Chapter 2

Analyzing and Recording Transactions

QUESTIONS

1. a. Common asset accounts: cash, accounts receivable, notes receivable, prepaid expenses (rent, insurance, etc.), office supplies, store supplies, equipment, building, and land.

   b. Common liability accounts: accounts payable, notes payable, and unearned revenue, wages payable, and taxes payable.

   c. Common equity accounts: common stock and dividends.

2. A note payable is formal promise, usually denoted by signing a promissory note to pay a future amount. A note payable can be short-term or long-term, depending on when it is due. An account payable also references an amount owed to an entity. An account payable can be oral or implied, and often arises from the purchase of inventory, supplies, or services. An account payable is usually short-term.

3. There are several steps in processing transactions: (1) Identify and analyze the transaction or event, including the source document(s), (2) apply double-entry accounting, (3) record the transaction or event in a journal, and (4) post the journal entry to the ledger. These steps would be followed by preparation of a trial balance and then with the reporting of financial statements.

4. A general journal can be used to record any business transaction or event.

5. Debited accounts are commonly recorded first. The credited accounts are commonly

indented.

6. **A transaction is first recorded in a journal to create a complete record of the transaction in one place. (The journal is often referred to as the book of original entry.) This process reduces the likelihood of errors in ledger accounts.**

7. **Expense accounts have debit balances because they are decreases to equity (and equity has a normal credit balance).**

8. **The recordkeeper prepares a trial balance to summarize the contents of the ledger and to verify the equality of total debits and total credits. The trial balance also serves as a helpful internal document for preparing financial statements and other reports.**

9. **The error should be corrected with a separate (subsequent) correcting entry. The entry's explanation should describe why the correction is necessary.**

10. **The four financial statements are: income statement, balance sheet, statement of retained earnings, and statement of cash flows.**

11. **The balance sheet provides information that helps users understand a company's financial position at a point in time. Accordingly, it is often called the statement of financial position. The balance sheet lists the types and dollar amounts of assets, liabilities, and equity of the business.**

12. **The income statement lists the types and amounts of revenues and expenses, and reports whether the business earned a net income (also called profit or earnings) or a net loss.**

13. **An income statement user must know what time period is covered to judge whether the company's performance is satisfactory. For example, a statement user would not be able to assess whether the amounts of revenue and net income are satisfactory without knowing whether they were earned over a week, a month, a quarter, or a year.**

14. **(a) Assets are probable future economic benefits obtained or controlled by a specific entity as a result of past transactions or events. (b) Liabilities are probable future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or provide services to other entities in the future as a result of past transactions or events. (c) Equity is the residual interest in the assets of an entity that remains after deducting its liabilities. (d) Net assets refer to equity.**

15. **The balance sheet is sometimes referred to as the statement of financial position.**

16. **Debit balance accounts on the Polaris balance sheet include: Cash and cash equivalents; Trade receivables, net; Inventories, net; Prepaid expenses and other; Income taxes receivable; Deferred tax assets; Land, buildings and improvements; Equipment and tooling; Property and equipment, net; Investments in finance affiliate; Investments in other affiliates; Goodwill and other intangible assets, net.**

    Credit balance accounts on the Polaris balance sheet include: Accumulated depreciation; Current portion of long-term borrowings under credit agreement; Current portion of capital lease obligations; Accounts payable; Accrued expenses (including compensation, warranties, sales promotions and incentives, dealer holdback and other); Income taxes payable; Deferred income taxes; Capital lease obligations; Long-term debt; Preferred stock; Common stock; Additional paid-in capital; Retained earnings; Accumulated other comprehensive income, net.

17. **The asset account with *receivable* in its account title is: Accounts receivable, less allowances. The liabilities with *payable* in the account title are: Accounts payable and Income taxes payable.**

18. **KTM's revenue account is titled "Net sales."**

19. **Piaggio calls the asset referring to its merchandise available for sale: "Inventories."**

QUICK STUDIES

Quick Study 2-1 (10 minutes)

The likely source documents include:

- a. Sales ticket
- d. Telephone bill
- e. Invoice from supplier
- i. Bank statement

Quick Study 2-2 (5 minutes)

- a. B Balance sheet
- b. E Statement of retained earnings
- c. I Income statement
- d. B Balance sheet
- e. B Balance sheet
- f. I Income statement
- g. B Balance sheet
- h. B Balance sheet
- i. B Balance sheet

Quick Study 2-3 (10 minutes)

a.	Debit	d.	Debit	g.	Credit
b.	Debit	e.	Debit	h.	Debit
c.	Credit	f.	Debit	i.	Credit

Quick Study 2-4 (10 minutes)

a.	Debit	e.	Debit	i.	Credit
b.	Debit	f.	Credit	j.	Debit
c.	Credit	g.	Credit	k.	Debit
d.	Credit	h.	Debit	l.	Credit

Quick Study 2-5 (10 minutes)

a.	Debit	e.	Debit	i.	Credit
b.	Credit	f.	Credit	j.	Debit
c.	Debit	g.	Credit		
d.	Credit	h.	Credit		

Quick Study 2-6 (15 minutes)

May 15	Cash	70,000	
	Equipment	30,000	
	Common Stock...		100,000
	Owner invests cash and equipment for stock.		
21	Office Supplies	280	
	Accounts Payable		280
	Purchased office supplies on credit.		
25	Cash	7,800	
	Landscaping Services Revenue		7,800
	Received cash for landscaping services.		
30	Cash	1,000	
	Unearned Landscaping Services Revenue ..		1,000
	Received cash in advance for landscaping services.		

Quick Study 2-7 (10 minutes)

The correct answer is a.

Explanation: **If a $2,250 debit to Utilities Expense is incorrectly posted as a credit, the effect is to understate the Utilities Expense debit balance by $4,500. This causes the Debit column total on the trial balance to be $4,500 less than the Credit column total.**

Quick Study 2-8 (10 minutes)

a.	I	e.	B	i.	E
b.	B	f.	B	j.	B
c.	B	g.	B	k.	I
d.	I	h.	I	l.	I

Quick Study 2-9 (10 minutes)

a. Accounting under IFRS follows the same debit and credit system as under US GAAP.

b. The same four basic financial statements are prepared under IFRS and US GAAP: income statement, balance sheet, statement of changes in equity, and statement of cash flows. Although some variations from these titles exist within both systems, the four basic statements are present.

c. Accounting reports under both IFRS and US GAAP are likely different depending on the extent of accounting controls and enforcement. For example, the absence of controls and enforcement increase the possibility of fraudulent transactions and misleading financial statements. Without controls and enforcement, all accounting systems run the risk of abuse and manipulation.

EXERCISES

Exercise 2-1 (10 minutes)

__1__ a. Analyze each transaction from source documents.

__4__ b. Prepare and analyze the trial balance.

__2__ c. Record relevant transactions in a journal.

__3__ d. Post journal information to ledger accounts.

Exercise 2-2 (10 minutes)

a.	3	d.	5
b.	4	e.	2
c.	1		

Exercise 2-3 (5 minutes)

a.	2	b.	1

Exercise 2-4 (15 minutes)

	Account	Type of Account	Normal Balance	Increase (Dr. or Cr.)
a.	Cash	asset	debit	debit
b.	Legal Expense	expense	debit	debit
c.	Prepaid Insurance	asset	debit	debit
d.	Land	asset	debit	debit
e.	Accounts Receivable	asset	debit	debit
f.	Dividends	equity	debit	debit
g.	License Fee Revenue	revenue	credit	credit
h.	Unearned Revenue	liability	credit	credit
i.	Fees Earned	revenue	credit	credit
j.	Equipment	asset	debit	debit
k.	Notes Payable	liability	credit	credit
l.	Common Stock..........................	equity	credit	credit

Exercise 2-5 (15 minutes)

a.	Beginning accounts payable (credit)	$152,000
	Purchases on account in October (credits)	281,000
	Payments on accounts in October (debits)	(?)
	Ending accounts payable (credit)	$132,500
	Payments on accounts in October (debits)	$300,500
b.	Beginning accounts receivable (debit)	$102,500
	Sales on account in October (debits)	?
	Collections on account in October (credits)	(102,890)
	Ending accounts receivable (debit)	$ 89,000
	Sales on account in October (debits)	$ 89,390
c.	Beginning cash balance (debit)	$?
	Cash received in October (debits)	102,500
	Cash disbursed in October (credits)	(103,150)
	Ending cash balance (debit)	$ 18,600
	Beginning cash balance (debit)	$ 19,250

Exercise 2-6 (15 minutes)

Of the items listed, the following effects should be included:

- **a. $28,000 increase in a liability account.**
- **b. $10,000 increase in the Cash account.**
- **e. $62,000 increase in a revenue account.**

<u>Explanation</u>: This transaction created $62,000 in revenue, which is the value of the service provided. Payment is received in the form of a $10,000 increase in cash, an $80,000 increase in computer equipment, and a $28,000 increase in its liabilities. The net value received by the company is $62,000.

Exercise 2-7 (25 minutes)

Aug. 1	**Cash**	**6,500**	
	Photography Equipment	**33,500**	
	Common Stock		**40,000**
	Owner investment in business for stock.		
2	**Prepaid Insurance**	**2,100**	
	Cash		**2,100**
	Acquired 2 years of insurance coverage.		
5	**Office Supplies**	**880**	
	Cash		**880**
	Purchased office supplies.		
20	**Cash**	**3,331**	
	Photography Fees Earned		**3,331**
	Collected photography fees.		
31	**Utilities Expense**	**675**	
	Cash		**675**
	Paid for August utilities.		

Exercise 2-8 (30 minutes)

Cash				
Aug. 1	6,500	Aug.	2	2,100
20	3,331		5	880
			31	675
Balance	6,176			

Photography Equipment			
Aug. 1	33,500		

Common Stock			
		Aug. 1	40,000

Office Supplies			
Aug. 5	880		

Photography Fees Earned			
		Aug. 20	3,331

Prepaid Insurance			
Aug. 2	2,100		

Utilities Expense			
Aug. 31	675		

POSE-FOR-PICS
Trial Balance
August 31

	Debit	*Credit*
Cash	$ 6,176	
Office supplies	880	
Prepaid insurance	2,100	
Photography equipment	33,500	
Common stock		$40,000
Photography fees earned		3,331
Utilities expense..........................	675	
Totals	$43,331	$43,331

Exercise 2-9 (30 minutes)

		Debit	Credit
a.	Cash	100,750	
	Common Stock		100,750
	Owner invested in the business for stock.		
b.	Office Supplies	1,250	
	Cash		1,250
	Purchased supplies with cash.		
c.	Office Equipment	10,050	
	Accounts Payable		10,050
	Purchased office equipment on credit.		
d.	Cash	15,500	
	Fees Earned		15,500
	Received cash from customer for services.		
e.	Accounts Payable	10,050	
	Cash		10,050
	Made payment toward account payable.		
f.	Accounts Receivable	2,700	
	Fees Earned		2,700
	Billed customer for services provided.		
g.	Rent Expense	1,225	
	Cash		1,225
	Paid for this period's rental charge.		
h.	Cash	1,125	
	Accounts Receivable		1,125
	Received cash toward an account receivable.		
i.	Dividends	10,000	
	Cash		10,000
	Paid cash dividends.		

Exercise 2-9 (concluded)

Cash			
(a)	100,750	(b)	1,250
(d)	15,500	(e)	10,050
(h)	1,125	(g)	1,225
		(i)	10,000
Balance	94,850		

Accounts Payable			
(e)	10,050	(c)	10,050
		Balance	0

Common Stock			
		(a)	100,750
		Balance	100,750

Accounts Receivable			
(f)	2,700	(h)	1,125
Balance	1,575		

Dividends			
(i)	10,000		
Balance	10,000		

Office Supplies			
(b)	1,250		
Balance	1,250		

Fees Earned			
		(d)	15,500
		(f)	2,700
		Balance	18,200

Office Equipment			
(c)	10,050		
Balance	10,050		

Rent Expense			
(g)	1,225		
Balance	1,225		

Exercise 2-10 (15 minutes)

SPADE COMPANY
Trial Balance
May 31, 2013

	Debit	*Credit*
Cash	$ 94,850	
Accounts receivable	1,575	
Office supplies............................	1,250	
Office equipment	10,050	
Accounts payable		$ 0
Common stock		100,750
Dividends	10,000	
Fees earned		18,200
Rent expense	1,225	
Totals	$118,950	$118,950

Exercise 2-11 (20 minutes)

Transactions that created revenues:

b.	**Accounts Receivable**	**2,300**	
	Services Revenue		**2,300**
	Provided services on credit.		
c.	**Cash**	**875**	
	Services Revenue		**875**
	Provided services for cash.		

[Note: Revenues are inflows of assets (or decreases in liabilities) received in exchange for goods or services provided to customers.]

Transactions that did not create revenues along with the reasons are:

a. **This transaction brought in cash, but this is an owner investment.**

d. **This transaction brought in cash, but it created a liability because the services have not yet been provided to the client.**

e. **This transaction changed the form of the asset from accounts receivable to cash. Total assets were not increased (revenue was recognized when the receivable was originally recorded).**

f. **This transaction brought in cash and increased assets, but it also increased a liability by the same amount (no goods or services were provided to generate revenue).**