CHAPTER 3

Analyzing and Recording Transactions

Spinning an Accounting Web

Kitchener, ON—Maria Sanchez's second year on the job was nearly her last. She was working as a staff accountant for a shoe manufacturer where she was assigned to payroll and accounts receivable. In late December of her second year, she was instructed to add 1% to all employees' end-of-year paycheques as a bonus. Instead, she keyed an extra zero and gave everyone a 10% bonus. "The controller was furious," says Sanchez. "To top it off, the employees were so happy that the controller and board couldn't do anything but keep quiet, accept the error and thank everyone."

Today, Sanchez takes the blame for the error. But, it wasn't always that way. "I still partly blame our accounting technology. It was awful," says Sanchez. It was this experience that led Sanchez to add technology to her accounting. While taking evening classes in computing, Sanchez became convinced that accounting packages could be more user friendly. She also foresaw the power of the Web.

Sanchez is today the owner of RecordLink. It is an accounting software firm aimed at recordkeeping services for small business. It is unique in that it relies on the Web. This means there is no

need for software purchases or special computing hardware requirements for small business. Clients link into her Web servers for their computing needs.

The convenience and power of clients having access to their accounting information anytime, anywhere, are attracting new clients. “We offer 24-hour accounting and computing advice, and we are expanding our software options to include strategic planning, budget analyses and other sophisticated programs that few small businesses can individually afford.” RecordLink spreads these costs over all its clients.

Sanchez sees recordkeeping services for small business as a lucrative and underserved market. She has plans to expand her business. So far, her creativity has been a hit with clients. RecordLink’s revenues are growing rapidly. Adds Sanchez, “Not bad for a high-tech recordkeeper!”

Learning Objectives

- LO1 Explain the accounting cycle.
- LO2 Explain the steps in processing transactions.
- LO3 Describe source documents and their purpose.
- LO4 Describe an account and its use in recording information about transactions.
- LO5 Describe a ledger and a chart of accounts.
- LO6 Define debits and credits and explain their role in double-entry accounting.
- LO7 Analyze the impact of transactions on accounts.
- LO8 Record transactions in a journal and post entries to a ledger.
- LO9 Prepare and explain the use of a trial balance.

Chapter Preview

We explained in Chapter 2 how the accounting equation P.45 helps us understand and analyze transactions and events. Analyzing financial transactions is the first step in the *accounting cycle*. Chapters 3 through 5 continue to explain and demonstrate each of the steps in the accounting cycle. All accounting systems use steps similar to those described here. These procedures are important because they lead to financial statements P. 36. Maria Sanchez of RecordLink uses a Web-based system, but the steps in the accounting cycle are essentially identical for manual systems.

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

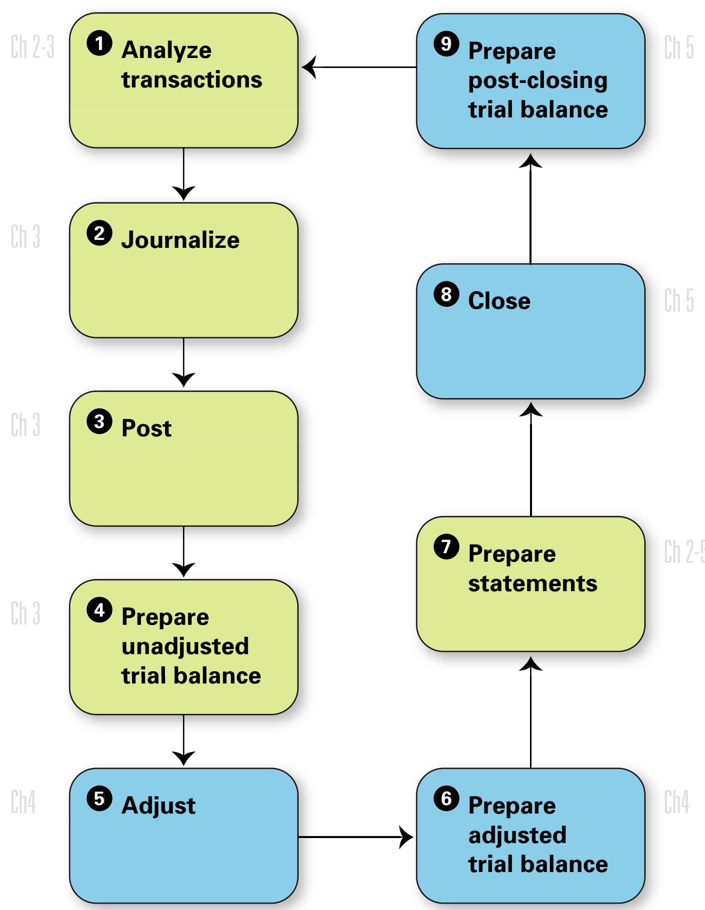
The Accounting Cycle

LO1 Explain the accounting cycle.

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

Exhibit 3.1

Accounting Cycle



Transactions and Documents

LO2 Explain the steps in processing transactions.

Transactions and events are the starting points in the accounting cycle. Relying on source documents, we analyze transactions and events using the accounting equation to understand how they affect organization performance and financial position. These effects are recorded in accounting records, informally referred to as the accounting books or simply the books. Additional processing steps such as posting and preparing a trial balance help us to summarize and classify the effects of transactions and events. A final step in the accounting process is to provide information in useful reports or financial statements to decision makers.

Transactions and Events

Business activities can be described in terms of transactions and events. We know from Chapter 2 that business transactions are exchanges of economic consideration between two parties. We also know that the accounting equation is affected by transactions and events.

External transactions are exchanges between an organization and some other person or organization. These external transactions yield changes in the accounting equation. **Internal transactions** are exchanges within an organization. Internal transactions can also affect the accounting equation. An example is a company using office supplies in its operating activities. As the office supplies are used, its remaining balance decreases. This using up of office supplies is an event that decreases assets and decreases owner's equity.

Many events can affect an organization's performance and financial position. The analysis and record of these events are explained in the next section.

Source Documents

LO3 Describe source documents and their purpose.

Organizations use various documents and papers when doing business. **Source documents** identify and describe transactions and events entering the accounting process. They are the source of accounting information, and can be in either paper or electronic form. Examples are sales invoices, cheques, purchase orders, charges to customers, bills from suppliers, employee earnings records, and bank statements.

Both buyers and sellers use sales invoices as source documents. Sellers use them for recording sales and for control purposes. Buyers use them for recording purchases and for monitoring purchasing activity. Source documents, especially if obtained from outside the organization, provide objective evidence about transactions, thus making the information more reliable and useful. Source documents are also part of important procedures used to help prevent mistakes and theft.

Today, computers assist us in recording and processing transaction data, although parts of many small business accounting systems are still manual. Computers are only part of the process and modern technology still demands human insight and understanding of transactions. In our discussion of the steps making up the accounting process, we use a manual system for presentation. The fundamental concepts of the manual system are identical to those of a computerized information system. Our understanding of how information proceeds through an accounting system is made clear through studying a manual system.

Judgement Call

Answer—p. 109

Cashier

You are a cashier at a retail convenience store. When you were hired, the assistant manager explained the policy of immediately entering each sale into the cash register. Recently, lunch hour traffic has increased dramatically and the assistant manager asks you to take customers' cash and make change without recording sales in the cash register to avoid delays. The assistant manager says she will add up cash and enter sales equal to the cash amount after lunch. She says that in this way the register will always be accurate when the manager arrives at three o'clock. What do you do?

Flashback

Answers—p. 109

1. Describe external and internal transactions.
2. Identify examples of accounting source documents.
3. Explain the importance of source documents.

Accounts and Double-Entry Accounting

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

The Account

LO4 Describe an account and its use in recording information about transactions.

An **account** is a detailed record of increases and decreases in a specific asset, liability, or equity item. Information is taken from accounts, analyzed, summarized, and presented in useful reports and financial statements for users. Separate accounts[1] are kept for each type of asset, liability and equity item. Exhibit 3.2 shows examples of the different types of accounts used by Finlay Interiors.

Exhibit 3.2

Types of Accounts for Finlay Interiors

Assets	=	Liabilities	+	Equity
Cash		Accounts Payable		Carol Finlay, Capital
Notes Receivable		Notes Payable		Carol Finlay, Withdrawals
Supplies				Service Revenue
Furniture				Rental Revenue
				Wages Expense
				Advertising Expense

A **ledger** is a record containing all accounts used by a business. This is often in electronic form and is what we mean when we refer to the *books*. While most companies' ledgers contain similar accounts, there are often several accounts that are unique to a company because of its individual type of operation. These accounts directly affect the preparation of financial reports and statements. The remainder of this section introduces accounts that are important to most organizations.

[1] As an example of an account, Exhibit 3.12 shows the Cash account for Finlay Interiors.

Asset Accounts

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

Cash

Increases and decreases in the amount of cash are recorded in a Cash account. A Cash account includes money and any form of exchange that a bank accepts for deposit. Examples are coins, currency, cheques, money orders, and chequing account balances.

Receivables

As the term implies, a receivable is an amount of cash that the business is expecting to receive in the future. There are different kinds of receivables, the most common are *accounts receivable* and *notes receivable.*

- *Accounts Receivable.* When services are performed for or goods are sold to customers in return for promises to pay in the future, an **account receivable** is recorded. These transactions are said to be *on credit* or *on account.* Accounts receivable are *increased* by services performed or goods sold on credit and *decreased* by customer payments.
- *Notes Receivable.* A **note receivable**, or a **promissory note**, is an unconditional written promise to pay a definite sum of money on demand or on a defined future date(s). A company holding a promissory note signed by another party has an asset. This asset is recorded in a Notes Receivable account.

Prepaid Expenses

Prepaid Expenses is an asset account containing payments made for assets that are to be used in the near future. As these assets are used up, the costs of the used assets become expenses. Prepaid expenses that are more crucial to the business are often accounted for in separate asset accounts such as Office Supplies, Store Supplies and Prepaid Insurance, as explained below. Other prepaids include Prepaid Rent and advance payments for legal and accounting services. An asset's cost can be initially recorded as an expense *if* it is used up before the end of the period when statements are prepared. If an asset will not be used before the end of the reporting period, then its cost is recorded in an asset account.

- *Office Supplies.* Companies use office supplies such as stationery, paper and pens. These supplies are assets until they are used. When they are used up, their cost is reported as an expense. The cost of unused supplies is an asset and is recorded in an Office Supplies account.
- *Store Supplies.* Many stores keep supplies for wrapping and packaging purchases for customers. These include plastic and paper bags, gift boxes, cartons and ribbons. The cost of these unused supplies is recorded in a Store Supplies account. Supplies are reported as expenses as they are used.
- *Prepaid Insurance.* Insurance contracts provide us with protection against losses caused by fire, theft, accidents and other events. The insurance policy often requires the fee, called a *premium*, to be paid in advance. Protection can be purchased for almost any time period, including monthly, yearly or even several years. When an insurance

premium is paid in advance, the cost is typically recorded in an asset account called Prepaid Insurance. Over time, the expiring portion of the insurance cost (the amount "used up") is removed from this asset account and reported in expenses on the income statement P. 37. The unexpired portion (the "unused" amount) remains in Prepaid Insurance and is reported on the balance sheet P. 38 as an asset.

Equipment

Most organizations own computers, printers, desks, chairs and other office equipment. Costs incurred to buy this equipment are recorded in an Office Equipment account. The costs of assets used in a store—such as counters, showcases and cash registers—are recorded in a Store Equipment account.

Buildings

A building owned by an organization can provide space for a store, an office, a warehouse or a factory. Buildings are assets because they provide benefits. Their costs are recorded in a Buildings account. When several buildings are owned, separate accounts are sometimes used for each of them.

Land

A Land account records the cost of land owned by a business. The cost of land is separated from the cost of buildings located on the land to provide more useful information in financial statements.

Liability Accounts

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

Payables

Payables are promises by a business to pay later for an asset or service already received. There are different kinds of payables; the most common are accounts payable and notes payable.

- *Accounts Payable.* Purchases of merchandise, supplies, equipment or services made by an oral or implied promise to pay later produce liabilities called Accounts Payable.
- *Notes Payable.* When an organization formally recognizes a promise to pay by signing a promissory note, the resulting liability is a Note Payable. It is recorded in either a Short-Term Notes Payable account or a Long-Term Notes Payable account depending on when it must be repaid. We explain details of account classification in Chapter 5.

Unearned Revenues

Chapter 2 explained that the revenue recognition principle P. 44 requires that revenues be reported on the income statement when earned. This principle means that we must be careful with transactions where customers pay in advance for products or services. Because cash from these transactions is received before revenues are earned, the seller considers them **unearned revenues**. *Unearned revenue* is a liability that is satisfied by delivering products or services in the future. Examples of unearned revenue include magazine subscriptions collected in advance by a publisher, sales of gift certificates by stores, airline tickets sold in advance, and rent collected in advance by a landlord.

WestJet Airlines Ltd. reported *advance ticket sales* of $10,907,000 on December 31, 1999.
See: Appendix I

When cash is received in advance for products and services, the seller records it in a liability account such as Unearned Subscriptions, Unearned Rent, or Unearned Professional Fees. When products and services are delivered, the now earned portion of the unearned revenues is transferred to revenue accounts such as Subscription Fees, Rent Earned or Professional Fees.[2]

Other Liabilities

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

The liabilities section of WestJet Airlines Ltd.'s balance sheet at December 31, 1999 included income taxes payable of $7,410,000.
See: Appendix I

Equity Accounts

We described in the previous chapter four types of transactions that affect owner's equity. They are (1) investments by the owner, (2) withdrawals by the owner, (3) revenues and (4) expenses. In Chapter 2, we entered all equity transactions in a single column under the owner's name. When we later prepared the income statement and the statement of owner's equity P. 38, we had to review the items in that column to properly classify them in financial statements.

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

Owner Capital

Owner investments P. 38 are recorded in an account identified by the owner's name and the title *Capital*.

Owner Withdrawals

Most accounting systems use an account with the name of the owner and the word *Withdrawals* in recording owner withdrawals P. 38. The owner withdrawals account also is sometimes called the owner's *Personal* account or *Drawing* account.

Revenues and Expenses

Decision makers often want information about revenues earned and expenses incurred for a period. Businesses use a variety of revenue and expense accounts to report this information on income statements. Different companies have different

[2] There are variations in account titles in practice. As one example, Subscription Fees is sometimes called: Subscription Fees Revenue, Subscription Fees Earned, or Earned Subscription Fees. As another example, Rent Earned is sometimes called Rent Revenue, Rental Revenue, or Earned Rent Revenue. We must use our good judgement when reading financial statements since titles can differ even within the same industry. Revenue or Sales are the most commonly used terms.

kinds of revenue and expense accounts reflecting their own important activities. Examples of revenue accounts are Sales, Commissions Earned, Professional Fees Earned, Rent Earned and Interest Earned. Examples of expense accounts are Advertising Expense, Store Supplies Expense, Office Salaries Expense, Office Supplies Expense, Rent Expense, Utilities Expense and Insurance Expense.

We can get an idea of the variety of revenues by looking at the chart of accounts in Appendix III. It lists accounts needed to solve some of the exercises and problems in this book.[3]

Did You Know?

NHL Accounting

The Vancouver Canucks report the following major revenue and expense accounts:

Revenues:	**Expenses:**
Game ticket sales	Hockey operations
Radio and television	Merchandise and programs
Merchandise and programs	Administrative and marketing
Advertising and promotions	

SOURCE: Orca Bay Hockey Holdings' Financial Statements.

Ledger and Chart of Accounts

LO5 Describe a ledger and a chart of accounts.

The actual recording of accounts can differ depending on the system. Computerized systems store accounts in files on electronic storage devices. Manual systems often record accounts on separate pages in a special booklet. The collection of all accounts for an electronic or manual information system is called a *ledger*.

A company's size and diversity of operations affect the number of accounts needed in its accounting system. A small company may get by with as few as 20 or 30 accounts, while a large company may need several thousand. The **chart of accounts** is a list of all accounts used by a company. The chart includes an identification number assigned to each account. A typical small business might use the following numbering system for its accounts:

101 – 199	Asset accounts
201 – 299	Liability accounts
301 – 399	Owner capital and withdrawals accounts
401 – 499	Revenue accounts
501 – 599	Expense accounts

While this particular system provides for 99 asset accounts, a company may not use all of them. The numbers provide a three-digit code that is useful in recordkeeping. In this case the first digit assigned to asset accounts is 1, while the first digit assigned to liability accounts is 2, and so on. The first digit of an account's number also shows whether the account appears on the balance sheet or the income statement. The second and subsequent digits may also relate to the accounts' categories. A partial chart of accounts for Finlay Interiors follows.

[3] Different companies can use different account titles than those in the list. For example, a company might use Interest Revenue instead of Interest Earned, or Rental Expense instead of Rent Expense. It is only important that an account title describes the item it represents.

Finlay Interiors

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

Flashback

4. Classify the following accounts as either assets, liabilities or equity: (1) Prepaid Rent, (2) Unearned Fees, (3) Buildings, (4) Owner Capital, (5) Wages Payable and (6) Office Supplies.
5. What is an account? What is a ledger?
6. What determines the quantity and types of accounts used by a company?

Answers—p. 109

T-Account

A **T-account** is a helpful tool in showing the effects of transactions and events on specific accounts. The T-account gets its name from its shape. Its shape looks like the letter T and is shown in Exhibit 3.3 below:

Exhibit 3.3

The T-Account

Account Title	
(Left side) *Debit*	(Right side) *Credit*

The format of a T-account includes (1) the account title on top, (2) a left or debit side, and (3) a right or credit side. A T-account provides one side for recording increases in the item and the other side for decreases. As an example, the T-account for Finlay Interiors' Cash account after recording the transactions in Chapter 2 is in Exhibit 3.4:

Exhibit 3.4

Cash T-Account for Finlay Interiors

Finlay Interiors

Cash			
Investment by owner	30,000	Purchase of supplies	2,500
Consulting services revenue received	2,200	Purchase of furniture	20,000
Collection of account receivable	1,900	Payment of rent	1,000
		Payment of salary	700
		Payment of account payable	900
		Withdrawal by owner	600

T-accounts are used throughout this text to help illustrate debits and credits and to solve accounting problems. This form of account is not used in the real business world.

Balance of an Account

An **account balance** is the difference between the increases and decreases recorded in an account. To determine the balance, we (1) compute the total increases shown on one side (including the beginning balance), (2) compute the total decreases shown on the other side, and (3) subtract the sum of the decreases from the sum of the increases. The total increases in Finlay Interiors' Cash account are $34,100, the total decreases are $25,700, and the account balance is $8,400. The T-account in Exhibit 3.5 shows how we calculate the $8,400 balance:

Exhibit 3.5

Computing the Balance of a T-Account

Finlay Interiors

Cash			
Investment by owner	30,000	Purchase of supplies	2,500
Consulting services revenue earned	2,200	Purchase of furniture	20,000
Collection of account receivable	1,900	Payment of rent	1,000
		Payment of salary	700
		Payment of account payable	900
		Withdrawal by owner	600
Total increases	34,100	Total decreases	25,700
Less decreases	−25,700		
Balance	8,400		

Debits and Credits

LO6 Define debits and credits and explain their role in double-entry accounting.

The left side of a T-account is called the **debit** side, often abbreviated Dr. The right side is called the **credit** side, abbreviated Cr.[4] To enter amounts on the left side of an account is to *debit* the account. To enter amounts on the right side is to *credit* the account. The difference between total debits and total credits for an account is the account balance. When the sum of debits exceeds the sum of credits, the account has a *debit balance*. It has a *credit balance* when the sum of credits exceeds the sum of debits. When the sum of debits equals the sum of credits, the account has a zero balance. This dual method of recording transactions as debits and credits is an essential feature of *double-entry accounting*, and is the topic of the next section.

Double-Entry Accounting

Debits = Credits

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

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

occurred. Double-entry accounting helps to prevent errors by assuring that debits and credits for each transaction are equal.

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

Exhibit 3.6

Accounting Equation

Assets = **Liabilities** + **Owner's Equity**

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

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

Exhibit 3.7

Debit and Credit Effects for Accounts

Assets		=	Liabilities		+	Owner's Equity	
Debit for increases +	Credit for decreases −		Debit for decreases −	Credit for increases +		Debit for decreases −	Credit for increases +

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

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

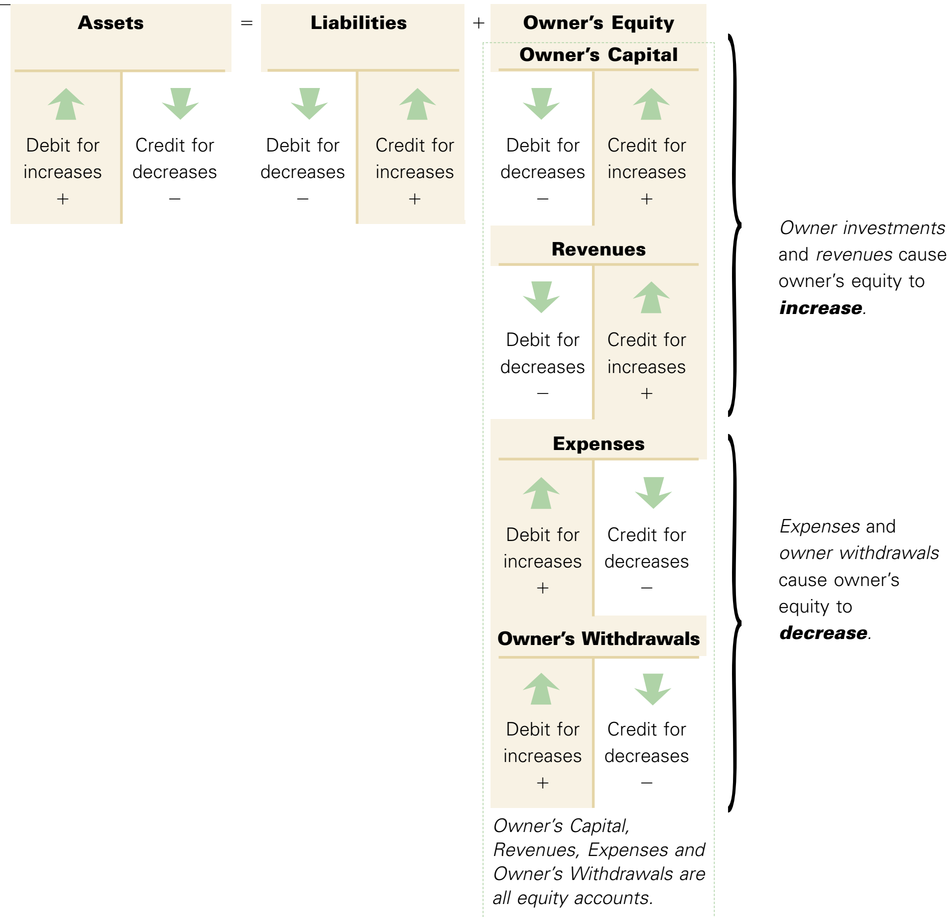
We explained in Chapter 2 how owner's equity increases with owner investments and revenues and decreases with expenses and owner withdrawals. We can therefore expand the accounting equation and debit and credit effects as shown in Exhibit 3.8.

CAUTION

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

Exhibit 3.8

Debit and Credit Effects for Accounts



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

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

Our understanding of these diagrams and rules is crucial to analyzing and recording transactions. This also helps us to prepare and analyze financial statements.[5]

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

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

Mid-Chapter Demonstration Problem

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

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

SOLUTION TO Mid-Chapter Demonstration Problem

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

Analyzing Transactions

LO7 Analyze the impact of transactions on accounts.

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

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

1. Investment by owner.

Cash			
(1)	30,000		

Carol Finlay, Capital			
		(1)	30,000

Transaction. Carol Finlay invested $30,000 in Finlay Interiors on January 1, 2001.
Analysis. Assets increase. Owner's equity increases.
Double-entry. Debit the Cash asset account for $30,000. Credit the Carol Finlay, Capital account in owner's equity for $30,000.

2. Purchase supplies for cash.

Supplies			
(2)	2,500		

Cash			
(1)	30,000	(2)	2,500

Transaction. Finlay Interiors purchases supplies by paying $2,500 cash.
Analysis. Assets increase. Assets decrease. This changes the composition of assets, but does not change the total amount of assets.
Double-entry. Debit the Supplies asset account for $2,500. Credit the Cash asset account for $2,500.

3. Purchase furniture for cash.

Furniture			
(3)	20,000		

Cash			
(1)	30,000	(2)	2,500
		(3)	20,000

Transaction. Finlay Interiors purchases furniture by paying $20,000 cash.
Analysis. Assets increase. Assets decrease. This changes the composition of assets, but does not change the total amount of assets.
Double-entry. Debit the Furniture asset account for $20,000. Credit the Cash asset account for $20,000.

4. Purchase furniture and supplies on credit.

Supplies

(2)	2,500		
(4)	**1,100**		

Furniture

(3)	20,000		
(4)	**6,000**		

Accounts Payable

		(4)	**1,100**

Notes Payable

		(4)	**6,000**

Transaction. Finlay Interiors purchases $1,100 of supplies and $6,000 of furniture on credit. Finlay Interiors signs a promissory note for the $6,000 of furniture.
Analysis. Assets increase. Liabilities increase.
Double-entry. Debit two asset accounts: Supplies for $1,100 and Furniture for $6,000. Credit two liability accounts: Accounts Payable for $1,100 and Notes Payable for $6,000.

5. Services rendered for cash.

Cash

(1)	30,000	(2)	2,500
(5)	**2,200**	(3)	20,000

Consulting Revenue

		(5)	**2,200**

Transaction. Finlay Interiors provided consulting services to a customer and immediately collected $2,200 cash.
Analysis. Assets increase. Owner's equity increases from Revenue.
Double-entry. Debit the Cash asset account for $2,200. Credit the Consulting Revenue account for $2,200 (this increases owner's equity).

6. Payment of expense in cash.

Rent Expense

(6)	**1,000**		

Cash

(1)	30,000	(2)	2,500
(5)	2,200	(3)	20,000
		(6)	**1,000**

Transaction. Finlay Interiors pays $1,000 cash for January rent.
Analysis. Assets decrease. Owner's equity decreases from Expense.
Double-entry. Debit the Rent Expense account for $1,000 (this decreases owner's equity). Credit the Cash asset account for $1,000.

7. Payment of expense in cash.

Salaries Expense

(7)	**700**		

Cash

(1)	30,000	(2)	2,500
(5)	2,200	(3)	20,000
		(6)	1,000
		(7)	**700**

Transaction. Finlay Interiors pays $700 cash for employee's salary for the pay period ending on January 12.
Analysis. Assets decrease. Owner's equity decreases from Expense.
Double-entry. Debit the Salaries Expense account for $700 (this decreases owner's equity). Credit the Cash asset account for $700.

8. Services and rental revenues rendered on credit.

Accounts Receivable

(8)	1,900		

Consulting Revenue

		(5)	2,200
		(8)	1,600

Accounts Payable

		(8)	300

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

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

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

9. Receipt of cash on account.

Cash

(1)	30,000	(2)	2,500
(5)	2,200	(3)	20,000
(9)	1,900	(6)	1,000
		(7)	700

Accounts Receivable

(8)	1,900	(9)	1,900

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

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

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

10. Partial payment of accounts payable.

Accounts Payable

(10)	900	(4)	1,100

Cash

(1)	30,000	(2)	2,500
(5)	2,200	(3)	20,000
(9)	1,900	(6)	1,000
		(7)	700
		(10)	900

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

Analysis. Assets decrease. Liabilities decrease.

Double-entry. Debit the Accounts Payable liability account for $900. Credit the Cash asset account for $900.

11. Withdrawal of cash by owner.

Carol Finlay, Withdrawals

(11)	600		

Cash

(1)	30,000	(2)	2,500
(5)	2,200	(3)	20,000
(9)	1,900	(6)	1,000
		(7)	700
		(10)	900
		(11)	600

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

Analysis. Assets decrease. Owner's equity decreases.

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

12. Receipt of cash for future services.

Cash

(1)	30,000	(2)	2,500
(5)	2,200	(3)	20,000
(9)	1,900	(6)	1,000
(12)	**3,000**	(7)	700
		(10)	900
		(11)	600

Unearned Consulting Revenue

		(12)	**3,000**

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

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

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

13. Payment of cash for future insurance coverage.

Prepaid Insurance

(13)	**2,400**		

Cash

(1)	30,000	(2)	2,500
(5)	2,200	(3)	20,000
(9)	1,900	(6)	1,000
(12)	3,000	(7)	700
		(10)	900
		(11)	600
		(13)	**2,400**

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

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

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

14. Payment of expense in cash.

Utilities Expense

(14)	**230**		

Cash

(1)	30,000	(2)	2,500
(5)	2,200	(3)	20,000
(9)	1,900	(6)	1,000
(12)	3,000	(7)	700
		(10)	900
		(11)	600
		(13)	2,400
		(14)	**230**

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

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

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

15. Payment of expense in cash.

Salaries Expense

(7)	700		
(15)	**700**		

Cash

(1)	30,000	(2)	2,500
(5)	2,200	(3)	20,000
(9)	1,900	(6)	1,000
(12)	3,000	(7)	700
		(10)	900
		(11)	600
		(13)	2,400
		(14)	230
		(15)	**700**

Transaction. Finlay Interiors pays $700 cash for employee's salary for the two-week pay period ending on January 26.

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

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

Accounting Equation Analysis

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

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

Assets	=	Liabilities	+	Owner's Equity
\$40,070	=	\$9,200	+	\$30,870

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

Exhibit 3.9

Ledger for Finlay Interiors

Finlay Interiors

Assets = **Liabilities** + **Owner's Equity**

Assets

Cash

(1)	30,000	(2)	2,500
(5)	2,200	(3)	20,000
(9)	1,900	(6)	1,000
(12)	3,000	(7)	700
		(10)	900
		(11)	600
		(13)	2,400
		(14)	230
		(15)	700
Total	37,100	Total	29,030
	−29,030		
Balance	**8,070**		

Accounts Receivable

(8)	1,900	(9)	1,900
Balance	0		

Prepaid Insurance

(13)	2,400		
Balance	**2,400**		

Supplies

(2)	2,500		
(4)	1,100		
Balance	**3,600**		

Furniture

(3)	20,000		
(4)	6,000		
Balance	**26,000**		

Liabilities

Accounts Payable

(10)	900	(4)	1,100
		Balance	**200**

Unearned Consulting Revenue

		(12)	3,000
		Balance	**3,000**

Notes Payable

		(4)	6,000
		Balance	**6,000**

Accounts in the white area reflect increases and decreases in owner's equity. Their balances are reported on the income statement or the statement of owner's equity.

Owner's Equity

Carol Finlay, Capital

		(1)	30,000
		Balance	**30,000**

Carol Finlay, Withdrawals

(11)	600		
Balance	**600**		

Consulting Revenue

		(5)	2,200
		(8)	1,600
		Balance	**3,800**

Rental Revenue

		(8)	300
		Balance	**300**

Rent Expense

(6)	1,000		
Balance	**1,000**		

Salaries Expense

(7)	700		
(15)	700		
Balance	**1,400**		

Utilities Expense

(14)	230		
Balance	**230**		

TOTALS: **\$40,070**[1] = **\$9,200**[2] + **\$30,870**[3]

[1] \$8,070 + \$0 + \$2,400 + \$3,600 + \$26,000 = \$40,070

[2] \$200 + \$3,000 + 6,000 = \$9,200

[3] \$30,000 − \$600 + \$3,800 + \$300 − \$1,000 − \$1,400 − \$230 = \$30,870

Flashback

Answers—p. 110

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

LO8 Record transactions in a journal and post entries to a ledger.

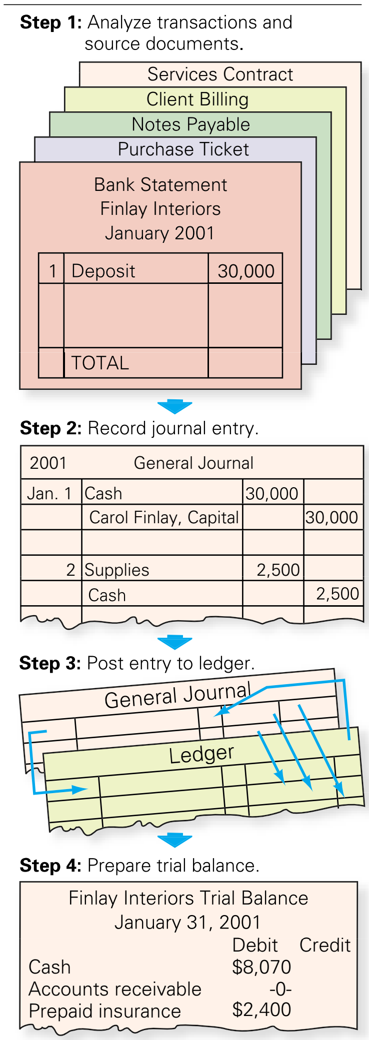
Recording and Posting Transactions

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

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

Exhibit 3.10

First Four Steps of the Accounting Cycle



The Journal Entry

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

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

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

The January 4 entry in Exhibit 3.11 uses four accounts. There are debits to the two assets purchased, Supplies and Furniture. There are also credits to the two sources of payment, Accounts Payable and Notes Payable. A transaction affecting three or more accounts is called a **compound journal entry**.

Date		General Journal Account Titles and Explanation	PR	Debit	Page 1 Credit
2001					
Jan.	1	Cash		30,000	
		Carol Finlay, Capital			30,000
		Investment by owner.			
	2	Supplies		2,500	
		Cash			2,500
		Purchased store supplies for cash.			
	3	Furniture		20,000	
		Cash			20,000
		Purchased furniture for cash.			
	4	Supplies		1,100	
		Furniture		6,000	
		Accounts Payable			1,100
		Notes Payable			6,000
		Purchased supplies and furniture on credit.			

Exhibit 3.11

Partial General Journal for Finlay Interiors

Journalizing Transactions

There are standard procedures for recording entries in a General Journal. We can identify nine steps in journalizing the entries in Exhibit 3.11. It is helpful to review the entries when studying these steps.

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

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

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

Computerized Journals

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

Balance Column Ledger

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

Exhibit 3.12

Cash Account in Balance Column Ledger

Finlay Interiors

		Cash				Account No. 101
Date		Explanation	PR	Debit	Credit	Balance
2001						
Jan.	1		G1	30,000		30,000
	2		G1		2,500	27,500
	3		G1		20,000	7,500
	10		G1	2,200		9,700

The T-account was derived from the balance column ledger account format and it too has a column for debits and a column for credits. Look at the imaginary T-account superimposed over Exhibit 3.12. The balance column ledger account is different from a T-account because it includes a transaction's date and explanation and has a third column with the balance of the account after each entry is posted. This means that the amount on the last line in this column is the account's current balance. For example, Finlay Interiors' Cash account in Exhibit 3.12 is debited on January 1 for the $30,000 investment by Finlay. The account then shows a $30,000 debit balance. The account is credited on January 2 for $2,500, and its new $27,500 balance is shown in the third column. On January 3, it is credited again, this time for $20,000, and its balance is reduced to $7,500. The Cash account is debited for $2,200 on January 10, and its balance increases to $9,700.

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

Abnormal Balance

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

Zero Balance

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

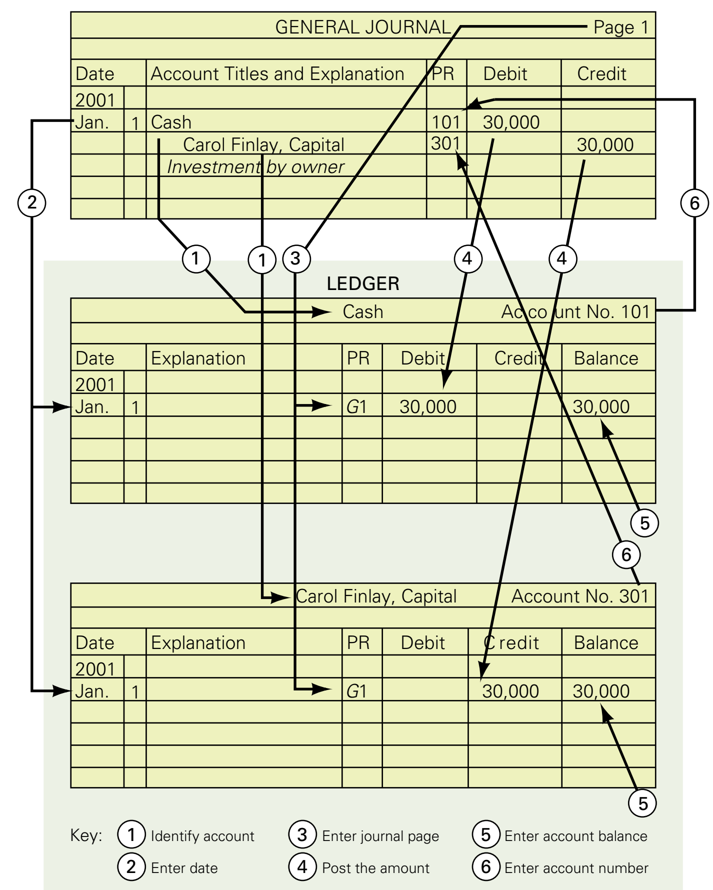
Posting Journal Entries

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

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

Exhibit 3.13

Posting an Entry to the Ledger



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

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

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

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

Posting in Computerized Systems

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

Flashback

Answers—p. 110

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

Trial Balance

LO9 Prepare and explain the use of a trial balance.

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

Step Four of the accounting cycle shown in Exhibit 3.1 requires the preparation of a trial balance to check whether debit and credit account balances are equal. A **trial balance** is a list of accounts and their balances at a point in time. Account balances are reported in the debit or credit column of the trial balance. Exhibit 3.14 shows the trial balance for Finlay Interiors after the fifteen entries described earlier in the chapter are posted to the ledger.

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

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

Exhibit 3.14
Trial Balance

FINLAY INTERIORS
Trial Balance
January 31, 2001

	Debit	Credit
Cash	$8,070	
Accounts receivable	-0-	
Prepaid insurance	2,400	
Supplies	3,600	
Furniture	26,000	
Accounts payable		$200
Unearned consulting revenue		3,000
Notes payable		6,000
Carol Finlay, capital		30,000
Carol Finlay, withdrawals	600	
Consulting revenue		3,800
Rental revenue		300
Rent expense	1,000	
Salaries expense	1,400	
Utilities expense	230	
Total	$43,300	$43,300

Preparing a Trial Balance

Preparing a trial balance involves five steps:

1. Identify each account balance from the ledger.
2. List each account and its balance (in the same order as the Chart of Accounts). Debit balances are entered in the Debit column and credit balances in the Credit column.[7]
3. Compute the total of debit balances.
4. Compute the total of credit balances.
5. Verify that total debit balances equal total credit balances.

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

Using a Trial Balance

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

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

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

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

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

Searching for Errors

At least one error exists if the trial balance does not balance. The error (or errors) must be found and corrected ***before*** preparing financial statements. Searching for the error is more efficient if we check the journalizing, posting and trial balance preparation process in *reverse order*. Otherwise we would need to look at every transaction until the error is found.

Several steps are involved. Step One is to verify that the trial balance columns are correctly added.

If Step One fails to find the error, then Step Two is to verify that account balances are accurately copied from the ledger.

Step Three in identifying the error is to see if a debit or credit balance is mistakenly listed in the trial balance as a credit or debit. A clue pointing to this kind of error is when the difference between total debits and total credits in the trial balance equals twice the amount of the incorrect account balance.

If the error is still undiscovered, Step Four is to recalculate each account balance.

Step Five if the error remains is to verify that each journal entry is properly posted to ledger accounts.

Step Six is to verify that the original journal entry has equal debits and credits.

One frequent error is called a *transposition*. This error is when two digits are switched or transposed within a number. If transposition is the only error, then it yields a difference between two trial balance columns that is *evenly divisible by nine*. For example, assume that a $691 debit in a journal entry is incorrectly posted to the ledger as $619 instead of the correct $691. Total credits in the trial balance are then larger than total debits by $72 ($691–$619). The $72 error is evenly divisible by 9 ($72/9=8). Also, the quotient (in our example, it is 8) equals the difference between the two transposed numbers (91 vs. 19). The number of digits in the quotient also tells the location of the transposition. Because the quotient in our example had only one digit (8), it tells us that the transposition is in the first digit of the transposed numbers, starting from the right.[8]

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

Correcting Errors

If errors are discovered in either the journal or the ledger, they must be corrected. Our approach to correcting errors depends on the kind of error and when it is discovered.

If an error in a journal entry is discovered before the error is posted, it can be corrected in a manual system by drawing a line through the incorrect information. The correct information is written above it to create a record of change for the auditor. Many computerized systems allow the operator to replace the incorrect information directly. If a correct amount in the journal is posted incorrectly to the ledger, we can correct it the same way.

Another case is when an error in a journal entry is not discovered until after it is posted. We usually do not erase incorrect entries in the journal and ledger. Instead, the usual practice is to correct the error in the original journal entry by creating *another* journal entry. This *correcting entry* removes the amount from the wrong account and records it to the correct account. As an example, suppose we recorded a purchase of office supplies in the journal with an incorrect debit to Office Equipment as follows:

Oct. 14	Office Equipment	1,600	
	Cash		1,600
	To record the purchase of office supplies.		

We then post this entry to the ledger. The Office Supplies ledger account balance is understated by $1,600 and the Office Equipment ledger account balance is overstated by the same amount. When we discover the error three days later, the following correcting entry is made:

17	Office Supplies	1,600	
	Office Equipment		1,600
	To correct the entry of October 14 that incorrectly debited Office Equipment instead of Office Supplies.		

The credit in the correcting entry removes the error from the first entry. The debit correctly records the supplies. The explanation reports exactly what happened.

An alternative approach to correcting the entry would be to reverse the incorrect entry and then journalize the entry as it should have been recorded in the first place.

17	Cash	1,600	
	Office Equipment		1,600
	To reverse the incorrect entry.		
	Office Supplies	1,600	
	Cash		1,600
	To correctly journalize the purchase of office supplies.		

Both methods achieve the same final results.

Computerized systems often use similar correcting entries. The exact procedure depends on the system used and management policy. Yet nearly all systems include controls to show when and where a correction is made.

Formatting Conventions

Dollar signs are *not* used in journals and ledgers. They *do* appear in financial statements and other reports, including trial balances to identify the kind of currency being used. This book follows the usual practice of putting a dollar sign beside the first amount in each column of numbers and the first amount appearing after a ruled line that indicates that an addition or subtraction has been performed. The financial statements in Exhibit 2.11 on page 52 demonstrate how dollar signs are used in this book. Different companies use various conventions for dollar signs. For example, dollar signs are usually printed beside only the first and last numbers in columns of the financial statements for ClubLink.

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

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

Flashback

Answers—p. 110

14. Explain a chart of accounts.

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

16. If a $4,000 debit to Equipment in a journal entry is incorrectly posted to the ledger as a $4,000 credit, and the ledger account has a resulting debit balance of $20,000, what is the effect of this error on the trial balance column totals?

Summary

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

LO2 **Explain the steps in processing transactions.** The accounting cycle captures business transactions and events, analyzes and records their effects, and summarizes and prepares information useful in making decisions. Transactions and events are the starting points in the accounting cycle. Source documents help in analyzing them. The effects of transactions and events are recorded in the accounting books. Postings and the trial balance help to summarize and classify these effects. The final step is to provide this information in useful reports or financial statements to decision makers.

LO3 **Describe source documents and their purpose.** Source documents are business papers that identify and describe transactions and events. Examples are sales invoices, cheques, purchase orders, bills, and bank statements. Source documents help to ensure that accounting records include all transactions. They also help to prevent mistakes and theft, and are important to internal control. Source documents provide objective evidence that makes information more reliable and useful.

LO4 **Describe an account and its use in recording information about transactions.** An account is a detailed record of increases and decreases in a specific asset, liability or equity item. Information is taken from accounts, analyzed, summarized, and presented in useful reports and financial statements for users.

LO5 **Describe a ledger and a chart of accounts.** A ledger is a record that contains all accounts used by a company. This is what is referred to as *the books*. The chart of accounts is a listing of all accounts and usually includes an identification number that is assigned to each account.

LO6 **Define debits and credits and explain their role in double-entry accounting.** Debit refers to left, and credit refers to right. The following table summarizes debit and credit effects by account type:

Increase/ Decrease	Assets =	Liabil- ities +	Owner's Equity			
			Owner's Capital	Owner's Withdrawals	Revenues	Expenses
Increases	Debits	Credits	Credits	Debits	Credits	Debits
Decreases	Credits	Debits	Debits	Credits	Debits	Credits

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

LO7 **Analyze the impact of transactions on accounts.** We analyze transactions using the concepts of double-entry accounting. This analysis is performed by determining a transaction's effects on accounts. These effects are recorded in journals and posted to accounts in the ledger.

LO8 **Record transactions in a journal and post entries to a ledger.** We record transactions in a journal to give a record of their effects. Each entry in a journal is posted to the accounts in the ledger. This provides information in accounts that is used to produce financial statements. Balance column ledger accounts are widely used and include columns for debits, credits and the account balance after each entry.

LO9 **Prepare and explain the use of a trial balance.** A trial balance is a list of accounts in the ledger showing their debit and credit balances in separate columns. The trial balance is a convenient summary of the ledger's contents and is useful in preparing financial statements. It reveals errors of the kind that produce unequal debit and credit account balances.

GUIDANCE ANSWER TO Judgement Call

Cashier

There are advantages to the process proposed by the assistant manager. They include improved customer service, fewer delays, and less work for you. However, you should have serious concerns about control and the potential for fraud. In particular, there is no control over the possibility of embezzlement by the assistant manager. The assistant manager could steal cash and simply enter fewer sales in the cash register to match the remaining cash. You should reject her suggestion without approval by the manager. Moreover, you should have an ethical concern about the assistant manager's suggestion to ignore store policy.

GUIDANCE ANSWERS TO Flashback

1. External transactions are exchanges between an organization and some other person or organization. Internal transactions are exchanges within an organization; for example, a company that is using supplies in its operating activities.
2. Examples of source documents are sales invoices, cheques, purchase orders, charges to customers, bills from suppliers, employee earnings records, and bank statements.
3. Source documents serve many purposes, including recordkeeping and internal control. Source documents, especially if obtained from outside the organization, provide objective evidence about transactions and their amounts for recording. Objective evidence is important because it makes information more reliable and useful.
4. | Assets | Liabilities | Equity |
   |---|---|---|
   | 1, 3, 6 | 2, 5 | 4 |
5. An account is a record in an accounting system where increases and decreases in a specific asset, liability, or equity item are recorded and stored. A ledger is a collection of all accounts used by a business.
6. A company's size and diversity affect the number of accounts needed in its accounting system. The types of accounts used by a business depend on information that the business needs to both effectively operate and report its activities in financial statements.

7. No. Debit and credit both can mean increase or decrease. The particular meaning depends on the type of account.
8. Owner's equity is increased by revenues and owner's investments in the company. Owner's equity is decreased by expenses and owner's withdrawals.
9. The name double-entry is used because all transactions affect and are recorded in at least two accounts. There must be at least one debit in one account and at least one credit in another.
10. Answer is (c).
11. The entry is:

Cash	15,000	
Equipment	23,000	
Notes payable		18,000
Maria Sanchez, capital		20,000

12. A compound journal entry is one that affects three or more accounts.
13. Posting reference numbers are entered in the journal when posting to the ledger as a control over the posting process. They provide a cross-reference that allows the bookkeeper or auditor to trace debits and credits from journals to ledgers and vice versa. They also create a marker in case the posting process is interrupted.
14. A chart of accounts is a listing of all of a company's accounts and their identifying numbers.
15. Dollar signs are used in financial statements and other reports to identify the kind of currency being used in the reports. At a minimum, they are placed beside the first and last numbers in each column. Some companies place dollar signs beside any amount that appears after a ruled line to indicate that an addition or subtraction has taken place.
16. The effect of this error is to understate the trial balance's debit column total by $8,000 and overstate the credit column total by $4,000. This results in a $4,000 difference between the two totals.

Demonstration Problem

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

a. On August 1, Schmidt put $3,000 cash into a chequing account in the name of The Cutlery. She also invested $15,000 of equipment that she already owned.
b. On August 1, Barbara paid $600 for six months of insurance effective immediately.
c. On August 2, she paid $600 cash for furniture for the shop.
d. On August 3, she paid $500 cash to rent space in a strip mall for August.
e. On August 4, she furnished the shop by installing the old equipment and some new equipment that she bought on credit for $1,200. This amount is to be repaid in three equal payments at the end of August, September, and October.
f. On August 5, The Cutlery opened for business. Cash receipts from haircutting services provided in the first week and a half of business (ended August 15) were $825.
g. On August 15, Schmidt provided haircutting services on account for $100.
h. On August 17, Schmidt received a $100 cheque in the mail for services previously rendered on account.
i. On August 17, Schmidt paid $125 to an assistant for working during the grand opening.
j. On August 18, a regular customer paid $500 for services to be provided over the next three months.
k. Cash receipts from haircutting services provided during the second half of August were $930.
l. On August 31, Schmidt paid an instalment on the accounts payable.
m. On August 31, the August hydro bill for $75 was received. It will be paid on September 14.
n. On August 31, she withdrew $900 cash for her personal use.

Required

1. Prepare General Journal entries for the preceding transactions.
2. Open the following accounts: Cash, 101; Accounts Receivable 102; Prepaid Insurance, 128; Furniture, 161; Store Equipment, 165; Accounts Payable, 201; Unearned Haircutting Services Revenue, 236; Barbara Schmidt, Capital, 301; Barbara Schmidt, Withdrawals, 302; Haircutting Services Revenue, 403; Wages Expense, 623; Rent Expense, 640; and Hydro Expense, 690.
3. Post the journal entries to the ledger accounts.
4. Prepare a trial balance as of August 31, 2001.

Review of Financial Statement Preparation Component:

5. Prepare an income statement and a statement of owner's equity for the month ended August 31, 2001 and a balance sheet at August 31, 2001.

Planning the Solution

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

SOLUTION TO Demonstration Problem

1. General Journal entries:

Date	General Journal Account Titles and Explanations	PR	Debit	Page G1 Credit
2001				
Aug. 1	Cash	101	3,000	
1	Store Equipment	165	15,000	
	Barbara Schmidt, Capital	301		18,000
	Owner's initial investment.			
1	Prepaid Insurance	128	600	
	Cash	101		600
	Purchased six months of insurance.			
2	Furniture	161	600	
	Cash	101		600
	Purchased furniture for cash.			
3	Rent Expense	640	500	
	Cash	101		500
	Paid rent for August.			
4	Store Equipment	165	1,200	
	Accounts Payable	201		1,200
	Purchased additional equipment on credit.			
15	Cash	101	825	
	Haircutting Services Revenue	403		825
	Cash receipts from 10 days of operations.			
15	Accounts Receivable	102	100	
	Haircutting Services Revenue	403		100
	To record revenue for services provided on account.			
17	Cash	101	100	
	Accounts Receivable	102		100
	To record cash received as payment on account.			
17	Wages Expense	623	125	
	Cash	101		125
	Paid wages to assistant.			
18	Cash	101	500	
	Unearned Haircutting Services Revenue	236		500
	To record payment in advance.			
31	Cash	101	930	
	Haircutting Services Revenue	403		930
	Cash receipts from second half of August.			
31	Accounts Payable	201	400	
	Cash	101		400
	Paid an installment on accounts payable.			
31	Hydro Expense	690	75	
	Accounts Payable	201		75
	August hydro to be paid by Sept. 14.			
31	Barbara Schmidt, Withdrawals	302	900	
	Cash	101		900
	Owner withdrew cash from the business.			

2. & 3.
Accounts in the ledger:

Cash						Account No. 101
Date		Explanation	PR	Debit	Credit	Balance
2001						
Aug.	1		G1	3,000		3,000
	1		G1		600	2,400
	2		G1		600	1,800
	3		G1		500	1,300
	15		G1	825		2,125
	17		G1	100		2,225
	17		G1		125	2,100
	18		G1	500		2,600
	31		G1	930		3.530
	31		G1		400	3,130
	31		G1		900	2,230

Accounts Receivable						Account No. 102
Date		Explanation	PR	Debit	Credit	Balance
2001						
Aug.	15		G1	100		100
	17		G1		100	-0-

Prepaid Insurance						Account No. 128
Date		Explanation	PR	Debit	Credit	Balance
2001						
Aug.	1		G1	600		600

Furniture						Account No. 161
Date		Explanation	PR	Debit	Credit	Balance
2001						
Aug.	2		G1	600		600

Store Equipment						Account No. 165
Date		Explanation	PR	Debit	Credit	Balance
2001						
Aug.	1		G1	15,000		15,000
	4		G1	1,200		16,200

Accounts Payable						Account No. 201
Date		Explanation	PR	Debit	Credit	Balance
2001						
Aug.	4		G1		1,200	1,200
	31		G1	400		800
	31		G1		75	875

Unearned Haircutting Services Revenue						Account No. 236
Date		Explanation	PR	Debit	Credit	Balance
2001 Aug.	18		G1		500	500

Barbara Schmidt, Capital						Account No. 301
Date		Explanation	PR	Debit	Credit	Balance
2001 Aug.	1		G1		18,000	18,000

Barbara Schmidt, Withdrawals						Account No. 302
Date		Explanation	PR	Debit	Credit	Balance
2001 Aug.	31		G1	900		900

Haircutting Services Revenue						Account No. 403
Date		Explanation	PR	Debit	Credit	Balance
2001 Aug.	15		G1		825	825
	15		G1		100	925
	31		G1		930	1,855

Wages Expense						Account No. 623
Date		Explanation	PR	Debit	Credit	Balance
2001 Aug.	17		G1	125		125

Rent Expense						Account No. 640
Date		Explanation	PR	Debit	Credit	Balance
2001 Aug.	3		G1	500		500

Hydro Expense						Account No. 690
Date		Explanation	PR	Debit	Credit	Balance
2001 Aug.	31		G1	75		75

4.

THE CUTLERY
Trial Balance
August 31, 2001

Account Title	Debit	Credit
Cash	$ 2,230	
Accounts receivable	-0-	
Prepaid insurance	600	
Furniture	600	
Store Equipment	16,200	
Accounts payable		$ 875
Unearned haircutting services revenue		500
Barbara Schmidt, capital		18,000
Barbara Schmidt, withdrawals	900	
Haircutting services revenue		1,855
Wages expenses	125	
Rent expense	500	
Hydro expense	75	
Totals	$ 21,230	$ 21,230

5.

THE CUTLERY
Income Statement
For Month Ended August 31, 2001

Revenues		
Haircutting services revenue		$1,855
Operating expenses		
Rent expense	$500	
Wages expense	125	
Hydro expense	75	
Total operating expenses		700
Net income		$1,155

THE CUTLERY
Statement of Owner's Equity
For Month Ended August 31, 2001

Barbara Schmidt, capital August 1		$ -0-
Add: Investments by owner	$18,000	
Net income	1,155	19,155
Total		$19,155
Less: Withdrawals by owner		900
Barbara Schmidt, capital, August 31		$ 18,255

THE CUTLERY
Balance Sheet
August 31, 2001

Assets	
Cash	$ 2,230
Prepaid insurance	600
Furniture	600
Store Equipment	16,200
Total assets	$ 19,630
Liabilities	
Accounts payable	$ 875
Unearned haircutting services revenue	500
Total liabilities	$ 1,375
Owner's Equity	
Barbara Schmidt, capital	$ 18,255
Total liabilities and owner's equity	$ 19,630

Glossary

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

Account balance The difference between the increases (including the beginning balance) and decreases recorded in an account. (p. 92)

Accounting cycle The steps repeated each reporting period for the purpose of preparing financial statements for users. (p. 84)

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

Balance column ledger account An account with debit and credit columns for recording entries and a third column for showing the balance of the account after each entry is posted. (p. 102)

Chart of accounts A list of all accounts used by a company; includes the identification number assigned to each account. (p. 90)

Compound journal entry A journal entry that affects at least three accounts. (p. 100)

Credit An entry that decreases asset, expenses, and owner's withdrawals accounts or increases liability, owner's capital, and revenue accounts; recorded on the right side of a T-account. (p. 92)

Debit An entry that increases asset, expense, and owner's withdrawals accounts or decreases liability, owner's capital, and revenue accounts; recorded on the left side of a T-account. (p. 92)

Double-entry accounting An accounting system where every transaction affects and is recorded in at least two accounts; the sum of the debits for all entries must equal the sum of the credits for all entries. (p. 92)

External transactions Exchanges between the entity and some other person or organization. (p. 85)

General Journal The most flexible type of journal; can be used to record any kind of transaction. (p. 100)

Internal transactions Exchanges within an organization that can also affect the accounting equation. (p. 85)

Journal A record where transactions are recorded before they are recorded in accounts; amounts are posted from the journal to the ledger; also called the *book of original entry*. (p. 100)

Journalizing The process of recording transactions in a journal. (p. 100)

Normal balance The debit or credit side on which an account increases. For example, assets increase with debits, therefore the normal balance for an asset is a debit. Revenues increase with credits, therefore a credit is the normal balance for a revenue account. (p. 94)

Ledger A record containing all accounts used by a business. (p. 86)

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

Post(ing) Transfer journal entry information to ledger accounts. (p. 100)

Posting reference (PR) column A column in *journals* where individual account numbers are entered when entries are posted to the ledger. A column in *ledgers* where journal page numbers are entered when entries are posted. (p. 102)

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

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

Source documents Documents that are the source of information recorded with accounting entries; can be in either paper or electronic form. (p. 85)

T-account A simple characterization of an account form used as a helpful tool in showing the effects of transactions and events on specific accounts. (p. 91)

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

Unearned revenues Liabilities created when customers pay in advance for products or services; created when cash is received before revenues are earned; satisfied by delivering the products or services in the future. (p. 88)

Questions

1. Describe the fundamental steps in the accounting process.
2. What is the difference between a note receivable and an account receivable?
3. If assets are valuable resources and asset accounts have debit balances, why do expense accounts have debit balances?
4. Why does the bookkeeper prepare a trial balance?
5. Should a transaction be recorded first in a journal or the ledger? Why?
6. Are debits or credits listed first in general journal entries? Are the debits or the credits indented?
7. What kinds of transactions can be recorded in a General Journal?
8. If an incorrect amount was journalized and posted to the accounts, how should the error be corrected?
9. Review the WestJet balance sheet for fiscal year-end December 31, 1999 in Appendix I. Identify three accounts on the balance sheet that would carry debit balances and three accounts on the balance sheet that would carry credit balances.
10. Review the ClubLink balance sheet for fiscal year-end December 31, 1999 in Appendix I. Identify four different asset accounts that include the word "receivable" in the account title.
11. Reread the chapter's opening scenario describing Maria Sanchez's company, RecordLink. Last year, RecordLink's revenues exceeded $850,000. Suggest an appropriate account title for RecordLink's revenue account.

Quick Study

QS 3-1
Identifying source documents
LO3

Select the items from the following list that are likely to serve as source documents:

a. Income statement.
b. Trial balance.
c. Telephone bill.
d. Invoice from supplier.
e. Owner's withdrawals account.
f. Balance sheet.
g. Bank statement.
h. Sales invoice.

QS 3-2
Developing a chart of accounts
LO5

Using the numbering system on page 90, develop a chart of accounts that assigns an account number to each of the following accounts:

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

QS 3-3
Identifying normal balance as a debit or credit
LO6

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

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

QS 3-4
Linking credit or debit with normal balance
LO6

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

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

QS 3-5
Analyzing debit or credit by account
LO6

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

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

QS 3-6
Preparing journal entries
LO8

Prepare journal entries for the following transactions that occurred during January 2001:

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

QS 3-7
Recording in T-accounts
LO7

Post the journal entries from QS 3-6 into the following T-accounts:

101	Cash

124	Office Supplies

163	Equipment

201	Accounts Payable

301	Stan Adams, Capital

403	Landscaping Services Revenue

QS 3-8
Preparing a trial balance
LO7

Using your account balances from QS 3-7, prepare a trial balance at January 31, 2001.

QS 3-9
Identifying a posting error
LO9

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

a. A $4,500 debit to Salaries Expense in a journal entry was incorrectly posted to the ledger as a $4,500 credit, leaving the Salaries Expense account with a $750 debit balance.

b. A $2,250 credit to Consulting Fees Earned in a journal entry was incorrectly posted to the ledger as a $2,250 debit, leaving the Consulting Fees Earned account with a $6,300 credit balance.

c. A $2,250 debit to Rent Expense in a journal entry was incorrectly posted to the ledger as a $2,250 credit, leaving the Rent Expense account with a $3,000 debit balance.

Exercises

Exercise 3-1
Increases, decreases, and normal balances of accounts
LO4, 6

Complete the following table by: 1. Identifying the type of account listed on each line. 2. Entering *debit* or *credit* in the blank spaces to identify the kind of entry that would increase or decrease the account balance. 3. Identifying the normal balance of the account.

	Account	Type of Account	Increase	Decrease	Normal Balance
a.	Land				
b.	Harold Cooper, Capital				
c.	Accounts Receivable				
d.	Harold Cooper, Withdrawals				
e.	Cash				
f.	Equipment				
g.	Unearned Revenue				
h.	Accounts Payable				
i.	Postage Expense				
j.	Prepaid Insurance				
k.	Wages Expense				
l.	Fees Earned				

Exercise 3-2
Chart of accounts

LO5

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

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

Using the account information from Exercise 3-3 (found in requirement 1), develop a chart of accounts for NorthCo.

Exercises 3-3
Journalizing, posting, preparing a trial balance, and financial statements

LO7, 8, 9

Check figure
Total assets = $30,500

NorthCo incurred the following transactions during July 2001, its first month of operations:

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

Required

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

Exercise 3-4
Chart of accounts

LO5

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

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

Using the account information from Exercise 3-5, develop a chart of accounts for EastCo.

Exercise 3-5
Journalizing, posting, preparing a trial balance and financial statements

LO7, 8, 9

Check figure:
Total assets = $57,000

EastCo showed the following account balances in its General Ledger accounts as at January 31, 2001.

Cash	
23,000	

Accounts Receivable	
12,000	

Office Equipment	
25,000	

Accounts Payable	
	6,000

Unearned Revenue	
	1,000

Bill Evans, Capital	
	19,000

Bill Evans, Withdrawals	
4,000	

Consulting Revenues	
	75,000

Salaries Expense	
20,000	

Rent Expense	
15,000	

Utilities Expense	
2,000	

During February, the following transactions occurred:

Feb.	1	Performed work for a client and received cash of $17,000.
	5	Paid $4,000 regarding outstanding accounts payable.
	10	Received cash of $5,000 for work to be done in March.
	17	The owner withdrew cash of $1,000.
	27	Paid salaries of $20,000.

Required

1. Journalize the February transactions in the General Journal.
2. Post the transactions from your General Journal to the General Ledger (T-accounts above).
3. Prepare a trial balance based on the balances in your General Ledger.
4. Prepare the balance sheet as at February 27, 2001.

Exercise 3-6

Recording the effects of transactions directly in T-accounts

LO7

Check figure:
Total cash = $6,425

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

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

Exercise 3-7

Preparing a trial balance

LO9

Check figure:
Total Dr = $16,950

After recording the transactions of Exercise 3-6 in T-accounts and calculating the balance of each account, prepare the trial balance for the ledger. Use May 31, 2001, as the date.

Exercise 3-8

Analyzing transactions from T-accounts

LO7

Cash

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

Office Supplies

(c)	600		
(d)	200		

Prepaid Insurance

(b)	3,600		

Equipment

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

Automobiles

(a)	11,000		

Accounts Payable

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

Jerry Steiner, Capital

		(a)	23,600

Delivery Services Revenue

		(e)	2,500

Gas and Oil Expense

(g)	700		

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

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

Exercise 3-9
General Journal entries

LO8

Use the information in the T-accounts in Exercise 3-8 to prepare General Journal entries for the seven transactions.

Exercise 3-10
General Journal entries

LO8

TLC Laser Eye Centres showed the following selected transactions during the month of April 2002. Journalize the transactions in your General Journal.

April	5	Performed surgery on a customer today and collected $1,500 cash.
	8	Purchased surgical supplies on credit; $3,000.
	15	Paid salaries; $57,000.
	20	Paid for the surgical supplies purchased on April 8.
	27	Performed six surgeries today, all on credit; $1,500 each.
	30	Paid the April utilities bill today; $1,800.

Exercise 3-11
Analyzing and journalizing revenue transactions

LO8

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

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

Exercise 3-12
Analyzing and journalizing expense transactions

LO8

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

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

Exercise 3-13
Posting from the General Journal to the ledger

LO8

Hay's Landscape Consultants is in its second month of operations. You have been given the following journal entries regarding its January 2001 transactions.

Required

a. Open the following accounts (use the balance column format) entering the opening balances brought forward from the end of last month, December 31, 2000: Cash (101) $1,700; Accounts Receivable (106) $600; Equipment (167) $3,000; Accounts Payable (201) $650; Alice Hay, Capital (301) $4,650; Alice Hay, Withdrawals (302) $600; Fees Earned (401) $3,600; and Salaries Expense (622) $3,000.
b. Post the journal entries to the accounts and enter the balance after each posting.

	General Journal			Page 1
Date	Account Titles and Explanation	PR	Debit	Credit
2001				
Jan. 1	Cash		7,000	
	Alice Hay, Capital			7,000
	Additional owner investment.			
12	Accounts Receivable		18,000	
	Fees Earned			18,000
	Performed work for a customer on account.			
20	Equipment		24,000	
	Accounts Payable			20,000
	Cash			4,000
	Purchased equipment by paying cash and the balance on credit.			
31	Cash		10,000	
	Accounts Receivable			10,000
	Collected cash from credit customer.			
31	Salaries Expense		6,000	
	Cash			6,000
	Paid month-end salaries.			
31	Alice Hay, Withdrawals		1,500	
	Cash			1,500
	Alice Hay withdrew cash for personal use.			

Exercise 3-14

Preparing a trial balance

LO9

Check figure:
Total Dr = $53,900

Required

Using the information in Exercise 3-13, prepare a trial balance.

Exercise 3-15

General Journal entries

LO8

Prepare General Journal entries to record the following August 2001 transactions of a new business called PhotoFinish Co.

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

Exercise 3-16

Ledger accounts and the trial balance

LO8, 9

Check figure:
Total Dr = $42,650

Open the following accounts (use the balance column format): Cash; Office Supplies; Prepaid Rent; Photography Equipment; Hannah Young, Capital; Photography Fees Earned; and Utilities Expense. Then, using your General Journal entries from Exercise 3-15, post to the T-accounts. Finally, prepare the August 31, 2001 trial balance.

Exercise 3-17

Effects of posting errors on the trial balance

LO 7, 9

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

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

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

Exercise 3-18

Preparation of financial statements from a trial balance

LO 9

Check figure: Total assets = $2,950

JenCo showed the following trial balance information (in alphabetical order) for its first month just ended March 31, 2001:

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

Required

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

Jenco
Income Statement
For Month Ended March 31, 2001

Revenues:		
Service revenue		
Operating expenses:		
Salaries expense		
Interest expense		
Total expenses		
Net income		

JenCo
Statement of Owner's Equity
For Month Ended March 31, 2001

Marie Jensen, capital, March 1		
Add: Investments by owner		
Net income		
Total		
Less: Withdrawal by owner		
Marie Jensen, capital, March 31		

Jenco
Balance Sheet
March 31, 2001

Assets		Liabilities	
Cash		Accounts payable	
Accounts receivable		Unearned service revenue	
Prepaid insurance		Notes payable	
Equipment		Total liabilities	
		Owner's Equity	
		Marie Jensen, capital	
		Total liabilities and	
Total assets	$38,000	owner's equity	$38,000

Exercise 3-19

Preparation of financial statements from a trial balance

LO9

XYZ Co. showed the following trial balance information (in alphabetical order) for its first month just ended March 31, 2001:

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

Required

Using the information provided, prepare an income statement, a statement of owner's equity, and a balance sheet.

XYZ Co.
Income Statement
For Month Ended March 31, 2001

Revenues:		
Operating expenses:		
Total operating expenses		
Net loss		

XYZ Co.
Statement of Owner's Equity
For Month Ended March 31, 2001

John Biggs, capital, March 1		
John Biggs, capital, March 31		

XYZ Co.
Balance Sheet
March 31, 2001

Assets		**Liabilities**	
		Total liabilities	
		Owner's Equity	
		John Biggs, capital	
Total assets		Total liabilities and owner's equity	

Check figure:
Total assets = $146,500

Exercise 3-20
Journalizing correcting entries

LO9

For each of the following incorrect entries, journalize the appropriate correcting entry(ies).

a. The purchase of office supplies on credit for $1,800 was recorded as:

	Office Supplies	1,800	
	Cash		1,800

b. A credit customer paid her account in full: $4,500. This was recorded as:

	Cash	4,500	
	Revenue		4,500

c. The owner withdrew cash of $1,500. This was recorded as:

	Salaries Expense	1,500	
	Cash		1,500

d. Work was performed for a customer today and cash of $750 was received. This was recorded as:

	Cash	750	
	Accounts Receivable		750

Exercise 3-21

Preparing a corrected trial balance

LO9

On January 1, 2001, Jan Taylor started a new business called The Party Place. Near the end of the year, she hired a new bookkeeper without making a careful reference check. As a result, a number of mistakes have been made in preparing the following trial balance:

THE PARTY PLACE
Trial Balance
December 31

	Debit	Credit
Cash	$ 5,500	
Accounts receivable		$ 7,900
Office supplies	2,650	
Office equipment	20,500	
Accounts payable		9,465
Jan Taylor, capital	16,745	
Services revenue		22,350
Wages expense		6,000
Rent expense		4,800
Advertising expense		1,250
Totals	$45,395	$52,340

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

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

Other errors were made in placing account balances in the trial balance columns and in taking the totals of the columns. Use all of this information to prepare a correct trial balance.

Check figure:
Total Dr = $49,860

Problems

Problem 3-1A

Recording transactions in T-accounts

LO7

Check figure:
Cash balance = $18,600

Following are business transactions completed by Kevin Smith during the month of November 2001:

a. Kevin Smith invested $80,000 cash and office equipment with a $30,000 fair value in a new sole proprietorship named Apex Consulting.
b. Purchased land and a small office building. The land was worth $30,000, and the building was worth $170,000. The purchase price was paid with $40,000 cash and a long-term note payable for $160,000.
c. Purchased $2,400 of office supplies on credit.
d. Kevin Smith transferred title of his personal automobile to the business. The automobile had a value of $18,000 and was to be used exclusively in the business.
e. Purchased $6,000 of additional office equipment on credit.
f. Paid $1,500 salary to an assistant.
g. Provided services to a client and collected $6,000 cash.
h. Paid $800 for the month's utilities.
i. Paid account payable created in transaction (c).
j. Purchased $20,000 of new office equipment by paying $18,600 cash and trading in old equipment with a recorded cost of $1,400.
k. Completed $5,200 of services for a client. This amount is to be paid within 30 days.
l. Paid $1,500 salary to an assistant.
m. Received $3,800 payment on the receivable created in transaction (k).
n. Kevin Smith withdrew $6,400 cash from the business for personal use.

Required

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

Problem 3-2A
Preparing General Journal entries

LO8

Carrie Ford opened a new accounting practice called Carrie Ford, Public Accountant, and completed these transactions during March 2001:

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

Required
Prepare General Journal entries to record the transactions.

Problem 3-3A
Posting, preparing a trial balance

LO8, 9

Check figure:
Total Dr = $34,360

Required
Using the General Journal entries prepared in Problem 3-2A, complete the following:

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

Problem 3-4A
Preparing journal entries

LO8

Spin Master Toys showed the following selected transactions for the month ended May 31, 2002:

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

Required
Prepare journal entries for each of the above transactions.

Problem 3-5A

Analyzing accounting errors

LO 7, 8, 9

Check figure:
Total Dr = $59,200

During January, Dallas Glynn, the owner of Glynn's Window Washing Services, had difficulty getting the debits to equal credits on the January 31, 2000 trial balance.

The following errors were discovered:

a. Glynn omitted a $2,000 purchase of Equipment on credit.
b. In posting a $700 collection from a credit customer, Glynn debited Accounts Receivable and credited Cash.
c. In journalizing a cash receipt, Glynn correctly debited Cash for $350 but incorrectly credited Accounts Receivable for $530.
d. In posting a $2,200 payment on account, Glynn debited Accounts Payable but forgot to post the credit to Cash.
e. In journalizing services of $1,800 performed for a customer on credit, Glynn debited Accounts Receivable but credited Maintenance Expense.

Glynn's Window Washing Services
Trial Balance
January 31, 2000

	Debit	Credit
Cash	$ 5,800	
Accounts receivable	4,620	
Prepaid insurance	1,200	
Equipment	12,000	
Accounts payable		$ 2,700
Dallas Glynn, capital		22,500
Dallas Glynn, withdrawals	4,100	
Service revenues		30,200
Salaries expense	18,000	
Insurance expense	2,600	
Maintenance expense	6,500	
Utilities expense	2,600	
Totals	$57,420	$55,400

Required

Prepare a corrected trial balance.

Problem 3-6A

Preparing and posting General Journal entries and preparing a trial balance

LO 8, 9

Check figure:
Total Dr = $137,440

Hector Mendez opened a computer consulting business called Capital Consultants and completed the following transactions during May 2001:

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

Required

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

Problem 3-7A

Journalizing, posting, preparing a trial balance

LO 8, 9

Jamil Engineering, a sole proprietorship, completed the following transactions during July 2001, the second month of operations:

July	1	Jamil Alsuwaidi, the owner, invested $105,000 cash, office equipment with a value of $6,000, and $45,000 of drafting equipment in the business.
	2	Purchased land for an office. The land was worth $54,000, which was paid with $5,400 cash and a long-term note payable for $48,600.
	3	Purchased a portable building with $75,000 cash and moved it onto the land.
	5	Paid $6,000 cash for the premiums on two one-year insurance policies.
	7	Completed and delivered a set of plans for a client and collected $5,700 cash.
	9	Purchased additional drafting equipment for $22,500. Paid $10,500 cash and signed a long-term note payable for the $12,000 balance.
	10	Completed $12,000 of engineering services for a client. This amount is to be paid within 30 days.
	12	Purchased $2,250 of additional office equipment on credit.
	15	Completed engineering services for $18,000 on credit.
	16	Received a bill for rent on equipment that was used on a completed job. The $1,200 rent must be paid within 30 days.
	17	Collected $7,200 from the client of July 10.
	19	Paid $1,500 wages to a drafting assistant.
	22	Paid the account payable created on July 12.
	25	Paid $675 cash for some repairs to an item of drafting equipment.
	26	Jamil Alsuwaidi withdrew $9,360 cash from the business for personal use.
	30	Paid $1,500 wages to a drafting assistant.
	31	Paid $3,000 cash to advertise in the local newspaper.

Required

1. Prepare General Journal entries to record the transactions. Use page 1 for the journal.
2. Open the following accounts (use the balance column format) entering the balances brought forward from June 30, 2001: Cash (101) $3,000; Accounts Receivable (106) $1,500; Prepaid Insurance (128) $250; Office Equipment (163) $850; Drafting Equipment (167) $600; Building (173) $21,000; Land (183) $14,000; Accounts Payable (201) $870; Long-Term Notes Payable (251) $12,000; Jamil Alsuwaidi, Capital (301) $17,000; Jamil Alsuwaidi, Withdrawals (302) $500; Engineering Fees Earned (401) $14,800; Wages Expense (623) $2,000; Equipment Rental Expense (645) $500; Advertising Expense (655) $320; and Repairs Expense (684) $150.
3. Post the entries to the accounts and enter the balance after each posting.
4. Prepare a trial balance as of the end of the month.

Check figure: Total Dr = $298,170

Alternate Problems

Problem 3-1B

Recording transactions in T-accounts

West Consulting completed these transactions during June 2001:

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

l. Paid $800 salary to an assistant.
m. Received $1,000 payment on the receivable created in transaction (k).
n. Susan West withdrew $1,050 cash from the business for personal use.

Required

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

Problem 3-2B

Preparing General Journal entries

LO8

Adam Uppe, Public Accountant, completed these transactions during September 2001, the first month of operations:

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

Required

Prepare General Journal entries to record the transactions.

Problem 3-3B

Posting, preparing a trial balance.

LO8, 9

Check figure:
Total Dr = $10,425

Required

Using the General Journal entries prepared in Problem 3-2B, complete the following:

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

Problem 3-4B
Preparing journal entries

LO 8

SunBlush Technologies showed the following selected transactions for the month ended March 31, 2002:

Mar.	1	Purchased a new building, paying cash of $250,000 and signing a note payable for the balance of $500,000.
	1	Purchased six months of insurance to begin March 1; paid $7,200.
	3	Provided consulting services to the local botanical garden society; collected $5,000.
	4	Purchased cleaning supplies on account; $750.
	10	Performed work for a client today on account; $55,000.
	15	Paid for the March 4 purchase.
	20	Collected cash of $10,000 from a customer. The consulting work will be done in April.
	30	Paid month-end salaries of $49,000.
	30	Received the March telephone bill today; $1,300. It will be paid April 14.
	30	Collected half of the amount owed by the customer of March 10.

Required
Prepare journal entries for each of the above transactions.

Problem 3-5B
Analyzing accounting errors

LO 7, 8, 9

During March, Shawna Cameron, the owner of Cameron Cleaning Services, had trouble keeping her debits and credits equal.

Required
For each of the errors described below, indicate:

1. Whether debits equal credits on the trial balance, and
2. Which account(s) have incorrect balances.
   - **a.** Shawna omitted the entry to record $7,000 of services performed on account.
   - **b.** In posting a $600 payment on account, Shawna debited Cash and credited Accounts Payable.
   - **c.** In journalizing a cash payment, Shawna correctly debited Accounts Payable for $850 but incorrectly credited Cash for $580.
   - **d.** In posting a cash receipt, Shawna debited Cash but forgot to post the credit to Accounts Receivable.
   - **e.** In journalizing the purchase of $2,000 of equipment on credit, Shawna debited Accounts Payable and credited Equipment.

Problem 3-6B
Preparing and posting General Journal entries; preparing a trial balance

LO 8, 9

Leonard Management Services completed these transactions during November 2001:

Nov.	1	Arthur Leonard, the owner, invested $28,000 cash and office equipment that had a fair value of $25,000 in the business.
	2	Prepaid $10,500 cash for three months' rent for an office.
	4	Made credit purchases of office equipment for $9,000 and office supplies for $1,200.
	8	Completed work for a client and immediately received $2,600 cash.
	12	Completed a $13,400 project for a client, who will pay within 30 days.
	13	Paid the account payable created on November 4.
	19	Paid $5,200 cash as the annual premium on an insurance policy.
	22	Received $7,800 as partial payment for the work completed on November 12.
	24	Completed work for another client for $1,900 on credit.
	28	Arthur Leonard withdrew $5,300 from the business for personal use.
	29	Purchased $1,700 of additional office supplies on credit.
	30	Paid $460 for the month's utility bill.

Required

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

Check figure:
Total Dr = $72,600

Problem 3-7B
Journalizing, posting, preparing a trial balance

LO8, 9

At the beginning of June 2001, Avery Wilson created a custom computer programming company called Softouch Co. The company had the following transactions during July, its second month of operations:

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

Check figure:
Total Dr = $148,495

Required

1. Prepare General Journal entries to record the transactions. Use page 1 for the journal.
2. Open the following accounts (use the balance column format) entering the balances brought forward from June 30, 2001: Cash (101) $51,175; Accounts Receivable (106) $950; Prepaid Insurance (128) $275; Office Equipment (163) $1,200; Computer Equipment (167) $800; Building (173) $14,000; Land (183) $6,000; Accounts Payable (201) $725; Unearned Fees (233) $ -0-; Long-Term Notes Payable (251) $7,000; Avery Wilson, Capital (301) $60,000; Avery Wilson, Withdrawals (302) $600; Fees Earned (401) $8,400; Wages Expense (623) $780; Computer Rental Expense (645) $230; Advertising Expense (655) $75; and Repairs Expense (684) $40.
3. Post the entries to the accounts and enter the balance after each posting.
4. Prepare a trial balance as of the end of the month.

Analytical & Review Problems

A & R Problem 3-1
Analyzing account balances

Carlos Young started an engineering firm called Young Engineering. He began operations in March 2001 and completed seven transactions, including his initial investment of $17,000 cash. After these transactions, the ledger included the following accounts with their normal balances:

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

Required

Preparation component:
Prepare a trial balance for the business.

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

A & R Problem 3-2

Analyzing financial statement errors

Travis McAllister operates a surveying company. For the first few months of the company's life (through April), the accounting records were maintained by an outside bookkeeping service. According to those records, McAllister's owner's equity balance was $75,000 as of April 30. To save on expenses, McAllister decided to keep the records himself. He managed to record May's transactions properly, but was a bit rusty when the time came to prepare the financial statements. His first versions of the balance sheet and income statement follow. McAllister is bothered that the company apparently operated at a loss during the month, even though he had been very busy.

McALLISTER SURVEYING
Income Statement
For Month Ended May 31, 2001

Revenue:		
Investments by owner		$ 3,000
Unearned surveying fees		6,000
Total revenues		$ 9,000
Operating expenses:		
Rent expense	$3,100	
Telephone expense	600	
Surveying equipment	5,400	
Advertising expense	3,200	
Utilities expense	300	
Insurance expense	900	
Withdrawals by owner	6,000	
Total operating expenses		19,500
Net income (loss)		$(10,500)

McALLISTER SURVEYING
Balance Sheet
May 31, 2001

Assets		**Liabilities**	
Cash	$ 3,900	Accounts payable	$ 2,400
Accounts receivable	2,700	Surveying fees earned	18,000
Prepaid insurance	1,800	Short-term notes payable	48,000
Prepaid rent	4,200	Total liabilities	$ 68,400
Office supplies	300		
Buildings	81,000	**Owner's Equity**	
Land	36,000	Travis McAllister, capital	64,500
Salaries expense	3,000	Total liabilities and	
Total assets	$132,900	owner's equity	$132,900

Required

Using the information contained in the original financial statements, prepare revised statements, including a statement of owner's equity, for the month of May.

A & R Problem 3-3

Sandra Castell started a computer consulting business called Aribas Computer Services. She invested $25,000 and her automobile, which had a market value of $23,000. The business was an instant success; however she could not say the same about her bookkeeper, who prepared the following trial balance:

ARIBAS COMPUTER SERVICES Trial Balance September 30, 2001		
Cash	$26,200	
Accounts receivable	4,000	
Supplies	4,800	
Automobiles	26,000	
Accounts payable		$ -0-
Sandra Castell, capital		61,000
Totals	$61,000	$61,000

The following information was obtained from the accounting records:

a. Consulting fees earned and billed during September amounted to $16,000, of which $9,000 was collected.
b. Office equipment purchased but not as yet paid for, $3,000.
c. Supplies purchased for cash, $1,800.
d. Paid $1,800 for two months' office rent.
e. Wages paid for September, $2,200.
f. Castell withdrew $3,000 for living expenses.

Required

1. List the errors the bookkeeper made.
2. Prepare a corrected trial balance.
3. Explain why the original trial balance balanced.

Serial Problem

Echo Systems

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

On October 1, 2001, Mary Graham organized a computer service company called Echo Systems. Echo is organized as a sole proprietorship and will provide consulting services, computer system installations, and custom program development. Graham has adopted the calendar year for reporting, and expects to prepare the company's first set of financial statements as of December 31, 2001. The initial chart of accounts for the accounting system includes these items:

Account Number	Account Name	Account Number	Account Name
101	Cash	301	Mary Graham, Capital
106	Accounts Receivable	302	Mary Graham, Withdrawals
126	Computer Supplies	403	Computer Services Revenue
128	Prepaid Insurance	623	Wages Expense
131	Prepaid Rent	655	Advertising Expense
163	Office Equipment	676	Mileage Expense
167	Computer Equipment	677	Miscellaneous Expense
201	Accounts Payable	684	Repairs Expense, Computer

Required

1. Prepare journal entries to record each of the following transactions for Echo Systems.
2. Open balance column accounts for the company and post the journal entries to them.

Oct.	1	Mary Graham invested $45,000 cash, an $18,000 computer system, and $9,000 of office equipment in the business.
	2	Paid rent in advance of $4,500.
	3	Purchased computer supplies on credit for $1,320 from Abbott Office Products.
	5	Paid $2,160 cash for one year's premium on a property and liability insurance policy.
	6	Billed Capital Leasing $3,300 for installing a new computer.
	8	Paid for the computer supplies purchased from Abbott Office Products.
	10	Hired Carly Smith as a part-time assistant for $100 per day, as needed.
	12	Billed Capital Leasing another $1,200 for computer services rendered.
	15	Received $3,300 from Capital Leasing on its account.
	17	Paid $705 to repair computer equipment damaged when moving into the new office.
	20	Paid $1,860 for an advertisement in the local newspaper.
	22	Received $1,200 from Capital Leasing on its account.
	28	Billed Decker Company $3,225 for services.
	31	Paid Carly Smith for seven days' work.
	31	Mary Graham withdrew $3,600 cash from the business for personal use.
Nov.	1	Reimbursed Mary Graham's business automobile expense for 1,000 kilometres at $0.50 per kilometre.
	2	Received $4,650 cash from Elite Corporation for computer services rendered.
	5	Purchased $960 of computer supplies from Abbott Office Products.
	8	Billed Fostek Co. $4,350 for computer services rendered.
	13	Notified by Alamo Engineering Co. that Echo's bid of $3,750 for an upcoming project was accepted.
	18	Received $1,875 from Decker Company against the bill dated October 28.
	22	Donated $750 to the United Way in the company's name.
	24	Completed work for Alamo Engineering Co. and sent a bill for $3,750.
	25	Sent another bill to Decker Company for the past due amount of $1,350.
	28	Reimbursed Mary Graham's business automobile expense for 1,200 kilometres at $0.50 per kilometre.
	30	Paid Carly Smith for 14 days' work.
	30	Mary Graham withdrew $1,800 cash from the business for personal use.