A Look Back

Chapter 1 explained the importance of accounting to different types of organizations. We also described the use and users of accounting information.

A Look at This Chapter

This chapter explains the accounting equation and how it helps to describe business transactions. We also show how accounting information is reflected in financial statements.

A Look Ahead

Chapter 3 further describes the analysis of business transactions. We also introduce and explore the basics of double-entry accounting.

Chapter 2

Accounting for Business Transactions

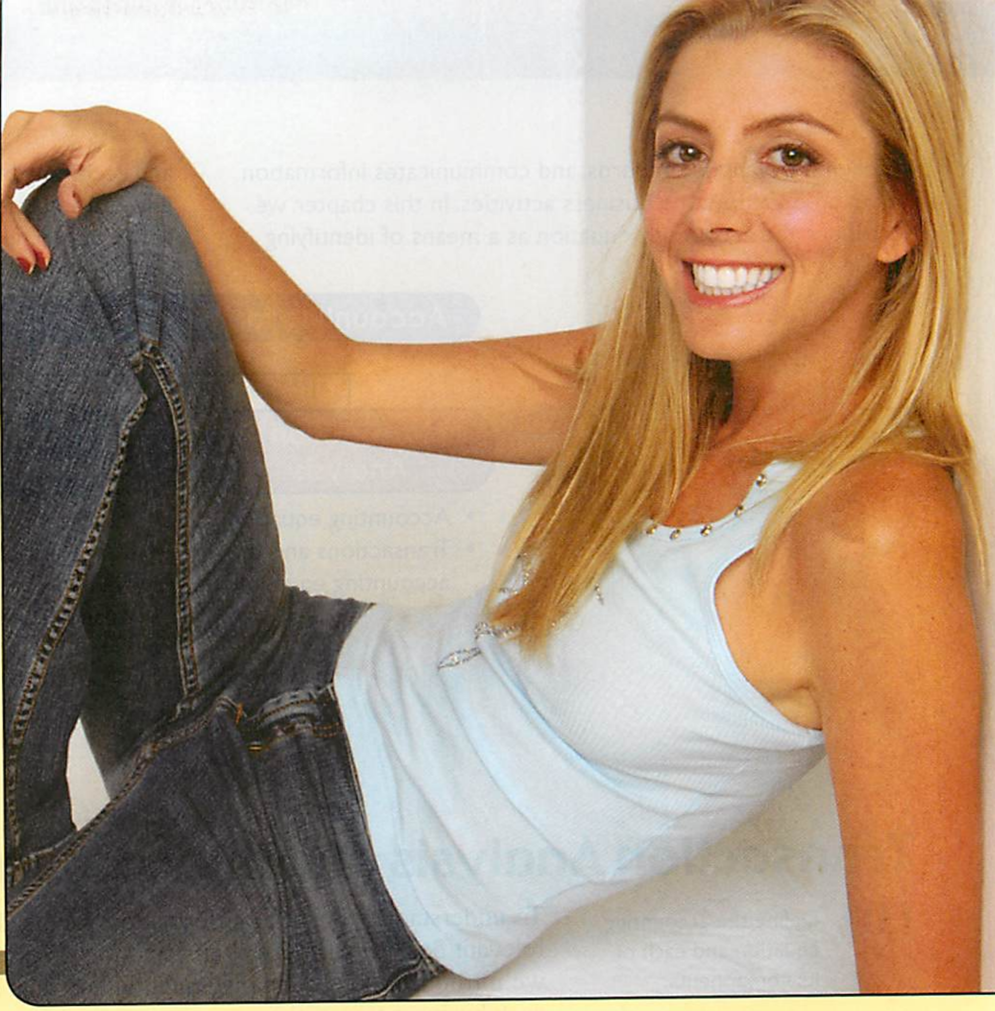
Learning Objectives

LO 1 Define the accounting equation and each of its components.

LO 2 Analyze business transactions using the accounting equation.

LO 3 Identify and prepare basic financial statements and explain how they interrelate.

ENTREPRENEUR



"It has been a dream come true"
—Sara Blakely

The Bottom Line

ATLANTA—"Working as a sales trainer by day and performing stand-up comedy at night, I didn't know the first thing about the pantyhose industry," admits Sara Blakely. "Except, I dreaded wearing most pantyhose." One night Sara cut the feet out of her pantyhose to wear with white pants and open-toed shoes, and at that moment, Sara knew she had a unique idea. Sara took $5,000 in savings and launched **SPANX (Spanx.com)**, a manufacturer of footless pantyhose, slimming intimates, hosiery, and other women's apparel.

To pursue her business ambitions, Sara studied business activities and learned the value of accounting information. She established recordkeeping processes, transaction analysis, inventory accounting, and financial statement reporting. I had to get a handle on my financial situation, says Sara, as I wanted to remain self-funded. To this day, Sara remains self-funded and has a reliable accounting system to help her make good business decisions.

I had to account for product costs, office expenses, supplier payments, patent fees, and other expenses, says Sara. At the same time, Sara expanded sales and struggled to stay profitable. "I had no money to advertise, so I hit the road," laughs Sara. "For the entire first year, I did in-store rallies . . . staying all day introducing customers to Spanx."

In her first three months, Sara sold over 50,000 pairs of footless pantyhose. Today, just seven short years from her launch, Sara reports over $150 million in retail sales. "We are still a small company of women," claims Sara, "obsessed with inventing and improving comfortable undergarments." Sara continues to track and account for all revenues and expenses. She maintains that success requires proper accounting for and analysis of the financial side.

The bigger message of SPANX, says Sara, is promoting comfort and confidence for women. Insists Sara, "We believe all women deserve the opportunity to make the most of their assets!"

[Sources: *SPANX Website*, January 2009; *Entrepreneur*, May 2007; *Smart Money*, September 2002; *TV Guide*, July 2007; *Financial Times*, 2006; *ABC Television*, 2007]

Accounting identifies, records, and communicates information about an organization's business activities. In this chapter, we introduce the accounting equation as a means of identifying and recording business transactions. We also introduce basic financial statements that communicate accounting information about the company's performance and financial position.

Accounting for Business Transactions

Transaction Analysis
- Accounting equation
- Transactions and the accounting equation

Financial Statements
- Income statement
- Statement of owner's equity
- Balance sheet

Transaction Analysis and the Accounting Equation

LO1 Define the accounting equation and each of its components.

To understand accounting information, we need to know how an accounting system captures relevant data about transactions, and then classifies, records, and reports data. In this section, we introduce the accounting equation and then show how the accounting equation represents each business transaction.

Accounting Equation

The accounting system reflects two basic aspects of a company: what it owns and what it owes. **Assets** are resources with future benefits that are owned or controlled by a company. The claims on a company's assets—what it owes—are separated into owner and nonowner claims. **Liabilities** are what a company owes its nonowners (creditors) in future payments, products, or services. **Equity** (also called owner's equity or capital) refers to the claims of its owner(s). Together, liabilities and equity are the source of funds to acquire assets. The relation of assets, liabilities, and equity is reflected in the following **accounting equation:**

Assets = Liabilities + Equity

Liabilities are usually shown before equity in this equation because creditors' claims must be paid before the claims of owners. (The terms in this equation can be rearranged; for example, Assets − Liabilities = Equity.) The accounting equation applies to all transactions and events, to all companies and forms of organization, and to all points in time. Let's now look at the accounting equation in more detail.

Assets **Assets** are resources owned or controlled by a company that are expected to yield future benefits. Examples of assets include Web servers for an online services company, musical instruments for a rock band, land for a vegetable grower, and cash in the company's bank account. The term *receivable* refers to an asset that promises a future inflow of resources. A company that provides a service or product on credit is said to have an account receivable from that customer. The phrases *on credit* and *on account* imply that cash payment will occur at a future date. Other typical assets include supplies, equipment, land, and buildings.

Liabilities **Liabilities** are creditors' claims on assets. **Creditors** are individuals and organizations that own the right to receive payment from a company. These claims reflect obligations

IN THE NEWS

Web Info Most organizations maintain Websites that include accounting data—see **Best Buy** (**BestBuy.com**) as an example. The SEC keeps an online database called **EDGAR** (**www.sec.gov/edgar.shtml**), which has accounting information for thousands of companies that issue stock to the public. Information services such as **Finance.Google.com** and **Finance.Yahoo.com** offer additional online data and analysis.

to provide assets, products, or services to others. The term *payable* refers to a liability that promises a future outflow of resources. Examples are wages payable to workers, accounts payable to suppliers, loans (or notes) payable to banks, and taxes payable to the government.

Equity **Equity** is the owner's claim on assets. Equity is equal to assets minus liabilities. This is the reason equity is also called *net assets* or *residual equity*.

Equity for a proprietorship (or partnership)—commonly called owner's equity—increases and decreases as follows: owner investments and revenues *increase* equity, whereas owner withdrawals and expenses *decrease* equity. **Owner investments** are assets an owner puts into the company and are included under the generic account **Owner, Capital. Owner withdrawals** are assets an owner takes from the company for personal use.

Revenues increase equity and are the assets earned from a company's earnings activities. Examples are consulting services provided, sales of products, facilities rented to others, and commissions from services. **Expenses** decrease equity and are the cost of assets or services used to earn revenues. Examples are costs of employee time, use of supplies, and advertising, utilities, and insurance services from others. At any point in time, equity is the accumulated revenues and owner investments minus the accumulated expenses and owner withdrawals since the company began. This breakdown of equity yields the following **expanded accounting equation.**

$$\text{Assets} = \text{Liabilities} + \overbrace{\text{Owner, Capital} - \text{Owner, Withdrawals} + \text{Revenues} - \text{Expenses}}^{\text{Equity}}$$

Net income occurs when revenues exceed expenses. Net income increases equity. A **net loss** occurs when expenses exceed revenues, which decreases equity. Owner investments and withdrawals are not included in net income.

Transactions and the Accounting Equation

LO2 Analyze business transactions using the accounting equation.

A transaction is defined as a business activity that affects the accounting equation. **External transactions** are exchanges of value between two entities, which yield changes in the accounting equation. An example is a company's payment of its electric bill. **Internal transactions** are exchanges within an entity; they can also affect the accounting equation. An example is a company's use of its supplies, which are reported as expenses when used. **Events** refer to those happenings that affect an entity's accounting equation *and* can be reliably measured. They include natural events such as floods and fires that destroy assets and create losses. They do not include, for example, the signing of service or product contracts, which by themselves do not impact the accounting equation.

An **account** is a record within an accounting system in which increases and decreases are entered and stored. Specific asset, liability, equity, revenue, and expense items are recorded in separate accounts. This section uses the accounting equation and accounts to analyze 11 selected transactions and events of FastForward, a start-up consulting (service) business, in its first month

FASTForward

of operations. We focus on two questions when analyzing the effects of a transaction on the accounting equation.

1. Which accounts are affected by the transaction?
2. How is the accounting equation affected?

Remember that each transaction and event leaves the accounting equation in balance and that assets *always* equal the sum of liabilities and equity.

Starting the Business On December 1, Chuck Taylor forms a consulting business, focused on assessing the performance of athletic footwear and accessories, which he names FastForward. He sets it up as a proprietorship; he owns and manages the business. The marketing plan for the business is to focus primarily on consulting with sports clubs, amateur athletes, and others who place orders for athletic footwear and accessories with manufacturers.

Transaction 1: Investment by Owner

Chuck Taylor invests $30,000 cash in FastForward.

Taylor personally invests $30,000 cash in the new company and deposits the cash in a bank account opened under the name of FastForward. The accounts in this transaction are Cash (an asset) and C. Taylor, Capital (owner's equity). (Owner investments are always included under the title "Owner name," Capital). Both accounts increase by $30,000 as a result of this transaction. After this transaction, Fastforward's assets equal its equity, and the accounting equation is in balance.The effect of this transaction on FastForward is reflected in the accounting equation as follows.

	Assets	=	Liabilities	+	Equity
	Cash	=			C. Taylor, Capital
(1)	+$30,000	=			+$30,000

Transaction 2: Purchase Supplies for Cash

FastForward pays $2,500 cash for supplies.

FastForward uses $2,500 of its cash to buy supplies of brand name athletic footwear for performance testing over the next few months. This transaction is an exchange of cash, an asset, for another kind of asset, supplies. It merely changes the form of assets from cash to supplies. The decrease in cash exactly equals the increase in supplies. Fastforward's total assets and owner's equity each remain at $30,000 after this transaction. The supplies of athletic footwear are assets because of the expected future benefits from the test results of their performance. This transaction is reflected in the accounting equation as follows:

	Assets			=	Liabilities	+	Equity
	Cash	+	Supplies	=			C. Taylor, Capital
Old Bal.	$30,000			=			$30,000
(2)	−2,500	+	$2,500				
New Bal.	$27,500	+	$ 2,500	=			$30,000
	$30,000				$30,000		

Transaction 3: Purchase Equipment for Cash

FastForward pays $26,000 cash for equipment.

FastForward spends $26,000 to acquire equipment for testing athletic footwear. Like transaction 2, transaction 3 is an exchange of one asset, cash, for another asset, equipment. The equipment is an asset because of its expected future benefits from testing athletic footwear. This purchase changes the makeup of assets but does not change the asset total. The accounting equation remains in balance. Transactions 2 and 3 illustrate a fundamental idea in accounting: *Payments of cash are not always expenses.*

	Assets					=	Liabilities + Equity
	Cash	+	Supplies	+	Equipment	=	C. Taylor, Capital
Old Bal.	$27,500	+	$2,500			=	$30,000
(3)	−26,000			+	$26,000		
New Bal.	$ 1,500	+	$2,500	+	$ 26,000	=	$30,000
			$30,000				$30,000

Transaction 4: Purchase Supplies on Credit

FastForward purchases $7,100 of supplies on credit.

Taylor decides he needs more supplies of athletic footwear and accessories. These additional supplies total $7,100, but as we see from the accounting equation in transaction 3, FastForward has only $1,500 in cash. Taylor arranges to purchase the supplies on credit from CalTech Supply Company. Thus, FastForward acquires supplies in exchange for a promise to pay for them later. This purchase increases assets by $7,100 in supplies, and liabilities (called *accounts payable*) increase by the same amount. The effects of this purchase follow:

	Assets					=	Liabilities	+	Equity
	Cash	+	Supplies	+	Equipment	=	Accounts Payable	+	C. Taylor, Capital
Old Bal.	$1,500	+	$2,500	+	$26,000	=			$30,000
(4)		+	7,100				+$7,100		
New Bal.	$1,500	+	$9,600	+	$26,000	=	$ 7,100	+	$30,000
			$37,100						$37,100

Transaction 5: Provide Services for Cash

FastForward provides consulting services and immediately collects $4,200 cash.

FastForward earns revenues by consulting with clients about test results on athletic footwear and accessories. In one of its first jobs, FastForward provides consulting services to an athletic club and immediately collects $4,200 cash. The accounting equation reflects this increase in cash of $4,200 and in equity of $4,200. This increase in equity is shown in the far right column under Revenues because the cash received is earned by providing consulting services. Using separate accounts to record revenues and owner investments (transaction 1) helps in preparing accurate financial statements.

	Assets					=	Liabilities	+	Equity		
	Cash	+	Supplies	+	Equipment	=	Accounts Payable	+	C. Taylor, Capital	+	Revenues
Old Bal.	$1,500	+	$9,600	+	$26,000	=	$7,100	+	$30,000		
(5)	+4,200									+	$4,200
New Bal.	$5,700	+	$9,600	+	$26,000	=	$7,100	+	$30,000	+	$ 4,200
			$41,300						$41,300		

Transactions 6 and 7: Payment of Expenses in Cash

FastForward pays $1,000 in cash for December rent.
FastForward pays $700 cash for employee salaries.

In transaction 6, FastForward pays $1,000 rent to the landlord of the building where its facilities are located. Paying this amount allows FastForward to occupy the space for the month of December. In transaction 7, FastForward pays the biweekly $700 salary of the company's only employee. Both transactions 6 and 7 are December expenses for FastForward. The costs of both rent and salary are expenses, as opposed to assets, because their benefits are used in December (they have no future benefits after December). The accounting equation shows that both transactions reduce cash and equity. The far right column identifies these decreases as Expenses.

By definition, increases in expenses yield decreases in equity.

	Assets					=	Liabilities	+	Equity				
	Cash	+	Supplies	+	Equipment	=	Accounts Payable	+	C. Taylor, Capital	+	Revenues	−	Expenses
Old Bal.	$5,700	+	$9,600	+	$26,000	=	$7,100	+	$30,000	+	$4,200		
(6)	−1,000											−	$1,000
Bal.	4,700	+	9,600	+	26,000	=	7,100	+	30,000	+	4,200	−	1,000
(7)	− 700											−	700
New Bal.	$4,000	+	$9,600	+	$26,000	=	$7,100	+	$30,000	+	$4,200	−	$ 1,700
	$39,600						$39,600						

Transaction 8: Provide Services and Facilities for Credit

FastForward provides consulting services of $1,600 and rents its test facilities for $300. The customer is billed $1,900 for these services.

FastForward provides consulting services of $1,600 and rents its test facilities for $300 to an amateur sports club. The rental involves allowing club members to try recommended footwear and accessories at FastForward's testing grounds. The sports club is billed for the $1,900 total. This transaction results in a new asset, called *accounts receivable,* which means the client has not yet paid the $1,900 bill. Since FastForward has already provided the consulting services and the rental, FastForward considers the full $1,900 as Revenues. These two revenue items increase equity as shown in the Revenues column of the accounting equation below. Transaction 8 reveals another important concept: *Revenues do not require immediate receipt of cash.*

	Assets							=	Liabilities	+	Equity				
	Cash	+	Accounts Receivable	+	Supplies	+	Equipment	=	Accounts Payable	+	C. Taylor, Capital	+	Revenues	−	Expenses
Old Bal.	$4,000	+		+	$9,600	+	$26,000	=	$7,100	+	$30,000	+	$4,200	−	$1,700
(8)		+	$1,900									+	1,600		
												+	300		
New Bal.	$4,000	+	$ 1,900	+	$9,600	+	$26,000	=	$7,100	+	$30,000	+	$6,100	−	$1,700
	$41,500								$41,500						

Transaction 9: Receipt of Cash from Accounts Receivable

FastForward receives $1,900 cash from the customer billed in transaction 8.

The client in transaction 8 (the amateur sports club) pays $1,900 to FastForward 10 days after it is billed for consulting services. This transaction 9 does not change the total amount of assets and does not affect liabilities or equity. It converts the receivable (an asset) to cash (another asset). It does not create new revenue. Revenue was recognized when FastForward rendered the services in transaction 8, not when the cash is now collected. Transaction 9 shows that *receipt of cash is not always a revenue.* The new balances follow:

	Assets				= Liabilities +	Equity		
	Cash	+ Accounts Receivable	+ Supplies	+ Equipment	= Accounts Payable	+ C. Taylor, Capital	+ Revenues	− Expenses
Old Bal.	$4,000	+ $1,900	+ $9,600	+ $26,000	= $7,100	+ $30,000	+ $6,100	− $1,700
(9)	+1,900	− 1,900						
New Bal.	$5,900	+ $ 0	+ $9,600	+ $26,000	= $7,100	+ $30,000	+ $6,100	− $1,700
	$41,500				$41,500			

Transaction 10: Payment of Accounts Payable

FastForward pays its supplier $900 cash toward the account payable from transaction 4.

FastForward pays CalTech Supply $900 cash as partial payment for its earlier $7,100 purchase of supplies (transaction 4), leaving $6,200 unpaid. The accounting equation shows that this transaction decreases FastForward's cash by $900 and decreases its liability to CalTech Supply by $900. Equity does not change. This event does not create an expense even though cash flows out of FastForward. Instead, the expense is recorded when FastForward uses the supplies. (We show this and other adjustments in later chapters).

	Assets				= Liabilities +	Equity		
	Cash	+ Accounts Receivable	+ Supplies	+ Equipment	= Accounts Payable	+ C. Taylor, Capital	+ Revenues	− Expenses
Old Bal.	$5,900	+ $ 0	+ $9,600	+ $26,000	= $7,100	+ $30,000	+ $6,100	− $1,700
(10)	− 900				− 900			
New Bal.	$5,000	+ $ 0	+ $9,600	+ $26,000	= $6,200	+ $30,000	+ $6,100	− $1,700
	$40,600				$40,600			

Transaction 11: Withdrawal of Cash by Owner

Chuck Taylor withdraws $200 cash from FastForward for personal use.

The owner of FastForward withdraws $200 cash for personal use. Withdrawals are accounted for as a decrease in equity. Withdrawals are not expenses because they are not part of the company's earning process. Since withdrawals are not company expenses, they are not used in computing net income.

By definition, increases in withdrawals yield decreases in equity.

	Assets				= Liabilities +	Equity			
	Cash	+ Accounts Receivable	+ Supplies	+ Equipment	= Accounts Payable	+ C. Taylor, Capital	− C. Taylor, Withdrawals	+ Revenues	− Expenses
Old Bal.	$5,000	+ $ 0	+ $9,600	+ $26,000	= $6,200	+ $30,000		+ $6,100	− $1,700
(11)	− 200						− $200		
New Bal.	$4,800	+ $ 0	+ $9,600	+ $26,000	= $6,200	+ $30,000	− $200	+ $6,100	− $1,700
	$40,400				$40,400				

Summary of Transactions

We summarize in Exhibit 2.1 the effects of these 11 transactions of FastForward using the accounting equation. Two points should be noted. First, the accounting equation remains in balance after each transaction. Second, transactions can be analyzed by their effects on components of the accounting equation. For example, in transactions 2, 3, and 9, one asset increased while another asset decreased by equal amounts.

Exhibit 2.1

Summary of Transactions Using the Accounting Equation

	Assets				= Liabilities +	Equity			
	Cash	+ Accounts Receivable	+ Supplies	+ Equipment	= Accounts Payable	+ C. Taylor, Capital	− C. Taylor, Withdrawals	+ Revenues	− Expenses
(1)	$30,000				=	$30,000			
(2)	− 2,500		+ $2,500						
Bal.	27,500		+ 2,500		=	30,000			
(3)	−26,000			+ $26,000					
Bal.	1,500		+ 2,500	+ 26,000	=	30,000			
(4)			+ 7,100		+$7,100				
Bal.	1,500		+ 9,600	+ 26,000	= 7,100	+ 30,000			
(5)	+ 4,200							+ $4,200	
Bal.	5,700		+ 9,600	+ 26,000	= 7,100	+ 30,000		+ 4,200	
(6)	− 1,000								− $1,000
Bal.	4,700		+ 9,600	+ 26,000	= 7,100	+ 30,000		+ 4,200	− 1,000
(7)	− 700								− 700
Bal.	4,000		+ 9,600	+ 26,000	= 7,100	+ 30,000		+ 4,200	− 1,700
(8)		+ $1,900						+ 1,600 + 300	
Bal.	4,000	+ 1,900	+ 9,600	+ 26,000	= 7,100	+ 30,000		+ 6,100	− 1,700
(9)	+ 1,900	− 1,900							
Bal.	5,900	+ 0	+ 9,600	+ 26,000	= 7,100	+ 30,000		+ 6,100	− 1,700
(10)	− 900				− 900				
Bal.	5,000	+ 0	+ 9,600	+ 26,000	= 6,200	+ 30,000		+ 6,100	− 1,700
(11)	− 200						− $200		
Bal.	$ 4,800	+ $ 0	+ $ 9,600	+ $ 26,000	= $ 6,200	+ $ 30,000	− $200	+ $6,100	− $1,700

HOW YOU DOIN'?

Answers—p. 33

1. When is the accounting equation in balance, and what does that mean?
2. How can a transaction not affect any liability and equity accounts?
3. Describe a transaction that increases equity and another transaction that decreases equity.
4. Identify a transaction that decreases both assets and liabilities.

IN THE NEWS

Women Entrepreneurs The Center for Women's Business Research reports that women-owned businesses, such as **SPANX**, are growing and that they

- Total approximately 11 million and employ nearly 20 million workers.
- Generate $2.5 trillion in annual sales and tend to embrace technology.
- Are philanthropic—70% of owners volunteer at least once per month.
- Are more likely funded by individual investors (73%) than venture firms (15%).

Financial Statements

LO3 Identify and prepare basic financial statements and explain how they interrelate.

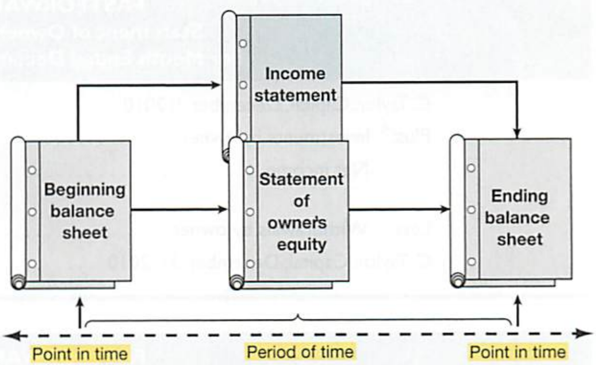
This section shows how three basic financial statements are prepared from the analysis of business transactions. The financial statements and their purposes are:

1. **Income statement**—describes a company's revenues and expenses along with the resulting net income or loss over a period of time due to earnings activities. This statement is sometimes called a *profit and loss statement,* or *P&L.*
2. **Statement of owner's equity**—explains changes in owner's equity from net income (or loss) and from any owner investments and withdrawals over a period of time. This statement is also called the *statement of changes in owner's equity.*
3. **Balance sheet**—describes a company's financial position (types and amounts of assets, liabilities, and equity) at a point in time.

Exhibit 2.2 shows the links between financial statements across time. A balance sheet reflects financial position at a *point in time.* The income statement and the statement of owner's equity reflect activity over a *period of time.* Information from these two financial statements updates the balance sheet at the next *point in time.*

Exhibit 2.2

Links between Financial Statements across Time



We prepare these financial statements using the 11 selected transactions of FastForward from Exhibit 2.1. Note, a financial statement's heading lists the 3 W's: Who—name of organization; What—name of statement; and When—statement's point in time or period of time.

Income Statement

The income statement shows the profitability of business operations over a period of time. FastForward's income statement for December is shown at the top of Exhibit 2.3. Information about revenues and expenses is from the Equity columns of Exhibit 2.1. Revenues are reported first on the income statement. They include consulting revenues of $5,800 from transactions 5 and 8 and rental revenue of $300 from transaction 8. Expenses are reported after revenues. (Here we list larger amounts first, but we can sort expenses in different ways.) Rent and salary expenses are from transactions 6 and 7. Expenses reflect the costs to generate the revenues reported. Net income (or loss) is reported at the bottom of the income statement. During the month of December, FastForward had net income, or profit, of $4,400. Notice that owner's investments and withdrawals are *not* part of income.

Exhibit 2.3

Financial Statements and Their Links

A single ruled line denotes an addition or subtraction. Final totals are double underlined.

Arrow lines show how the statements interrelate. ① Net income is used to update equity (capital) ② Ending capital is used to prepare the balance sheet.

FASTFORWARD
Income Statement
For Month Ended December 31, 2010

Revenues		
Consulting revenue	$ 5,800	
Rental revenue	300	
Total revenues		$ 6,100
Expenses		
Rent expense	1,000	
Salaries expense	700	
Total expenses		1,700
Net income		$ 4,400

FASTFORWARD
Statement of Owner's Equity
For Month Ended December 31, 2010

C. Taylor, Capital, December 1, 2010		$ 0
Plus: Investments by owner	$30,000	
Net income	4,400	34,400
		34,400
Less: Withdrawals by owner		200
C. Taylor, Capital, December 31, 2010		$34,200

FASTFORWARD
Balance Sheet
December 31, 2010

Assets		Liabilities	
Cash	$ 4,800	Accounts payable	$ 6,200
Supplies	9,600		
Equipment	26,000	**Equity**	
		C. Taylor, Capital	34,200
Total assets	$40,400	Total liabilities and equity	$ 40,400

Statement of Owner's Equity

The statement of owner's equity reports information about how equity changes over the reporting period. This statement shows beginning capital, events that increase it (owner investments and net income), and events that decrease it (owner withdrawals and net loss). FastForward's statement of owner's equity is the second report in Exhibit 2.3. The beginning capital balance is measured as of the start of business on December 1. It is zero because FastForward did not exist before then. An existing business reports the beginning balance as of the end of the prior reporting period (such as from November 30). FastForward's statement shows that Taylor's initial investment created $30,000 of equity. It also shows the $4,400 of net income earned during the period. This links the income statement to the statement of owner's equity (see line ①). The statement also reports Taylor's $200 cash withdrawal and FastForward's end-of-period capital balance of $34,200. This ending capital is carried over and reported on the balance sheet. This links the statement of owner's equity to the balance sheet (see line ②).

Balance Sheet

The balance sheet reports the type and amounts of assets, liabilities, and owner's equity at a point in time. FastForward's balance sheet is the third report in Exhibit 2.3. This statement refers to FastForward's financial condition at the close of business on December 31. The left side of the balance sheet lists FastForward's assets: cash, supplies, and equipment. The upper right side of the balance sheet shows that FastForward owes $6,200 to creditors. Any other liabilities (such as a bank loan) would be listed here. The equity (capital) balance is $34,200. Note again the link between the ending balance of the statement of owner's equity and the equity balance here—see line ②.

HOW YOU DOIN'? Answers—p. 33

5. Explain the link between the income statement and the statement of owner's equity.

6. Describe the link between the balance sheet and the statement of owner's equity.

Demonstration Problem

After several months of planning, Jasmine Worthy started a haircutting business called Expressions. The following events occurred during its first month of business.

a. On August 1, Worthy invested $3,000 cash and $15,000 of equipment in Expressions.
b. On August 2, Expressions paid $600 cash for furniture for the shop.
c. On August 3, Expressions paid $500 cash to rent space in a strip mall for August.
d. On August 4, it purchased $1,200 of equipment on credit for the shop (using an account payable).
e. On August 5, Expressions opened for business. Cash received from services provided in the first week and a half of business (ended August 15) is $825.
f. On August 15, it provided $100 of haircutting services on account.
g. On August 17, it received a $100 check for services previously rendered on account on August 15.
h. On August 17, it paid $125 cash to an assistant for working during the grand opening.
i. Cash received from services provided during the second half of August is $930.
j. On August 31, it paid $400 toward the account payable entered into on August 4.
k. On August 31, Worthy made a $900 cash withdrawal for personal use.

Required

1. Arrange the following asset, liability, and equity titles in a table similar to the one in Exhibit 2.1: Cash; Accounts Receivable; Furniture; Store Equipment; Accounts Payable; J. Worthy, Capital; J. Worthy, Withdrawals; Revenues; and Expenses. Show the effects of each transaction using the accounting equation.
2. Prepare an income statement for August.
3. Prepare a statement of owner's equity for August.
4. Prepare a balance sheet as of August 31.

Planning the Solution

- Set up a table like Exhibit 2.1 with the appropriate columns for accounts.
- Analyze each transaction and show its effects as increases or decreases in the appropriate columns. Be sure the accounting equation remains in balance after each transaction.
- Prepare the income statement, and identify revenues and expenses. List those items on the statement, compute the difference, and label the result as *net income* or *net loss*.
- Use information in the Equity columns to prepare the statement of owner's equity.
- Use information in the last row of the transactions table to prepare the balance sheet.

Solution to Demonstration Problem

1.

	Assets							=	Liabilities	+	Equity						
	Cash	+	Accounts Receivable	+	Furniture	+	Store Equipment	=	Accounts Payable	+	J. Worthy, Capital	−	J. Worthy, Withdrawals	+	Revenues	−	Expenses
a.	$3,000						$15,000				$18,000						
b.	− 600			+	$600												
Bal.	2,400	+		+	600	+	15,000	=			18,000						
c.	− 500															−	$500
Bal.	1,900	+		+	600	+	15,000	=			18,000					−	500
d.						+	1,200		+$1,200								
Bal.	1,900	+		+	600	+	16,200	=	1,200	+	18,000					−	500
e.	+ 825													+	$ 825		
Bal.	2,725	+		+	600	+	16,200	=	1,200	+	18,000			+	825	−	500
f.		+	$100											+	100		
Bal.	2,725	+	100	+	600	+	16,200	=	1,200	+	18,000			+	925	−	500
g.	+ 100	−	100														
Bal.	2,825	+	0	+	600	+	16,200	=	1,200	+	18,000			+	925	−	500
h.	− 125															−	125
Bal.	2,700	+	0	+	600	+	16,200	=	1,200	+	18,000			+	925	−	625
i.	+ 930													+	930		
Bal.	3,630	+	0	+	600	+	16,200	=	1,200	+	18,000			+	1,855	−	625
j.	− 400								− 400								
Bal.	3,230	+	0	+	600	+	16,200	=	800	+	18,000			+	1,855	−	625
k.	− 900											−	$900				
Bal.	$ 2,330	+	$ 0	+	$600	+	$ 16,200	=	$ 800	+	$ 18,000	−	$900	+	$1,855	−	$625

2.

EXPRESSIONS
Income Statement
For Month Ended August 31

Revenues		
Haircutting services revenue		$1,855
Expenses		
Rent expense	$500	
Wages expense	125	
Total expenses		625
Net income		$1,230

3.

EXPRESSIONS
Statement of Owner's Equity
For Month Ended August 31

J. Worthy, Capital, August 1*		$ 0
Plus: Investments by owner	$18,000	
Net income	1,230	19,230
		19,230
Less: Withdrawals by owner		900
J. Worthy, Capital, August 31		$18,330

* If Expressions had been an existing business from a prior period, the beginning capital balance would equal the Capital account balance from the end of the prior period.

4.

EXPRESSIONS **Balance Sheet** **August 31**			
Assets		**Liabilities**	
Cash	$ 2,330	Accounts payable	$ 800
Furniture	600	**Equity**	
Store equipment	16,200	J. Worthy, Capital	18,330
Total assets	$19,130	Total liabilities and equity	$19,130

Summary

LO1 Define the accounting equation and each of its components. The accounting equation is: Assets = Liabilities + Equity. Assets are resources owned by a company. Liabilities are creditors' claims on assets. Equity is the owner's claim on assets (*the residual*). The expanded accounting equation is: Assets = Liabilities + [Owner Capital − Owner Withdrawals + Revenues − Expenses].

LO2 Analyze business transactions using the accounting equation. A *transaction* is an exchange of value between two parties. Examples include exchanges of products, services, money, and rights to collect money. Transactions always have at least two effects on one or more components of the accounting equation. This equation is always in balance.

LO3 Identify and prepare basic financial statements and explain how they interrelate. Three basic financial statements report on an organization's activities: balance sheet, income statement, and statement of owner's equity. Net income from the income statement updates equity on the statement of owner's equity. Ending owner's equity is reported on the ending balance sheet.

Guidance Answers to HOW YOU DOIN'?

1. The accounting equation is: Assets = Liabilities + Equity. This equation is always in balance, both before and after each transaction. This means that a company's assets are equal to the claims on those assets.
2. A transaction that changes the makeup of assets would not affect liability and equity accounts. FastForward's transactions 2, 3, and 9 are examples. Each exchanges one asset for another.
3. Earning revenue by performing services, as in FastForward's transaction 5, increases equity (and assets). Incurring expenses while servicing clients, such as in transactions 6 and 7, decreases equity (and assets). Other examples include owner investments that increase equity and owner withdrawals that decrease equity.
4. Paying a liability with an asset reduces both asset and liability totals. One example is FastForward's transaction 10 that reduces a payable by paying cash.
5. An income statement reports a company's revenues and expenses along with the resulting net income or loss. A statement of owner's equity shows changes in equity, including that from net income or loss. Both statements report transactions occurring over a period of time.
6. The balance sheet describes a company's financial position (assets, liabilities, and equity) at a point in time. The equity amount in the balance sheet is obtained from the statement of owner's equity.

Key Terms

Account (p. 23) Record within an accounting system in which increases and decreases are entered and stored in a specific asset, liability, equity, revenue, or expense.

Accounting equation (p. 22) Equality involving a company's assets, liabilities, and equity; Assets = Liabilities + Equity; also called *balance sheet equation.*

Assets (p. 22) Resources a business owns or controls that are expected to provide current and future benefits to the business.

Balance sheet (p. 29) Financial statement that lists types and dollar amounts of assets, liabilities, and equity at a specific date.

Creditors (p. 22) Individuals and organizations that are entitled to receive payment from a company.

Equity (p. 23) Owner's claim on the assets of a business; equals the residual interest in an entity's assets after deducting liabilities; also called *net assets.*

Events (p. 23) Those happenings that affect an entity's accounting equation *and* can be reliably measured.

Expanded accounting equation (p. 23) Assets = Liabilities + Equity; Equity equals [Owner capital − Owner withdrawals + Revenues − Expenses].

Expenses (p. 23) Outflows or using up of assets as part of operations of a business to generate sales.

External transactions (p. 23) Exchanges of value between one entity and another entity.

Income statement (p. 29) Financial statement that subtracts expenses from revenues to yield a net income or loss over a specified period of time; also includes any gains or losses.

Internal transactions (p. 23) Activities within an organization that can affect the accounting equation.

Liabilities (p. 22) Creditors' claims on an organization's assets; involves a probable future payment of assets, products, or services that a company is obliged to make due to past transactions or events.

Net income (p. 23) Amount earned after subtracting all expenses necessary for and matched with sales for a period; also called *income, profit,* or *earnings.*

Net loss (p. 23) Excess of expenses over revenues for a period.

Owner, Capital (p. 23) Account showing the owner's claim on company assets; equals owner investments plus net income (or less net losses) minus owner withdrawals since the company's inception; also referred to as *equity.*

Owner investment (p. 23) Assets put into the business by the owner.

Owner withdrawals (p. 23) Payment of cash or other assets from a proprietorship or partnership to its owner or owners.

Revenues (p. 23) Gross increase in equity from a company's business activities that earn income; also called *sales.*

Statement of owner's equity (p. 29) Report of changes in equity over a period; adjusted for increases (owner investment and net income) and for decreases (withdrawals and net losses).

Multiple Choice Quiz

Answers on p. 43

mhhe.com/wildCA2e

Additional Multiple Choice Quizzes are available at the book's Website.

1. When supplies are paid for with cash, which accounts increase or decrease?
   - **a.** Supplies increase; cash increases.
   - **b.** Supplies increase; accounts payable increases.
   - **c.** Supplies increase; cash neither increases nor decreases.
   - **d.** Supplies increase; cash decreases.
2. When supplies are purchased on account, which accounts increase or decrease?
   - **a.** Supplies increase; accounts payable increases.
   - **b.** Supplies increase; accounts receivable increases.
   - **c.** Supplies increase; accounts payable decreases.
   - **d.** Supplies increase; equity decreases.
3. If the assets of a company increase by $100,000 during the year and its liabilities increase by $35,000 during the same year, then the change in equity of the company during the year must have been:
   - **a.** An increase of $135,000.
   - **b.** A decrease of $135,000.
   - **c.** A decrease of $65,000.
   - **d.** An increase of $65,000.
   - **e.** An increase of $100,000.
4. A company borrows $50,000 cash from Third National Bank. How does this transaction affect the accounting equation for this company?
   - **a.** Assets increase by $50,000; liabilities increase by $50,000; no effect on equity.
   - **b.** Assets increase by $50,000; no effect on liabilities; equity increases by $50,000.
   - **c.** Assets increase by $50,000; liabilities decrease by $50,000; no effect on equity.
   - **d.** No effect on assets; liabilities increase by $50,000; equity increases by $50,000.
   - **e.** No effect on assets; liabilities increase by $50,000; equity decreases by $50,000.
5. Geek Squad performs services for a customer and bills the customer for $500. How would Geek Squad record this transaction?
   - **a.** Accounts receivable increase by $500; revenues increase by $500.
   - **b.** Cash increases by $500; revenues increase by $500.
   - **c.** Accounts receivable increase by $500; revenues decrease by $500.
   - **d.** Accounts receivable increase by $500; accounts payable increase by $500.
   - **e.** Accounts payable increase by $500; revenues increase by $500.

Discussion Questions

1. Define (*a*) *assets*, (*b*) *liabilities*, (*c*) *equity*, and (*d*) *net assets*.
2. What events or transactions change equity?
3. What do accountants mean by the term *revenue*?
4. Define *net income* and explain its computation.
5. Identify the three basic financial statements of a business.
6. What information is reported in an income statement?
7. Give two examples of expenses a business might incur.
8. What is the purpose of the statement of owner's equity?
9. What information is reported in a balance sheet?
10. Refer to the financial statements of **Best Buy** in Appendix A near the end of the book. To what level are dollar amounts rounded? What time period does its income statement cover?
11. Refer to the financial statements for **RadioShack** in Appendix A near the end of the book. What time period does its balance sheet cover? To what level are dollar amounts rounded?

connect

QUICK STUDY

QS 2-1
Applying the accounting equation
LO1

a. Total assets of Charter Company equal $700,000 and its equity is $420,000. What is the amount of its liabilities?

b. Total assets of Martin Marine equal $500,000 and its liabilities and equity amounts are equal to each other. What is the amount of its liabilities? What is the amount of its equity?

QS 2-2
Applying the accounting equation
LO1

Use the accounting equation to compute the missing financial statement amounts (*a*), (*b*), and (*c*).

Company	Assets	=	Liabilities	+	Equity
1	$75,000		$ (a)		$40,000
2	$ (b)		$25,000		$70,000
3	$85,000		$20,000		$ (c)

QS 2-3
Identifying items with financial statements LO3

Indicate in which financial statement each item would most likely appear: income statement (I), balance sheet (B), or statement of owner's equity (E).

a. Assets
b. Withdrawals
c. Equipment
d. Expenses
e. Liabilities
f. Revenues
g. Total liabilities and equity

QS 2-4
Identifying and computing assets, liabilities, and equity LO1

Use RadioShack's December 31, 2007, financial statements, in Appendix A near the end of the book, to answer the following:

a. Identify the dollar amounts of RadioShack's 2007 (1) total assets, (2) total liabilities, and (3) total equity.

b. Using RadioShack's amounts from part *a*, verify that Assets = Liabilities + Equity.

QS 2-5
Using the accounting equation
LO2

Explain how the transactions below impact the accounting equation.

a. Collect $4,000 cash from a customer for consulting services provided.

b. Bill a customer $2,800 for consulting services provided.

QS 2-6
Using the accounting equation
LO2

Explain how the transactions below impact the accounting equation.

a. Pay $1,800 cash for employee wages.

b. Pay $10,000 cash for office equipment.

QS 2-7
Using the accounting equation
LO2

Explain how the transactions below impact the accounting equation.

a. Owner invests $50,000 cash in her new business.

b. Owner withdraws $4,000 cash from the business for personal use.

QS 2-8
Using the accounting equation
LO2

Explain how the transactions below impact the accounting equation.

a. Pay $1,200 in cash for supplies.

b. Purchase $2,000 of office supplies on credit.

connect

EXERCISES

Exercise 2-1
Using the accounting equation
LO1

Determine the missing amount from each of the separate situations a, b, and c below.

	Assets	=	Liabilities	+	Equity
a.	?	=	$20,000	+	$45,000
b.	$100,000	=	$34,000	+	?
c.	$154,000	=	?	+	$40,000

Exercise 2-2
Classifying accounts
LO1 LO2

Classify each of the following accounts as an asset (A), liability (L), or equity (E) account.

______ **1.** Accounts Payable
______ **2.** Loan (or Notes) Payable
______ **3.** Accounts Receivable
______ **4.** Cash
______ **5.** Supplies
______ **6.** Equipment
______ **7.** Rod Smith, Capital

Exercise 2-3
Identifying effects of transactions on the accounting equation
LO1 LO2

Provide an example of a transaction that creates the described effects for the separate cases *a* through *g*.

a. Decreases an asset and decreases equity.
b. Increases an asset and increases a liability.
c. Decreases a liability and increases a liability.
d. Decreases an asset and decreases a liability.
e. Increases an asset and decreases an asset.
f. Increases a liability and decreases equity.
g. Increases an asset and increases equity.

Exercise 2-4
Using the accounting equation
LO1 LO2

Answer the following questions. (*Hint:* Use the accounting equation.)

a. Cadence Office Supplies has assets equal to $123,000 and liabilities equal to $47,000 at year-end. What is the total equity for Cadence at year-end?

b. At the beginning of the year, Addison Company's assets are $300,000 and its equity is $100,000. During the year, assets increase $80,000 and liabilities increase $50,000. What is the equity at the end of the year?

Check (c) Beg. equity, $60,000

c. At the beginning of the year, Quasar Company's liabilities equal $70,000. During the year, assets increase by $60,000, and at year-end assets equal $190,000. Liabilities decrease $5,000 during the year. What are the beginning and ending amounts of equity?

Exercise 2-5
Identifying effects of transactions using the accounting equation
LO1 LO2

Leora Holden began a professional practice on June 1 and plans to prepare financial statements at the end of each month. During June, Holden (the owner) completed these transactions.

a. Owner invested $60,000 cash along with equipment that had a $15,000 market value.
b. Paid $1,500 cash for rent of office space for the month.
c. Purchased $10,000 of additional equipment on credit (payment due within 30 days).
d. Completed work for a client and immediately collected the $2,500 cash earned.
e. Completed work for a client and sent a bill for $8,000 to be received within 30 days.
f. Purchased additional equipment for $6,000 cash.
g. Paid an assistant $3,000 cash as wages for the month.
h. Collected $5,000 cash on the amount owed by the client described in transaction *e*.
i. Paid $10,000 cash to settle the liability created in transaction *c*.
j. Owner withdrew $1,000 cash for personal use.

Required

Check Net income, $6,000

Create a table like the one in Exhibit 2.1, using the following headings for columns: Cash; Accounts Receivable; Equipment; Accounts Payable; Holden, Capital; Holden, Withdrawals; Revenues; and Expenses. Then use additions and subtractions to show the effects of the transactions on individual items of the accounting equation. Show new balances after each transaction.

Exercise 2-6
Identifying effects of transactions on accounting equation
LO1 LO2

The following table shows the effects of five transactions (*a* through *e*) on the assets, liabilities, and equity of Trista's Boutique. Write short descriptions of what likely happened in each transaction.

	Assets							=	Liabilities	+	Equity		
	Cash	+	Accounts Receivable	+	Office Supplies	+	Land	=	Accounts Payable	+	Trista, Capital	+	Revenues
	$ 21,000	+	$ 0	+	$3,000	+	$ 19,000	=	$ 0	+	$43,000	+	$ 0
a.	− 4,000					+	4,000						
b.				+	1,000				+1,000				
c.		+	1,900									+	1,900
d.	− 1,000								−1,000				
e.	+ 1,900	−	1,900										
	$ 17,900	+	$ 0	+	$4,000	+	$ 23,000	=	$ 0	+	$43,000	+	$1,900

Exercise 2-7
Preparing an income statement **LO3**

On October 1, Keisha King organized Real Answers, a new consulting firm. On October 31, the company's records show the following items and amounts. Use this information to prepare an October income statement for the business.

Cash	$11,500	Cash withdrawals by owner	$ 2,000
Accounts receivable	12,000	Consulting fees earned	14,000
Office supplies	24,437	Rent expense	2,520
Land	46,000	Salaries expense	5,600
Office equipment	18,000	Telephone expense	760
Accounts payable	25,037	Miscellaneous expenses	580
Owner investments	84,360		

Check Net income, $4,540

Exercise 2-8
Preparing a statement of owner's equity **LO3**

Use the information in Exercise 2-7 to prepare an October statement of owner's equity for Real Answers.

Exercise 2-9
Preparing a balance sheet **LO3**

Use the information in Exercise 2-7 (if completed, you can also use your solution to Exercise 2-8) to prepare an October 31 balance sheet for Real Answers.

Check Total assets, $111,937

Exercise 2-10
Preparing an income statement
LO3

The following is selected financial information for Elko Energy Company for the year ended December 31, 2010: revenues, $55,000; expenses, $40,000; net income, $15,000.

Required

Prepare the 2010 income statement for Elko Energy Company.

Exercise 2-11
Preparing a balance sheet **LO3**

The following is selected financial information for Amity Company as of December 31, 2010: liabilities, $44,000; equity, $46,000; assets, $90,000.

Required

Prepare the balance sheet for Amity Company as of December 31, 2010.

Exercise 2-12
Preparing a statement of owner's equity **LO3**

Following is selected financial information for Kasio Co. for the year ended December 31, 2010.

K. Kasio, Capital, Dec. 31, 2010	$14,000	K. Kasio, Withdrawals	$1,000
Net income	8,000	K. Kasio, Capital, Dec. 31, 2009	7,000

Required

Prepare the 2010 statement of owner's equity for Kasio.

Exercise 2-13

Preparing a statement of owner's equity LO3

Following is selected financial information of First Act for the year ended December 31, 2010.

I. Firstact, Capital, Dec. 31, 2010	$47,000	I. Firstact, Withdrawals	$ 7,000
Net income	5,000	I. Firstact, Capital, Dec. 31, 2009	49,000

Required

Prepare the 2010 calendar-year statement of owner's equity for First Act.

Exercise 2-14

Analyzing effects of transactions LO1 LO2

Isabel Lopez started Biz Consulting, a new business, and completed the following transactions during its first year of operations.

a. I. Lopez invests $70,000 cash and office equipment valued at $10,000 in the business.
b. Purchased a $20,000 building to use as an office. Biz paid $20,000 in cash.
c. Purchased office equipment for $15,000 cash.
d. Purchased $1,200 of office supplies credit.

Required

1. Create a table like the one in Exhibit 2.1, using the following headings for the columns: Cash; Office Supplies; Office Equipment; Building; Accounts Payable; I. Lopez, Capital.
2. Use additions and subtractions to show the effects of these transactions on individual items of the accounting equation. Show new balances after each transaction.

Exercise 2-15

Preparing financial statements LO3

Isabel Lopez's consulting business, Biz Consulting, reports the following accounting equation balances on December 31, 2010, the end of its first year of operations.

	Assets					=	Liabilities	+	Equity			
	Cash	+ Accounts Receivable	+ Office Supplies	+ Office Equipment	+ Building	=	Accounts Payable	+	+ I. Lopez, Capital	− I. Lopez, Withdrawals	+ Revenues	− Expenses
Bal.	$34,525	+ $1,000	+ $1,200	+ $26,700	+ $150,000	=	$132,200		+ $80,000	− $3,275	+ $6,800	− $2,300

Required

1. Compute net income for 2010.
2. Prepare a statement of owner's equity for 2010 and a balance sheet as of December 31, 2010.

Check (2) I. Lopez Capital, December 31, $81,225

Problem Set B located at the end of Problem Set A is provided for each problem to reinforce the learning process.

connect

PROBLEM SET A

Problem 2-1A

Computing missing information using accounting knowledge and the accounting equation LO1 LO2

The following financial statement information is from five separate companies.

	Company A	Company B	Company C	Company D	Company E
December 31, 2009					
Assets	$55,000	$34,000	$24,000	$60,000	$119,000
Liabilities	24,500	21,500	9,000	40,000	?
December 31, 2010					
Assets	58,000	40,000	?	85,000	113,000
Liabilities	?	26,500	29,000	24,000	70,000
During year 2010					
Owner investments	6,000	1,400	9,750	?	6,500
Net income	8,500	?	8,000	14,000	20,000
Owner cash withdrawals	3,500	2,000	5,875	0	11,000

Required

1. Answer the following questions about Company A.
   a. What is the amount of equity on December 31, 2009?
   b. What is the amount of equity on December 31, 2010?
   c. What is the amount of liabilities on December 31, 2010?

Check (1*b*) $41,500

2. Answer the following questions about Company B.
   a. What is the amount of equity on December 31, 2009?
   b. What is the amount of equity on December 31, 2010?
   c. What is net income for year 2010?
3. Calculate the amount of assets for Company C on December 31, 2010.
4. Calculate the amount of owner investments for Company D during year 2010.
5. Calculate the amount of liabilities for Company E on December 31, 2009.

Check (2c) $1,600
(3) $55,875

Problem 2-2A
Identifying effects of transactions on financial statements
LO1 LO2

Identify how each of the following separate transactions affects financial statements. For the balance sheet, identify how each transaction affects total assets, total liabilities, and total equity. For the income statement, identify how each transaction affects net income. For increases, place a "+" in the column or columns. For decreases, place a "−" in the column or columns. If both an increase and a decrease occur, place a "+/−" in the column or columns. The first transaction is completed as an example.

		Balance Sheet			Income Statement
	Transaction	Total Assets	Total Liab.	Total Equity	Net Income
1	Owner invests cash in business	+		+	
2	Receives cash for services provided				
3	Pays cash for employee wages				
4	Owner withdraws cash				
5	Provides services on credit				
6	Buys office equipment for cash				
7	Collects cash on receivable from (6)				

Problem 2-3A
Analyzing transactions and preparing financial statements
LO2 LO3

eXcel
mhhe.com/wildCA2e

Holden Graham started The Graham Co., a new business that began operations on May 1. Graham Co. completed the following transactions during that first month.

May	1	H. Graham invested $40,000 cash in the business.
	1	Rented a furnished office and paid $2,200 cash for May's rent.
	3	Purchased $1,890 of office equipment on credit.
	5	Paid $750 cash for this month's cleaning services.
	8	Provided consulting services for a client and immediately collected $5,400 cash.
	12	Provided $2,500 of consulting services for a client on credit.
	15	Paid $750 cash for an assistant's salary for the first half of this month.
	20	Received $2,500 cash payment for the services provided on May 12.
	22	Provided $3,200 of consulting services on credit.
	25	Received $3,200 cash payment for the services provided on May 22.
	26	Paid $1,890 cash for the office equipment purchased on May 3.
	27	Purchased $80 of advertising in this month's (May) local paper on credit.
	28	Paid $750 cash for an assistant's salary for the second half of this month.
	30	Paid $300 cash for this month's telephone bill.
	30	Paid $280 cash for this month's utilities.
	31	Graham withdrew $1,400 cash for personal use.

Required

1. Arrange the following asset, liability, and equity titles in a table like Exhibit 2.1: Cash; Accounts Receivable; Office Equipment; Accounts Payable; H. Graham, Capital; H. Graham, Withdrawals; Revenues; and Expenses.
2. Show effects of the transactions on the accounts of the accounting equation by recording increases and decreases in the appropriate columns. Do not determine new account balances after each transaction. Determine the final total for each account and verify that the equation is in balance.
3. Prepare an income statement for May, a statement of owner's equity for May, and a May 31 balance sheet.

Check (2) Ending balances: Cash, $42,780; Expenses, $5,110
(3) Net income, $5,990; Total assets, $44,670

Problem 2-4A
Analyzing transactions and preparing financial statements
LO2 LO3

excel
mhhe.com/wildCA2e

Helga Ander started a new business and completed these transactions during December.

Dec. 1 Helga Ander transferred $65,000 cash from a personal savings account to a checking account in the name of Ander Electric.
2 Rented office space and paid $1,000 cash for the December rent.
3 Purchased $13,000 of electrical equipment by paying $4,800 cash and agreeing to pay the $8,200 balance in 30 days.
5 Purchased office supplies by paying $800 cash.
6 Completed electrical work and immediately collected $1,200 cash for the work.
8 Purchased $2,530 of office equipment on credit.
15 Completed electrical work on credit in the amount of $5,000.
18 Purchased $350 of office supplies on credit.
20 Paid $2,530 cash for the office equipment purchased on December 8.
24 Billed a client $900 for electrical work completed.
28 Received $5,000 cash for the work completed on December 15.
29 Paid the assistant's salary of $1,400 cash for this month.
30 Paid $540 cash for this month's utility bill.
31 Ander withdrew $950 cash for personal use.

Required

1. Arrange the following asset, liability, and equity titles in a table like Exhibit 2.1: Cash; Accounts Receivable; Office Supplies; Office Equipment; Electrical Equipment; Accounts Payable; H. Ander, Capital; H. Ander, Withdrawals; Revenues; and Expenses.
2. Use additions and subtractions to show the effects of each transaction on the accounts in the accounting equation. Show new balances after each transaction.
3. Use the increases and decreases in the columns of the table from part 2 to prepare an income statement and a statement of owner's equity for the month. Also prepare a balance sheet as of the end of the month.

Check (2) Ending balances: Cash, $59,180, Accounts Payable, $8,550

(3) Net income, $4,160; Total assets, $76,760

PROBLEM SET B

Problem 2-1B
Computing missing information using accounting knowledge
LO1 LO2

The following financial statement information is from five separate companies.

	Company V	Company W	Company X	Company Y	Company Z
December 31, 2009					
Assets	$54,000	$ 80,000	$141,500	$92,500	$144,000
Liabilities	25,000	60,000	68,500	51,500	?
December 31, 2010					
Assets	59,000	100,000	186,500	?	170,000
Liabilities	36,000	?	65,800	42,000	42,000
During year 2010					
Owner investments	5,000	20,000	?	48,100	60,000
Net income	?	40,000	18,500	24,000	32,000
Owner cash withdrawals	5,500	2,000	0	20,000	8,000

Required

1. Answer the following questions about Company V.
   a. What is the amount of equity on December 31, 2009?
   b. What is the amount of equity on December 31, 2010?
   c. What is the net income or loss for the year 2010?
2. Answer the following questions about Company W.
   a. What is the amount of equity on December 31, 2009?
   b. What is the amount of equity on December 31, 2010?
   c. What is the amount of liabilities on December 31, 2010?
3. Calculate the amount of owner investments for Company X during 2010.
4. Calculate the amount of assets for Company Y on December 31, 2010.
5. Calculate the amount of liabilities for Company Z on December 31, 2009.

Check (1b) $23,000

(2c) $22,000

(4) $135,100

Problem 2-2B
Identifying effects of transactions on financial statements
LO1 LO2

Identify how each of the following separate transactions affects financial statements. For the balance sheet, identify how each transaction affects total assets, total liabilities, and total equity. For the income statement, identify how each transaction affects net income. For increases, place a "+" in the column or columns. For decreases, place a "−" in the column or columns. If both an increase and a decrease occur, place "+/−" in the column or columns. The first transaction is completed as an example.

		Balance Sheet			Income Statement
	Transaction	Total Assets	Total Liab.	Total Equity	Net Income
1	Owner invests cash in business	+		+	
2	Pays cash for salaries				
3	Provides services for cash				
4	Pays cash for rent				
5	Buys store equipment for cash				
6	Owner withdraws cash				
7	Provides services on credit				
8	Collects cash on receivable from (7)				

Problem 2-3B
Analyzing transactions and preparing financial statements
LO2 LO3

Holly Nikolas launched a new business, Holly's Maintenance Co., that began operations on June 1. The following transactions were completed by the company during that first month.

June 1 H. Nikolas invested $130,000 cash in the business.
2 Rented a furnished office and paid $6,000 cash for June's rent.
4 Purchased $2,400 of equipment on credit.
6 Paid $1,150 cash for the next week's advertising of the opening of the business.
8 Completed maintenance services for a customer and immediately collected $850 cash.
14 Completed $7,500 of maintenance services for City Center on credit.
16 Paid $800 cash for an assistant's salary for the first half of the month.
20 Received $7,500 cash payment for services completed for City Center on June 14.
21 Completed $7,900 of maintenance services for Paula's Beauty Shop on credit.
24 Completed $675 of maintenance services for Build-It Coop on credit.
25 Received $7,900 cash payment from Paula's Beauty Shop for the work completed on June 21.
26 Made payment of $2,400 cash for the equipment purchased on June 4.
28 Paid $800 cash for an assistant's salary for the second half of this month.
29 Nikolas withdrew $4,000 cash for personal use.
30 Paid $150 cash for this month's telephone bill.
30 Paid $890 cash for this month's utilities.

Required

1. Arrange the following asset, liability, and equity titles in a table like Exhibit 2.1: Cash; Accounts Receivable; Equipment; Accounts Payable; H. Nikolas, Capital; H. Nikolas, Withdrawals; Revenues; and Expenses.
2. Show the effects of the transactions on the accounts of the accounting equation by recording increases and decreases in the appropriate columns. Do not determine new account balances after each transaction. Determine the final total for each account and verify that the equation is in balance.
3. Prepare a June income statement, a June statement of owner's equity, and a June 30 balance sheet.

Check (2) Ending balances: Cash, $130,060; Expenses, $9,790

(3) Net income, $7,135; Total assets, $133,135

Problem 2-4B
Analyzing transactions and preparing financial statements
LO2 LO3

Truro Excavating Co., owned by Raul Truro, began operations in July and completed the following transactions during that first month.

July 1 R. Truro invested $80,000 cash in the business.
2 Rented office space and paid $700 cash for the July rent.
3 Purchased excavating equipment for $5,000 by paying $1,000 cash and agreeing to pay the $4,000 balance in 30 days.
6 Purchased office supplies for $600 cash.
8 Completed work for a customer and immediately collected $7,600 cash for the work.

10 Purchased $2,300 of office equipment on credit.
15 Completed work for a customer on credit in the amount of $8,200.
17 Purchased $3,100 of office supplies on credit.
23 Paid $2,300 cash for the office equipment purchased on July 10.
25 Billed a customer $5,000 for work completed.
28 Received $8,200 cash for the work completed on July 15.
30 Paid an assistant's salary of $1,560 cash for this month.
31 Paid $295 cash for this month's utility bill.
31 Truro withdrew $1,800 cash for personal use.

Required

1. Arrange the following asset, liability, and equity titles in a table like Exhibit 2.1: Cash; Accounts Receivable; Office Supplies; Office Equipment; Excavating Equipment; Accounts Payable; R. Truro, Capital; R. Truro, Withdrawals; Revenues; and Expenses.
2. Use additions and subtractions to show the effects of each transaction on the accounts in the accounting equation. Show new balances after each transaction.
3. Use the increases and decreases in the columns of the table from part 2 to prepare an income statement, and a statement of owner's equity. Also prepare a balance sheet as of the end of the month.

Check (2) Ending balances: Cash, $87,545; Accounts Payable, $7,100

(3) Net income, $18,245; Total assets, $103,545

SERIAL PROBLEM

Success Systems

(This serial problem started in Chapter 1 and continues through most of the chapters. If the Chapter 1 segment was not completed, the problem can begin at this point. It is helpful, but not necessary, to use the Working Papers that accompany this book.)

SP 2 On October 1, 2010, Adriana Lopez started a computer services company, **Success Systems,** that provides consulting services, computer system installations, and custom program development. Lopez expects to prepare the company's first set of financial statements on December 31, 2010.

Required

Create a table like the one in Exhibit 2.1 using the following headings for columns: Cash; Accounts Receivable; Computer Supplies; Computer System; Office Equipment; Accounts Payable; A. Lopez, Capital; A. Lopez, Withdrawals; Revenues; and Expenses. Then use additions and subtractions to show the effects of the October transactions for Success Systems on the individual items of the accounting equation. Show new balances after each transaction.

Oct. 1 Adriana Lopez invested $75,000 cash, a $25,000 computer system, and $10,000 of office equipment in the business.
3 Purchased $1,600 of computer supplies on credit from Corvina Office Products.
6 Billed Easy Leasing $6,200 for services performed in installing a new Web server.
8 Paid $1,600 cash for the computer supplies purchased from Corvina Office Products on October 3.
12 Billed Easy Leasing another $1,950 for services performed.
15 Received $6,200 cash from Easy Leasing toward its account.
17 Paid $900 cash to repair computer equipment damaged when moving it.
20 Paid $1,790 cash for an advertisement in the local newspaper.
22 Received $1,950 cash from Easy Leasing toward its account.
28 Billed Clark Company $7,300 for services performed.
31 Paid $1,050 cash for Michelle Jones's wages for seven days of work this month.
31 Lopez withdrew $4,000 cash for personal use.

Check Ending balances: Cash, $73,810; Revenues, $15,450; Expenses, $3,740

BEYOND THE NUMBERS

REPORTING IN ACTION

L01

BTN 2-1 Key financial figures for **Best Buy**'s fiscal year ended March 1, 2008, follow.

Key Figure	In Millions
Liabilities + Equity	$12,758
Net income	1,407
Revenues	40,023

Required

1. What is the total amount of assets invested in Best Buy?
2. How much are total expenses for Best Buy for the year ended March 1, 2008?

ETHICS CHALLENGE
LO1 LO2

BTN 2-2 WorldCom committed fraud by accounting for some expenses as if they were assets.

Required

1. Using the accounting equation, show the accounting for an expense and the accounting for an asset (assume $1,000 cash is paid in each instance). Does the accounting equation balance in both instances?
2. What ethical concerns would you have if your business accounted for an expense as if it were an asset?

WORKPLACE COMMUNICATION
LO3

BTN 2-3 Refer to this chapter's opening feature about SPANX. Assume that the founder, Sara Blakely, is having difficulty assessing how well her business has performed over the past year. Write Sara Blakely a half-page memo to explain which financial statement will provide her the best information on her company's performance and which particular number she should focus on.

TAKING IT TO THE NET
LO3

BTN 2-4 Visit the EDGAR database at (www.SEC.gov). Under "Filings and Forms" click on "Search for Company Filings." Access the Form 10-K report of Rocky Mountain Chocolate Factory (ticker RMCF) filed on May 14, 2007, covering its 2007 fiscal year.

Required

1. Item 6 of its 10-K report provides comparative financial highlights of RMCF for the years 2004–2007. How would you describe the revenue trend for RMCF over this five-year period?
2. Has RMCF been profitable (see net income) over this four-year period? Support your answer.

TEAMWORK IN ACTION
LO1 LO2

BTN 2-5 Divide the class into teams and play Monopoly™. Each team takes 10 turns. Each team starts with $1,500 of owners' capital, in cash.

Required

1. Each team accounts for its first 10 transactions using the accounting equation. Use a table like Exhibit 2.1.
2. Each team presents its accounting equation entries to one other team.

ENTREPRENEURS IN BUSINESS
LO2 LO3

BTN 2-6 Assume that Sara Blakely of SPANX wants to expand her business. She is considering financing her expansion in one of two ways: (1) contributing more of her own cash to the business or (2) borrowing cash from a bank.

Required

Identify the issues that Blakely should consider when trying to decide on the method for financing the expansion.

YOU CALL IT— ENTREPRENEUR

BTN 2-7 You open a wholesale business selling entertainment equipment to retail outlets. You find that most of your customers demand to buy on credit. How can you use the balance sheets of these customers to help you decide which ones to extend credit to?

ANSWERS TO MULTIPLE CHOICE QUIZ

1. d
2. a
3. d;

Assets	=	Liabilities	+	Equity
+$100,000	=	+35,000	+	?

Change in equity = $100,000 − $35,000 = $65,000

4. a
5. a