example, suppose you want to buy a \$100 lock for the mountain bike, but you have only \$60. You pay the store \$60 and sign an agreement to pay the remaining \$40 over the next two months. Since you owe the store (the creditor) \$40, you share the financial claim to the lock with the creditor. The creditor's financial claim to the lock is \$40 and your claim is \$60. The combined claims equal the cost of the property. Your purchase of the lock can be expressed as an equation:



$$\text{PROPERTY} = \text{FINANCIAL CLAIMS}$$

| Property  | = | Financial Claims           |                           |
|-----------|---|----------------------------|---------------------------|
| Bike Lock | = | Creditor's Financial Claim | + Owner's Financial Claim |
| \$100     | = | \$40                       | + \$60                    |

As you can see, two (or more) people can have financial claims to the same property.

Only the property owner has control of the property. For example, suppose that you buy a used vehicle for \$8,000. You pay \$1,200 in cash and take out a loan from the credit union for the remaining \$6,800.

| Property | = | Financial Claims               |                           |
|----------|---|--------------------------------|---------------------------|
| Vehicle  | = | Credit Union's Financial Claim | + Owner's Financial Claim |
| \$8,000  | = | \$6,800                        | + \$1,200                 |

As the owner, you have control of the vehicle. However, if you don't make the payments to the credit union, the credit union can exercise its legal claim to the vehicle and you will lose ownership.



## Reading Check

### Recall

*When you buy an item on credit, with whom do you share a financial claim?*

## Financial Claims in Accounting

### *What Are the Two Types of Equities?*

Property or items of value owned by a business are referred to as **assets**. Businesses can have various types of assets, such as:

- cash
- office equipment
- manufacturing equipment
- buildings
- land

The accounting term for the financial claims to these assets is **equities**. Let's explore the meaning of the term *equities* by introducing Crista Vargas and her new business, Zip Delivery Service, organized as a sole proprietorship.

Suppose Zip Delivery Service purchases a delivery truck for \$10,000. Zip makes a cash down payment of \$3,000 to the seller. A local bank loans Zip the remaining \$7,000. Both Zip and the bank now have financial claims to the truck.

| Property | = | Financial Claims           |                           |
|----------|---|----------------------------|---------------------------|
| Truck    | = | Creditor's Financial Claim | + Owner's Financial Claim |
| \$10,000 | = | \$7,000                    | + \$3,000                 |

Over the years as Zip repays the loan, its financial claim will increase. As less money is owed, the financial claim of the creditor (the bank) will decrease.

For example, after Zip pays one-half of the loan ( $\$7,000 \times \frac{1}{2} = \$3,500$ ), the financial claims to the property will change as follows:

| Property | = | Financial Claims           |                           |
|----------|---|----------------------------|---------------------------|
| Truck    | = | Creditor's Financial Claim | + Owner's Financial Claim |
| \$10,000 | = | \$3,500                    | + \$6,500                 |

When the loan is completely repaid, the creditor's financial claim will be canceled. In other words, the owner's financial claim will then equal the cost of the truck.

In accounting there are separate terms for owner's claims and creditor's claims. The owner's claims to the assets of the business are called **owner's equity**. Owner's equity is measured by the dollar amount of the owner's claims to the total assets of the business.

The creditor's claims to the assets of the business are called **liabilities**. Liabilities are the debts of a business. They are measured by the amount of money owed by a business to its creditors. The relationship between assets and the two types of equities (liabilities and owner's equity) is shown in the **accounting equation**:

$$\text{ASSETS} = \text{LIABILITIES} + \text{OWNER'S EQUITY}$$

|          |   |                            |   |                         |
|----------|---|----------------------------|---|-------------------------|
| Property | = | Creditor's Financial Claim | + | Owner's Financial Claim |
| ↓        |   | ↓                          |   | ↓                       |
| Assets   | = | Liabilities                | + | Owner's Equity          |

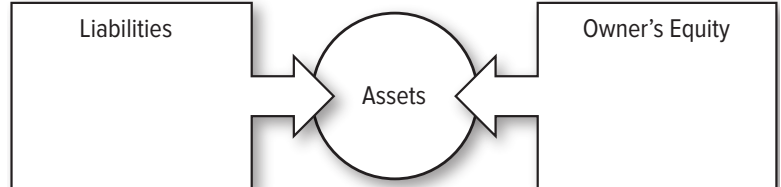
## SECTION 3.1

# Assessment

### After You Read

### Reinforce the Main Idea

Use a diagram like this one to describe the financial claims of creditors and owners.



### Problem 1 Balancing the Accounting Equation

**Instructions** Determine the missing dollar amount indicated by the question mark in each equation. Write each missing amount in your working papers.

|     | ASSETS    | = | LIABILITIES | + | OWNER'S EQUITY |
|-----|-----------|---|-------------|---|----------------|
| 1.  | \$ 17,000 | = | \$ 7,000    | + | ?              |
| 2.  | ?         | = | \$ 6,000    | + | \$20,000       |
| 3.  | \$ 10,000 | = | ?           | + | \$ 7,000       |
| 4.  | ?         | = | \$ 9,000    | + | \$ 17,000      |
| 5.  | \$ 8,000  | = | \$ 2,000    | + | ?              |
| 6.  | \$20,000  | = | \$ 7,000    | + | ?              |
| 7.  | ?         | = | \$12,000    | + | \$ 1,000       |
| 8.  | \$30,000  | = | ?           | + | \$22,000       |
| 9.  | \$22,000  | = | \$ 1,000    | + | ?              |
| 10. | \$25,000  | = | \$ 5,000    | + | ?              |
| 11. | ?         | = | \$10,000    | + | \$25,000       |
| 12. | \$ 7,500  | = | ?           | + | \$ 3,000       |

## SECTION 3.1

# Assessment

### Math for Accounting

Owner's equity can be expressed as a fraction of the total equities. It can also be expressed as a decimal. Consider the following example:

$$\text{Assets} = \text{Liabilities} + \text{Owner's Equity}$$

$$\$10,000 = \$9,000 + \$1,000$$

Owner's equity is equal to  $1/10$ , or 10 percent, of the total equities:

$$\text{Owner's Equity} \div \text{Total Equities}$$

$$= \$1,000 \div \$10,000$$

$$= 1/10$$

$$= 0.10$$

Convert the following fractions into decimals.

1.  $\frac{1}{2}$

3.  $\frac{1}{3}$

5.  $\frac{7}{8}$

2.  $\frac{1}{5}$

4.  $\frac{4}{5}$

6.  $\frac{7}{10}$

Convert the following decimals into fractions.

7. 0.889

8. 0.60

9. 0.375

10. 0.25

11. 0.667

12. 0.75

Review Copy

## SECTION 3.2

# Transactions that Affect Owner's Investment, Cash, and Credit

When you purchase a new sweater, buy popcorn at the movies, or put cash in your savings account, you are participating in business transactions. Business transactions involve the purchase, sale, or exchange of goods and services.

## Business Transactions

### How Are Accounts Used?

A **business transaction** is an economic event that causes a change—either an increase or a decrease—in assets, liabilities, or owner's equity. The change is reflected in the accounting system of the business.

When a business buys a computer with cash, its cash decreases, but its computer equipment increases. It records increases and decreases caused by business transactions in specific accounts. An **account** is a subdivision under assets, liabilities, or owner's equity. It shows the balance for a specific item and is a record of the increases or decreases for that item. Accounts represent things in the real world, such as money invested in a business or owed to a creditor. An account for office furniture represents the dollar cost of all office furniture the business owns.

Every business sets up its accounts and its accounting system to meet its needs. The number of accounts needed varies. Some businesses use only a few accounts, but others use hundreds. No matter how many accounts a business has, all of its accounts may be classified as either assets, liabilities, or owner's equity. Zip Delivery Service uses these accounts:

| Assets              | = | Liabilities      | + | Owner's Equity         |
|---------------------|---|------------------|---|------------------------|
| Cash in Bank        |   | Accounts Payable |   | Crista Vargas, Capital |
| Accounts Receivable |   |                  |   |                        |
| Computer Equipment  |   |                  |   |                        |
| Office Equipment    |   |                  |   |                        |
| Delivery Equipment  |   |                  |   |                        |

The second asset account listed is **Accounts Receivable**. **Accounts receivable** is the total amount of money owed to a business—money to be received later because of the sale of goods or services on credit. The **Accounts Receivable** account is an asset because it represents a claim to the assets of other people or businesses. It represents a future value that **eventually** will bring cash into the business. When the business receives payment, it cancels the claim.

The liability account is **Accounts Payable**. **Accounts payable** is the amount owed, or payable, to the creditors of a business. The owner's equity account title is the owner's name, a comma, and then the word *Capital*.

### Section Vocabulary

- business transaction
- account
- accounts receivable
- accounts payable
- investment
- on account
- eventually transfer

# Transactions and the Accounting Equation

## How Do Transactions Affect the Accounting Equation?

When a business transaction occurs, an accounting clerk analyzes the transaction to see how it affects each part of the accounting equation. Analyzing business transactions is simple. Use the following steps.

### Business Transaction

|                 |          |                                                                            |
|-----------------|----------|----------------------------------------------------------------------------|
| <b>Analysis</b> | Identify | 1. Identify the accounts affected.                                         |
|                 | Classify | 2. Classify the accounts affected.                                         |
|                 | +/-      | 3. Determine the amount of increase or decrease for each account affected. |
|                 | Balance  | 4. Make sure the accounting equation remains in balance.                   |

Most businesses have the following types of transactions: investments by the owner, cash transactions, credit transactions, revenue and expense transactions, and withdrawals by the owner.

### Investments by the Owner

An **investment** is money or other property paid out in order to produce profit. Owner Crista Vargas made two investments in her business, Zip Delivery Service. The first was a cash investment; the second was a **transfer** of property.



### Business Transaction 1

*Crista Vargas took \$25,000 from her personal savings and deposited that amount to open a business checking account in the name of Zip Delivery Service.*

|                 |          |                                                                                                                                                                                                                                    |
|-----------------|----------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>Analysis</b> | Identify | 1. Cash transactions are recorded in the account <b>Cash in Bank</b> . Crista Vargas is investing personal funds in the business. Her investment in the business is recorded in the account called <b>Crista Vargas, Capital</b> . |
|                 | Classify | 2. <b>Cash in Bank</b> is an asset account. <b>Crista Vargas, Capital</b> is an owner's equity account.                                                                                                                            |
|                 | +/-      | 3. <b>Cash in Bank</b> is increased by \$25,000. <b>Crista Vargas, Capital</b> is increased by \$25,000.                                                                                                                           |
|                 | Balance  | 4. The accounting equation remains in balance.                                                                                                                                                                                     |

|          | <u>Assets</u> | = | <u>Liabilities</u> | + | <u>Owner's Equity</u>  |
|----------|---------------|---|--------------------|---|------------------------|
|          | Cash in Bank  |   |                    |   | Crista Vargas, Capital |
| Trans. 1 | +\$25,000     | = | 0                  | + | +\$25,000              |

## Business Transaction 2

*Crista Vargas transferred two telephones valued at \$200 each from her home to the business.*

|                 |          |                                                                                                                                                                                             |
|-----------------|----------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>Analysis</b> | Identify | 1. Crista Vargas gave two telephones to the business. This affects the account <b>Office Equipment</b> . The investment of these assets affects the account <b>Crista Vargas, Capital</b> . |
|                 | Classify | 2. <b>Office Equipment</b> is an asset account. <b>Crista Vargas, Capital</b> is an owner's equity account.                                                                                 |
|                 | +/-      | 3. <b>Office Equipment</b> is increased by \$400. <b>Crista Vargas, Capital</b> is increased by \$400.                                                                                      |
|                 | Balance  | 4. The accounting equation remains in balance.                                                                                                                                              |

|            | <u>Assets</u> |                  | = | <u>Liabilities</u> |   | <u>Owner's Equity</u>  |
|------------|---------------|------------------|---|--------------------|---|------------------------|
|            | Cash in Bank  | Office Equipment |   |                    |   | Crista Vargas, Capital |
| Prev. Bal. | \$25,000      | 0                |   |                    |   | \$25,000               |
| Trans. 2   |               | +\$400           |   |                    |   | +400                   |
| Balance    | \$25,000      | +\$400           | = | 0                  | + | \$25,400               |

## Cash Payment Transactions

Transaction 3 is the cash purchase of an asset. Any asset purchased for cash is recorded this way, but the account name of the asset purchased may vary. Transaction 3 affects only the assets side of the equation. Zip exchanged one asset (cash) for another asset (computer equipment).

## Business Transaction 3

*Zip issued a \$3,000 check to purchase a computer system.*

|                 |          |                                                                                                                                                                                                                                                                                                       |
|-----------------|----------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>Analysis</b> | Identify | 1. Transactions involving any type of computer equipment are recorded in the <b>Computer Equipment</b> account. The business paid cash for the computer system, so the account <b>Cash in Bank</b> is affected. Check payments are treated as cash payments and are recorded in <b>Cash in Bank</b> . |
|                 | Classify | 2. <b>Computer Equipment</b> and <b>Cash in Bank</b> are both asset accounts.                                                                                                                                                                                                                         |
|                 | +/-      | 3. <b>Computer Equipment</b> is increased by \$3,000. <b>Cash in Bank</b> is decreased by \$3,000.                                                                                                                                                                                                    |
|                 | Balance  | 4. The accounting equation remains in balance.                                                                                                                                                                                                                                                        |

|            | Assets          |                       |                     | = | Liabilities | + | Owner's Equity            |
|------------|-----------------|-----------------------|---------------------|---|-------------|---|---------------------------|
|            | Cash<br>in Bank | Computer<br>Equipment | Office<br>Equipment |   |             |   | Crista Vargas,<br>Capital |
| Prev. Bal. | \$25,000        | 0                     | \$400               |   | 0           |   | \$25,400                  |
| Trans. 3   | −3,000          | +\$3,000              |                     |   |             |   |                           |
| Balance    | \$22,000 +      | \$3,000 +             | \$400               | = | 0           | + | \$25,400                  |

## Credit Transactions

Now that you have learned about cash transactions, let's look at how the use of credit affects the accounting equation. When a business buys an item on credit, it is buying **on account**. In the next four transactions, you will learn about a purchase on account, a sale on account, a payment made on account, and a payment received on account.

### Business Transaction 4

*Zip bought a used truck on account from Coast to Coast Auto for \$12,000.*

#### Analysis

- |          |                                                                                                                                                                                                                                                                             |
|----------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Identify | 1. Zip purchased a truck to be used as a delivery vehicle, so the account <b>Delivery Equipment</b> is affected. The business promised to pay for the truck at a later time. The promise to pay is a liability; therefore, the <b>Accounts Payable</b> account is affected. |
| Classify | 2. <b>Delivery Equipment</b> is an asset account. <b>Accounts Payable</b> is a liability account.                                                                                                                                                                           |
| +/-      | 3. <b>Delivery Equipment</b> is increased by \$12,000. <b>Accounts Payable</b> is also increased by \$12,000.                                                                                                                                                               |
| Balance  | 4. The accounting equation remains in balance.                                                                                                                                                                                                                              |

|            | Assets          |                       |                     |                       | = | Liabilities         | + | Owner's Equity            |
|------------|-----------------|-----------------------|---------------------|-----------------------|---|---------------------|---|---------------------------|
|            | Cash<br>in Bank | Computer<br>Equipment | Office<br>Equipment | Delivery<br>Equipment |   | Accounts<br>Payable |   | Crista Vargas,<br>Capital |
| Prev. Bal. | \$22,000        | \$3,000               | \$400               | 0                     |   | 0                   |   | \$25,400                  |
| Trans. 4   |                 |                       |                     | +\$12,000             |   | +\$12,000           |   |                           |
| Balance    | \$22,000 +      | \$3,000 +             | \$400 +             | \$12,000              | = | +\$12,000 +         |   | \$25,400                  |

### Business Transaction 5

*Zip sold one telephone to Green Company for \$200 on account.*

#### Analysis

- |          |                                                                                                                                                                                                                             |
|----------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Identify | 1. Since Zip has agreed to receive payment for the telephone at a later time, the <b>Accounts Receivable</b> account is affected. The business sold the telephone, so the account <b>Office Equipment</b> is also affected. |
|----------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|

|          |                                                                                                     |
|----------|-----------------------------------------------------------------------------------------------------|
| Classify | 2. Both <b>Accounts Receivable</b> and <b>Office Equipment</b> are asset accounts.                  |
| +/-      | 3. <b>Accounts Receivable</b> is increased by \$200. <b>Office Equipment</b> is decreased by \$200. |
| Balance  | 4. The accounting equation remains in balance.                                                      |

|            | Assets          |                        |                       |                     |                       | = Liabilities       | + Owner's Equity          |
|------------|-----------------|------------------------|-----------------------|---------------------|-----------------------|---------------------|---------------------------|
|            | Cash<br>in Bank | Accounts<br>Receivable | Computer<br>Equipment | Office<br>Equipment | Delivery<br>Equipment | Accounts<br>Payable | Crista Vargas,<br>Capital |
| Prev. Bal. | \$22,000        | 0                      | \$3,000               | \$400               | \$12,000              | \$12,000            | \$25,400                  |
| Trans. 5   |                 | + \$200                |                       | −200                |                       |                     |                           |
| Balance    | \$22,000        | + \$200                | + \$3,000             | + \$200             | + \$12,000            | = \$12,000          | + \$25,400                |

## Business Transaction 6

Zip issued a check for \$350 in partial payment of the amount owed to its creditor, Coast to Coast Auto.

|                 |          |                                                                                                                                                                                    |
|-----------------|----------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>Analysis</b> | Identify | 1. The payment decreased the total amount owed to the creditor, so <b>Accounts Payable</b> is affected. Payment was made by check, so the account <b>Cash in Bank</b> is affected. |
|                 | Classify | 2. <b>Accounts Payable</b> is a liability account. <b>Cash in Bank</b> is an asset account.                                                                                        |
|                 | +/-      | 3. <b>Accounts Payable</b> is decreased by \$350. <b>Cash in Bank</b> is also decreased by \$350.                                                                                  |
|                 | Balance  | 4. The accounting equation remains in balance.                                                                                                                                     |

|            | Assets          |                        |                       |                     |                       | = Liabilities       | + Owner's Equity          |   |          |   |          |   |          |
|------------|-----------------|------------------------|-----------------------|---------------------|-----------------------|---------------------|---------------------------|---|----------|---|----------|---|----------|
|            | Cash<br>in Bank | Accounts<br>Receivable | Computer<br>Equipment | Office<br>Equipment | Delivery<br>Equipment | Accounts<br>Payable | Crista Vargas,<br>Capital |   |          |   |          |   |          |
| Prev. Bal. | \$22,000        | \$200                  | \$3,000               | \$200               | \$12,000              | \$12,000            | \$25,400                  |   |          |   |          |   |          |
| Trans. 6   | −350            |                        |                       |                     |                       | −350                |                           |   |          |   |          |   |          |
| Balance    | \$21,650        | +                      | \$200                 | +                   | \$3,000               | +                   | \$200                     | + | \$12,000 | = | \$11,650 | + | \$25,400 |

## Business Transaction 7

Zip received and deposited a check for \$200 from Green Co. The check received is full payment for the telephone sold on account in Transaction 5.

| Analysis |  |    |                                                                                                                                                         |
|----------|--|----|---------------------------------------------------------------------------------------------------------------------------------------------------------|
| Identify |  | 1. | The check decreases the amount owed to Zip, so <b>Accounts Receivable</b> is affected. A check is given in payment, so <b>Cash in Bank</b> is affected. |
| Classify |  | 2. | <b>Accounts Receivable</b> and <b>Cash in Bank</b> are asset accounts.                                                                                  |
| + / -    |  | 3. | <b>Accounts Receivable</b> is decreased by \$200. <b>Cash in Bank</b> is increased by \$200.                                                            |
| Balance  |  | 4. | The accounting equation remains in balance.                                                                                                             |

|            | Assets          |                        |                       |                     |                       | = | Liabilities         | + | Owner's Equity            |   |          |   |          |
|------------|-----------------|------------------------|-----------------------|---------------------|-----------------------|---|---------------------|---|---------------------------|---|----------|---|----------|
|            | Cash<br>in Bank | Accounts<br>Receivable | Computer<br>Equipment | Office<br>Equipment | Delivery<br>Equipment |   | Accounts<br>Payable |   | Crista Vargas,<br>Capital |   |          |   |          |
| Prev. Bal. | \$21,650        | \$200                  | \$3,000               | \$200               | \$12,000              |   | \$11,650            |   | \$25,400                  |   |          |   |          |
| Trans. 7   | +\$200          | −200                   |                       |                     |                       |   |                     |   |                           |   |          |   |          |
| Balance    | \$21,850        | +                      | \$0                   | +                   | \$3,000               | + | \$200               | + | \$12,000                  | + | \$11,650 | + | \$25,400 |

As you can see, each business transaction causes a change in assets, liabilities, or owner's equity. Analyzing each transaction to see how it affects the accounting equation keeps everything in balance.

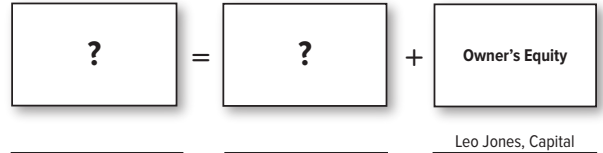
## SECTION 3.2

# Assessment

### After You Read

### Reinforce the Main Idea

Create a diagram like the one shown here. For the boxes marked “?”, fill in the correct labels and give one example of a related account for each category.



### Problem 2 Determining the Effects of Transactions on the Accounting Equation

**Instructions** Use these accounts to analyze the business transactions of WordService.

| Assets                     | = | Liabilities      | + | Owner's Equity     |
|----------------------------|---|------------------|---|--------------------|
| Cash in Bank Accounts      |   | Accounts Payable |   | Jan Swift, Capital |
| Receivable Computer        |   |                  |   |                    |
| Equipment Office Furniture |   |                  |   |                    |

On the form provided in your working papers, identify the accounts affected by each transaction and the amount of increase or decrease in each account. Make sure the accounting equation is in balance after each transaction.

- Jan Swift, owner, deposited \$30,000 in the business checking account.
- The owner transferred to the business a desk and chair valued at \$700.
- WordService issued a check for \$4,000 for the purchase of a computer.
- The business bought office furniture on account for \$5,000 from Eastern Furniture.
- The desk and chair previously transferred to the business by the owner were sold on account for \$700.
- WordService wrote a check for \$2,000 in partial payment of the amount owed to Eastern Furniture Company.

### Math for Accounting

The basic accounting equation is in the form of  $A = L + OE$

- What is the algebra equation to find L?
- What is the algebra equation to find OE?

Using the rules of algebra, determine the missing dollar amount in each equation.

| Assets   | = | Liabilities | + | Owners Equity |
|----------|---|-------------|---|---------------|
| ?        |   | \$9,000     |   | \$21,000      |
| \$25,000 |   | ?           |   | \$11,000      |
| \$10,000 |   | \$2,000     |   | ?             |

## SECTION 3.3

# Transactions that Affect Revenue, Expense, and Withdrawals by the Owner

United Parcel Service (UPS) has thousands of shareholders who expect a return on their investment in the business. The most common way for a business to provide a return is by selling goods or providing services. UPS earns revenue by providing a global delivery service. To provide the delivery service, UPS incurs expenses like salaries, transportation, and insurance. In this section you will learn about revenue and expense transactions as well as owner's withdrawals.

### Section Vocabulary

- revenue
- expense
- withdrawal
- generate
- conduct

## Revenue and Expense Transactions

### What Are Revenue and Expenses?

Income earned from the sale of goods or services is called **revenue**. Examples of revenue are fees earned for services performed and cash received from the sale of merchandise. Revenue increases owner's equity because it increases the assets of the business.

Both revenues and investments by the owner increase owner's equity, but these represent very different transactions:

- Revenue is income from the sale of goods and services.
- Investment by the owner is the dollar amount contributed to the business by the owner.

To **generate** revenue most businesses must also incur expenses to buy goods, materials, and services. An **expense** is the cost of products or services used to operate a business. Examples of business expenses are

- rent,
- utilities, and
- advertising.

Expenses decrease owner's equity because they decrease the assets of the business or increase liabilities.

The effects of revenue and expenses are summarized as follows:

- Revenue increases assets and increases owner's equity.
- Expenses decrease assets and decrease owner's equity or increase liabilities and decrease owner's equity.



## Reading Check

### Contrast

What is the difference between revenue and investments by the owner?

## Business Transaction 8

Zip received a check for \$1,200 from a customer, Sims Corporation, for delivery services.

### Analysis

Identify

1. Zip received cash, so **Cash in Bank** is affected. The payment received is revenue. Revenue increases owner's equity, so **Crista Vargas, Capital** is also affected.

Classify

2. **Cash in Bank** is an asset account. **Crista Vargas, Capital** is an owner's equity account.

+/-

3. **Cash in Bank** is increased by \$1,200. **Crista Vargas, Capital** is also increased by \$1,200.

Balance

4. The accounting equation remains in balance.

|            | Assets          |                        |                       |                     |                       | = Liabilities       | + Owner's Equity          |   |          |   |          |   |          |
|------------|-----------------|------------------------|-----------------------|---------------------|-----------------------|---------------------|---------------------------|---|----------|---|----------|---|----------|
|            | Cash<br>in Bank | Accounts<br>Receivable | Computer<br>Equipment | Office<br>Equipment | Delivery<br>Equipment | Accounts<br>Payable | Crista Vargas,<br>Capital |   |          |   |          |   |          |
| Prev. Bal. | \$21,850        | \$0                    | \$3,000               | \$200               | \$12,000              | \$11,650            | \$25,400                  |   |          |   |          |   |          |
| Trans. 8   | +1,200          |                        |                       |                     |                       |                     | +1,200                    |   |          |   |          |   |          |
| Balance    | \$23,050        | +                      | \$0                   | +                   | \$3,000               | +                   | \$200                     | + | \$12,000 | = | \$11,650 | + | \$26,600 |

## Business Transaction 9

Zip wrote a check for \$700 to pay the rent for the month.

### Analysis

Identify

1. Zip pays rent for use of building space. Rent is an expense. Expenses decrease owner's equity, so the account **Crista Vargas, Capital** is affected. The business is paying cash for the use of the building, so **Cash in Bank** is affected.

Classify

2. **Crista Vargas, Capital** is an owner's equity account. **Cash in Bank** is an asset account.

+/-

3. **Crista Vargas, Capital** is decreased by \$700. **Cash in Bank** is decreased by \$700.

Balance

4. The accounting equation remains in balance.

|            | Assets          |                        |                       |                     |                       | = Liabilities       | + Owner's Equity          |   |          |   |          |   |          |
|------------|-----------------|------------------------|-----------------------|---------------------|-----------------------|---------------------|---------------------------|---|----------|---|----------|---|----------|
|            | Cash<br>in Bank | Accounts<br>Receivable | Computer<br>Equipment | Office<br>Equipment | Delivery<br>Equipment | Accounts<br>Payable | Crista Vargas,<br>Capital |   |          |   |          |   |          |
| Prev. Bal. | \$23,050        | \$0                    | \$3,000               | \$200               | \$12,000              | \$11,650            | \$25,600                  |   |          |   |          |   |          |
| Trans. 9   | -700            |                        |                       |                     |                       |                     | -700                      |   |          |   |          |   |          |
| Balance    | \$22,350        | +                      | \$0                   | +                   | \$3,000               | +                   | \$200                     | + | \$12,000 | = | \$11,650 | + | \$25,900 |

## Withdrawals by the Owner

### What Is a Withdrawal?

If a business earns revenue, the owner will take cash or other assets from the business for personal use. This is called a **withdrawal**. Withdrawals and investments have opposite effects. A withdrawal decreases both assets and owner's equity.

A withdrawal is not the same as an expense. Both decrease owner's equity, but each represents a different transaction. An expense is the price paid for goods and services used to operate a business. For example, a gardening service purchases fertilizer and lawncare supplies to **conduct** daily operations. Withdrawals by the owner are cash or other assets taken from the business for the owner's personal use. Transaction 10 illustrates the impact of a withdrawal on the accounting equation.

### Business Transaction 10

*Crista Vargas withdrew \$500 from the business for her personal use.*

| Analysis | Identify | 1. A withdrawal decreases the owner's claim to the assets of the business, so <b>Crista Vargas, Capital</b> is affected. Cash is paid out, so the <b>Cash in Bank</b> account is affected. |
|----------|----------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
|          | Classify | 2. <b>Crista Vargas, Capital</b> is an owner's equity account. <b>Cash in Bank</b> is an asset account.                                                                                    |
|          | +/-      | 3. <b>Crista Vargas, Capital</b> is decreased by \$500. <b>Cash in Bank</b> is decreased by \$500.                                                                                         |
|          | Balance  | 4. The accounting equation remains in balance.                                                                                                                                             |

|            | Assets          |                        |                       |                     |                       | = Liabilities       | + Owner's Equity          |   |          |   |          |   |          |
|------------|-----------------|------------------------|-----------------------|---------------------|-----------------------|---------------------|---------------------------|---|----------|---|----------|---|----------|
|            | Cash<br>in Bank | Accounts<br>Receivable | Computer<br>Equipment | Office<br>Equipment | Delivery<br>Equipment | Accounts<br>Payable | Crista Vargas,<br>Capital |   |          |   |          |   |          |
| Prev. Bal. | \$22,350        | \$0                    | \$3,000               | \$200               | \$12,000              | \$11,650            | \$25,900                  |   |          |   |          |   |          |
| Trans. 10  | -500            |                        |                       |                     |                       |                     | -500                      |   |          |   |          |   |          |
| Balance    | \$21,850        | +                      | \$0                   | +                   | \$3,000               | +                   | \$200                     | + | \$12,000 | = | \$11,650 | + | \$25,400 |

The following summarizes the transactions of this chapter. Can you describe what is happening in each line?

|            | Cash<br>in Bank | Accounts<br>Receivable | Computer<br>Equipment   | Office<br>Equipment   | Delivery<br>Equipment    | = | Accounts<br>Payable | +        | Owner's<br>Equity |
|------------|-----------------|------------------------|-------------------------|-----------------------|--------------------------|---|---------------------|----------|-------------------|
| Prev. Bal. | 0               | 0                      | 0                       | 0                     | 0                        |   | 0                   |          | 0                 |
| Trans. 1   | +25,000         |                        |                         |                       |                          |   |                     |          | +25,000           |
| Trans. 2   |                 |                        |                         | +400                  |                          |   |                     |          | +400              |
| Trans. 3   | −3,000          |                        | +3,000                  |                       |                          |   |                     |          |                   |
| Trans. 4   |                 |                        |                         |                       | +12,000                  |   | +12,000             |          |                   |
| Trans. 5   |                 | +200                   |                         | −200                  |                          |   |                     |          |                   |
| Trans. 6   | −350            |                        |                         |                       |                          |   | −350                |          |                   |
| Trans. 7   | +200            | −200                   |                         |                       |                          |   |                     |          |                   |
| Trans. 8   | +1,200          |                        |                         |                       |                          |   |                     |          | +1,200            |
| Trans. 9   | −700            |                        |                         |                       |                          |   |                     |          | −700              |
| Trans. 10  | −500            |                        |                         |                       |                          |   |                     |          | −500              |
| Balance    | <u>\$21,850</u> | <u>+</u> <u>\$0</u>    | <u>+</u> <u>\$3,000</u> | <u>+</u> <u>\$200</u> | <u>+</u> <u>\$12,000</u> | = | <u>\$11,650</u>     | <u>+</u> | <u>\$25,400</u>   |

Review Copy

## SECTION 3.3

# Assessment

### After You Read

### Reinforce the Main Idea

Use a table like the one shown here to describe four transactions of a home decorating business. Indicate how each transaction affects owner's equity.

| Type of Transaction | Transaction Description | Does Owner's Equity Increase or Decrease? |
|---------------------|-------------------------|-------------------------------------------|
| Revenue             |                         |                                           |
| Expense             |                         |                                           |
| Investment          |                         |                                           |
| Withdrawal          |                         |                                           |

### Problem 3 Determining the Effect of Transactions on the Accounting Equation

**Instructions** Use the accounts of WordService to analyze these business transactions. The beginning balance for each account is shown following the account name.

| Assets                      | = | Liabilities      | + | Owners Equity      |
|-----------------------------|---|------------------|---|--------------------|
| Cash in Bank, \$24,000      |   | Accounts Payable |   | Jan Swift, Capital |
| Accounts Receivable, \$700  |   | \$3,000          |   | \$30,700           |
| Computer Equipment, \$4,000 |   |                  |   |                    |
| Office Equipment, \$5,000   |   |                  |   |                    |

On the form provided in your working papers, identify the accounts affected by each transaction and the amount of the increase or decrease for each account. Make sure the accounting equation is in balance after each transaction.

1. Paid \$50 for advertising in the local newspaper.
2. Received \$1,000 as payment for preparing a report.
3. Wrote a \$600 check for the monthly rent.
4. Jan Swift withdrew \$800 for her personal use.
5. Received \$200 on account from the person who had purchased the old office furniture.

### Math for Accounting

Determine the **Cash in Bank** balance for Wiemack Landscape Designs after the third transaction that follows. All three transactions occurred on the same day. The **Cash in Bank** balance before the first transaction was \$10,000.

1. John Wiemack, the owner, withdrew \$1,000 from personal savings and deposited that amount in the business checking account.
2. Purchased computer equipment for \$5,000; issued a check for 20 percent of the price and agreed to pay the balance at a later date.
3. Issued a check for \$100 to buy tools.

## Chapter 3

# Visual Summary

### Concepts

Describe the relationship between property and financial claims

#### PROPERTY

Property is anything of value that a person or business owns. Property is measured in dollars.



=

#### FINANCIAL CLAIMS

Financial claims are the legal rights to property and are also measured in dollars.



+



### Analysis

List and define each part of the accounting equation.

#### PROPERTY

=

#### FINANCIAL CLAIMS

#### ASSETS

Items of value owned by the business

=

#### LIABILITIES

Financial claims of creditors

+

#### OWNERS EQUITY

Financial claims of owners

### Procedures

Use the following steps to analyze a business transaction:

#### IDENTIFY

Identify the accounts affected.



#### CLASSIFY

Classify the accounts affected.



+/-

Determine the amount of increase or decrease for each account affected.



#### BALANCE

Make sure the accounting equation remains in balance.



### Answering the Essential Question

**Why is understanding the accounting equation crucial to understanding the condition of any business?**

Suppose your cell phone (property/asset) is worth \$150.00. You had to borrow \$100.00 from your parents (creditor's financial claim/liability) to buy it. What part of the total value of the phone is yours (owner's financial claim/owner's equity)? Why would it be important for owners and investors to have that kind of information about a business?

### Vocabulary Check

1. **Vocabulary** Arrange the vocabulary terms below into categories—groups of related words. Explain why you put the words together.

- |                       |                        |              |
|-----------------------|------------------------|--------------|
| • acquire             | • equities             | • investment |
| • credit              | • liabilities          | • transfer   |
| • creditor            | • owner's equity       | • on account |
| • financial claim     | • account              | • expense    |
| • funds               | • accounts receivable  | • generate   |
| • property            | • business transaction | • revenue    |
| • assets              | • eventually           | • withdrawal |
| • accounting equation | • accounts payable     | • conduct    |

### Concept Check

- Analyze** Define *property* and *financial claims*. What is the relationship between the two?
- Name the two types of equities in a business. Give an example of an account that is used for each.
- What is the accounting equation? Give an example of an account for each part of the equation.
- Evaluate** How does each of the following transactions affect the three parts of the accounting equation?
  - Owner transfer of cash from personal savings account to the business
  - Owner withdrawal of cash from the business for personal use
  - Purchase of equipment for cash
  - Purchase of equipment on credit
  - Issued check for payment on Transaction D
  - Received payment for design consulting
  - Issued check to pay telephone bill
- Synthesize** At least how many accounts must be affected by each business transaction. Why?

## Multiple Choice

1. A creditor's claim to the property of an individual or business is called —
  - a. an equity
  - b. an asset
  - c. a liability
  - d. a credit
2. An business owner's claim to the property of the business is called —
  - a. an equity
  - b. an asset
  - c. a liability
  - d. a credit
3. The money a business earns is
  - a. revenue
  - b. a withdrawal
  - c. an asset
  - d. an account payable

## True or False

4. The accounting equation is stated as "Assets + Liabilities = Owner's Equity."
5. Cash withdrawals decrease owner's equity by decreasing assets and the owner's financial claim.
6. Accounts payable is the amount of money owed, or payable, to the creditors of a business.

## Short Answer

7. List three kinds of assets that a business can own.

## Extended Response

8. Explain the difference between Accounts Receivable and Accounts Payable.

# Computerized Accounting

## Exploring Electronic Spreadsheets

Computer spreadsheets are important tools for organizing and analyzing data. A spreadsheet is made up of rows and columns. The columns are identified by letters and the rows are identified by numbers. As you create a spreadsheet, you will enter numbers, labels, and formulas into cells. Microsoft® Excel is the most commonly used spreadsheet application in the business world. The following is an example of a basic electronic spreadsheet:

|   | A          | B     | C     | D     | E      | F     | G     | H      |
|---|------------|-------|-------|-------|--------|-------|-------|--------|
| 1 |            | Jan   | Feb   | March | April  | May   | June  | July   |
| 2 | Sales      | 2,500 | 5,000 | 1,650 | 10,000 | 3,100 | 8,200 | 12,500 |
| 3 | Expenses   | 700   | 1,200 | 225   | 3,550  | 1,800 | 2,300 | 5,600  |
| 4 | Net income | 1,800 | 3,800 | 1,425 | 6,450  | 1,300 | 5,900 | 6,900  |
| 5 |            |       |       |       |        |       |       |        |
| 6 |            |       |       |       |        |       |       |        |

Before you create a computer spreadsheet, review the following spreadsheet terms.

| Spreadsheet Terms |               | Description                                                                                                                                                                        |
|-------------------|---------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 1                 | Row           | Identified by numbers down the left side of the spreadsheet.                                                                                                                       |
| 2                 | Column        | Identified by letters along the top of the spreadsheet.                                                                                                                            |
| 3                 | Cell address  | Identified by a column letter and row number. For example, the cell address B4 indicates the cell where the number 1,800 is found.                                                 |
| 4                 | Active cell   | Indicated by a dark border.                                                                                                                                                        |
| 5                 | Scroll arrows | Allows you to view other parts of the spreadsheet.                                                                                                                                 |
| 6                 | Labels        | Text that identifies columns or rows of information; cannot be used for calculations.                                                                                              |
| 7                 | Values        | Numbers inserted in cells that can be used for calculations.                                                                                                                       |
| 8                 | Formulas      | Mathematical functions entered in a particular cell that tells the software to add, subtract, divide, or multiply values. For example, E2 – E3 represents 10,000 – 3,550, or 6,450 |

## Chapter 3

# Problems

### Problem 4 Classifying Accounts

All accounts belong in one of the following classifications: Asset, Liability, Owner's Equity.

**Instructions** In your working papers, indicate the classification for each of the following accounts.

1. John Jones, Capital
2. Cash in Bank
3. Accounts Receivable
4. Accounts Payable
5. Office Equipment
6. Delivery Equipment
7. Camping Equipment
8. Building
9. Land
10. Computer Equipment



#### Analyze

Identify the accounts that represent financial claims to property.

### Problem 5 Completing the Accounting Equation

A business owned and operated by Mike Murray uses these accounts.

**Instructions** Look at the following list of accounts, and determine the missing amount for each of the question marks.

| Assets              |         | = | Liabilities      | + | Owners Equity                   |
|---------------------|---------|---|------------------|---|---------------------------------|
| Cash in Bank        | \$4,500 |   | Accounts Payable |   | Mike Murray,<br>Capital \$9,250 |
| Accounts Receivable | 1,350   |   | ?                |   |                                 |
| Office Equipment    | 5,000   |   |                  |   |                                 |
|                     | ?       |   |                  |   |                                 |



#### Analyze

Predict what would happen to owner's equity if this business paid all of its bills today.

## Chapter 3

# Problems

### Problem 6 Classifying Accounts Within the Accounting Equation

Listed here are the account names and balances for Wilderness Rentals.

|                     |          |                       |          |
|---------------------|----------|-----------------------|----------|
| Accounts Payable    | \$ 7,000 | Cash in Bank          | \$ 5,000 |
| Accounts Receivable | 2,000    | Office Equipment      | 3,000    |
| Camping Equipment   | 12,000   | Ronald Hicks, Capital | 15,000   |

**Instructions** Using these account names and balances:

1. List and total the assets of the business.
2. Determine the amount owed by the business.
3. Give the amount of the owner's equity in the business.



#### Analyze

Design a diagram that shows the accounting equation for Wilderness Rentals.

Review Copy

## Chapter 3

# Problems

### Problem 7 Determining Increases and Decreases in Accounts

Hot Suds Car Wash uses the following accounts:

| <u>Assets</u>       | = | <u>Liabilities</u> | + | <u>Owners Equity</u> |
|---------------------|---|--------------------|---|----------------------|
| Cash in Bank        |   | Accounts Payable   |   | Regina Delgado,      |
| Accounts Receivable |   |                    |   | Capital              |
| Office Equipment    |   |                    |   |                      |
| Office Furniture    |   |                    |   |                      |
| Car Wash Equipment  |   |                    |   |                      |

**Instructions** Use a form similar to the one that follows. For each transaction:

1. Identify the accounts affected.
2. Classify the accounts.
3. Determine the amount of the increase (+) or decrease (−) for each account affected.

The first transaction is completed as an example.

| Trans. | Account Affected        | Classification | Amount of Increase (+) or Decrease (−) |
|--------|-------------------------|----------------|----------------------------------------|
| 1      | Cash in Bank            | Asset          | +\$25,000                              |
|        | Regina Delgado, Capital | Owner's Equity | +\$25,000                              |

| Date   | Transactions                                                                                            |
|--------|---------------------------------------------------------------------------------------------------------|
| Jan. 1 | 1. Regina Delgado, the owner, invested \$25,000 cash in the business.                                   |
| 4      | 2. Bought car wash equipment with cash for \$12,000.                                                    |
| 5      | 3. Purchased, on account, \$2,500 of office equipment.                                                  |
| 10     | 4. Wrote a check for the monthly rent, \$800.                                                           |
| 12     | 5. Received cash for services performed, \$1,000.                                                       |
| 15     | 6. The owner withdrew \$600 cash from the business for personal use.                                    |
| 20     | 7. Purchased a desk for \$1,000, paying \$200 cash and agreeing to pay the balance of \$800 in 30 days. |
| 25     | 8. Provided services worth \$600 on account.                                                            |



### Analyze

Identify the transaction that affects the most accounts.

## Chapter 3

# Problems

### Problem 8 Determining the Effects of Transactions on the Accounting Equation

After graduating from college, Abe Shultz decided to start a pet grooming service called Kits & Pups Grooming.

**Instructions** Use a form similar to the one that follows. For each of the following transactions:

1. Identify the accounts affected, using the account names on the form.
2. Determine the amount of the increase or decrease for each account.
3. Write the amount of the increase (+) or decrease (–) in the space under each account affected.
4. On the following line, write the new balance for each account.
5. Transaction 1 is completed as an example.

|        | Assets       |             |               |                 | = | Liabilities      | + | Owner's Equity      |
|--------|--------------|-------------|---------------|-----------------|---|------------------|---|---------------------|
| Trans. | Cash in Bank | Accts. Rec. | Office Equip. | Grooming Equip. | = | Accounts Payable | + | Abe Shultz, Capital |
| 1      | +\$10,000    |             |               |                 |   |                  |   | +\$10,000           |

| Date   | Transactions                                                                                                                                                    |
|--------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Jan. 2 | 1. Abe Shultz began the business by depositing \$10,000 in a checking account at the Shoreline National Bank in the name of the business, Kits & Pups Grooming. |
| 3      | 2. Bought grooming equipment for cash, \$1,000.                                                                                                                 |
| 8      | 3. Issued a check for \$900 for the monthly rent.                                                                                                               |
| 9      | 4. Bought \$6,000 worth of new office equipment on account for use in the business.                                                                             |
| 15     | 5. Received \$700 cash for services performed for customers during the first week of business.                                                                  |
| 21     | 6. Issued a \$2,000 check to the creditor as partial payment for the office equipment purchased on account.                                                     |
| 29     | 7. Performed grooming services and agreed to be paid for them later, \$500.                                                                                     |



### Analyze

Explain the difference between Transaction 5 and Transaction 7.

## Chapter 3

# Problems

### Problem 9 Determining the Effects of Transactions on the Accounting Equation

Juanita Ortega is the owner of a professional guide service called Outback Guide Service.

**Instructions** Use a form similar to the one below. Complete these steps for each of the following transactions:

1. Identify the accounts affected.
2. Write the amount of the increase (+) or decrease (–) in the space provided on the form in your working papers.
3. Determine the new balance for each account.

|        | Assets       |             |               |                |               | = | Liabilities      | + | Owner's Equity          |
|--------|--------------|-------------|---------------|----------------|---------------|---|------------------|---|-------------------------|
| Trans. | Cash in Bank | Accts. Rec. | Hiking Equip. | Rafting Equip. | Office Equip. | = | Accounts Payable | + | Juanita Ortega, Capital |

| Date   | Transactions                                                                                                       |
|--------|--------------------------------------------------------------------------------------------------------------------|
| Jan. 3 | 1. Ms. Ortega, the owner, opened a checking account for the business by depositing \$60,000 of her personal funds. |
| 6      | 2. Paid by check the monthly rent of \$3,000.                                                                      |
| 8      | 3. Bought hiking equipment for the business by writing a check for \$3,000.                                        |
| 9      | 4. Purchased \$24,000 of rafting equipment by writing a check.                                                     |
| 11     | 5. Purchased office equipment on account for \$4,000.                                                              |
| 15     | 6. Received payment for guide services, \$2,500.                                                                   |
| 18     | 7. Ms. Ortega contributed a desk valued at \$450 to the business.                                                  |
| 21     | 8. Withdrew \$3,000 cash from the business for personal use.                                                       |
| 26     | 9. Wrote a check to a creditor as partial payment on account, \$1,500.                                             |
| 30     | 10. Took a group on a tour and agreed to accept payment later, \$1,200.                                            |



### Analyze

Calculate the amount owed to creditors after Transaction 10.

## Chapter 3

# Problems

### Problem 10 Describing Business Transactions

Showbiz Video is a business owned by Greg Failla. The transactions that follow are shown as they would appear in the accounting equation.

**Instructions** In your working papers, describe what has happened in each transaction. Transaction 1 is completed as an example.

#### Example:

- The owner invested \$30,000 in the business.

|        | Assets       |             |               |              | = | Liabilities      | + | Owner's Equity       |
|--------|--------------|-------------|---------------|--------------|---|------------------|---|----------------------|
| Trans. | Cash in Bank | Accts. Rec. | Office Equip. | Video Equip. | = | Accounts Payable | + | Greg Failla, Capital |
| 1      | +\$30,000    |             |               |              |   |                  |   | +\$30,000            |
| 2      | -\$ 2,000    |             | +\$ 2,000     |              |   |                  |   |                      |
| 3      |              |             |               | +\$ 8,000    |   | +\$ 8,000        |   |                      |
| 4      | +\$ 700      |             |               |              |   |                  |   | +\$ 700              |
| 5      |              | +\$ 500     |               |              |   |                  |   | +\$ 500              |
| 6      |              |             | +\$ 200       |              |   |                  |   | +\$ 200              |
| 7      | -\$ 3,000    |             |               |              |   | -\$ 3,000        |   |                      |
| 8      |              | +\$ 200     | -\$ 200       |              |   |                  |   |                      |
| 9      | +\$ 500      | -\$ 500     |               |              |   |                  |   |                      |
| 10     | -\$ 1,000    |             |               |              |   |                  |   | -\$ 1,000            |



#### Analyze

Calculate the balance of the account, Greg Failla, Capital.

## Chapter 3

# Problems

### Problem 11 Completing the Accounting Equation

The account names and balances for Job Connect are listed below.

**Instructions** Determine the missing amount for each of the question marks. Use the form in your working papers and write in the missing amounts.

|        | Assets       |                     |                    | = | Liabilities      | + | Owner's Equity        |
|--------|--------------|---------------------|--------------------|---|------------------|---|-----------------------|
| Trans. | Cash in Bank | Accounts Receivable | Business Equipment | = | Accounts Payable | + | Richard Tang, Capital |
| 1      | ?            | \$ 2,000            | \$ 1,000           |   | \$ 500           |   | \$ 7,500              |
| 2      | \$ 3,000     | \$ 9,000            | ?                  |   | \$2,000          |   | \$16,000              |
| 3      | \$ 8,000     | \$ 1,000            | \$ 10,000          |   | ?                |   | \$15,000              |
| 4      | \$ 4,000     | ?                   | \$ 4,000           |   | \$1,000          |   | \$17,000              |
| 5      | \$ 9,000     | \$ 7,000            | \$ 6,000           |   | \$5,000          |   | ?                     |
| 6      | \$10,000     | \$14,000            | ?                  |   | \$6,000          |   | \$32,000              |
| 7      | \$ 6,000     | \$ 4,000            | \$ 10,000          |   | ?                |   | \$15,000              |
| 8      | ?            | \$ 5,000            | \$ 9,000           |   | \$ 1,000         |   | ?                     |

**Hint:** In line 8, total assets are \$18,000.



#### Analyze

Explain the mathematical operations used to solve for the accounting equation.



### Career Wise

#### Certified Public Accountant (CPA)

A certified public accountant can be a great career for those who are interested in working with a variety of clients and doing a variety of accounting tasks, rather than working with only one organization or specializing in a certain type of task.

#### Education Requirements

Most states require a CPA to have 150 hours of college coursework, which means pursuing a master's degree in addition to a bachelor's degree. CPAs must also pass a special licensing exam and continue to take classes throughout their career.

#### Roles

The CPA acts as an accountant for the general public. The CPA advises the general public on tax and financial matters and advises companies on how to control their procedures to make sure they comply with accounting standards and procedures.

#### Responsibilities

CPAs must always exercise good judgment and conduct their work ethically. They must do a good job advising their clients and be a good representative of the accounting profession.

#### Activity

CPAs very often have their own businesses. Use the career information tools available to you (Internet, library, and your career center) to research the extra responsibilities that come with owning your own business. Write a paragraph summarizing what you discovered.

### Success Skills

#### Information and Media Literacy

Making decisions, whether business or personal, requires being able to acquire and analyze information. Imagine you have just graduated and are ready to look for a job matching your skills and interests.

#### Instructions

1. Use the Internet to find local job postings and then to research the companies that are hiring. Would you be interested in working for any of these companies?
2. Write a summary of your findings, and describe the accounting career opportunities you think these organizations might offer.

## A Matter of Ethics

### Company Property

Many companies provide office supplies for their employees' use while on the job. Imagine that you work for a large department store like JC Penney. Several of your coworkers take company supplies home for their personal use, such as pens, bags, hangers, and boxes. You need boxes to store some items at home, so you consider taking them from the supply room.

#### Activity

Define the ethical issue involved. Then describe how you think ethics relates to taking supplies from the workplace. Who are the affected parties? What are the alternatives? How do the alternatives affect the parties? What would you do?

## Spotlight on Personal Finance

### Your Earning Power

Your future income will depend on various things including your career choice, your education, and the region where you live.

#### Activity

List three jobs that are in different fields and different regions in the United States. Using the Internet or library, research the education requirements and the salary ranges of the three jobs. Create a table and organize the results of your research.

## H.O.T. Audit

### Conducting an Audit

To audit means to examine and verify financial records and reports.

#### Instructions

Review the business transactions recorded in the accounting equation below for errors. On a separate sheet of paper, make any corrections necessary.

- A. Purchased a delivery truck for \$25,000 on account from A-1 Trucks Inc.
- B. Wrote a check for \$1,000 to A-1 Trucks Inc. for payment on account.

| ASSETS       |                     | = | LIABILITIES      | + | OWNERS EQUITY     |
|--------------|---------------------|---|------------------|---|-------------------|
| Cash in Bank | Delivery Equip-ment |   | Accounts Payable |   | J. Smith, Capital |
| A. 0         | -\$25,000           |   | -\$25,000        |   | 0                 |
| B. -\$1,000  | 0                   |   | -\$ 1,000        |   | 0                 |