

1 Evaluating Transactions

LEARNING OBJECTIVES

After studying this chapter, you will be able to:

- Describe the accounting equation
- Differentiate between account types
- Evaluate a transaction
- Convey transaction details

Accounting allows a business to both convey how well it has performed and evaluate how it can improve. Understanding the language of accounting will allow you to communicate with the accountants and financial professionals in any organization. In this chapter, you will be introduced to the accounting equation. You will also learn a number of important accounts, and how to evaluate transactions.

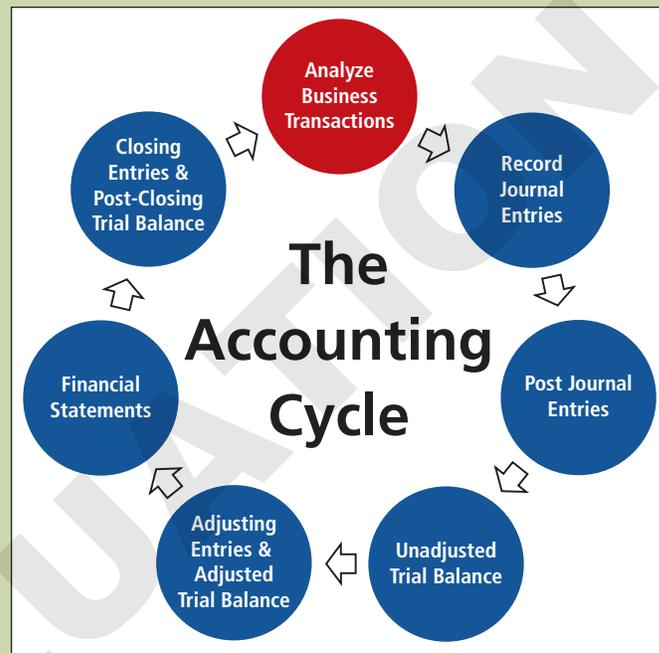
CASE STUDY

Opening Nathan's Donut School

Nathaniel H. Spencer has loved donuts since he was very young. His love of donuts led him to pursue a culinary degree, and now that he has graduated he is eager to start his own business. Unfortunately, he focused so heavily on his cooking courses in college, that he never learned any accounting. Nathaniel consulted a lawyer, who helped him to open Nathan's Donut School (a cooking school focused on gourmet baking), but now he is unsure how to track the activity of the business. Nathaniel has asked you to help with all accounting-related work for his new business.

As you will see in the upcoming chapter, to begin to understand accounting you must first examine the accounting equation. You then consider the best way to evaluate business activities, using the language of accounting. Lastly, you practice expressing a number of the business activities of Nathan's Donut School.

The Accounting Cycle includes all necessary steps, and begins with analyzing transactions.



Accounting provides a format in which business activity can be expressed.

	Assets					=	Liabilities	+	Owner's Equity					
	Cash	Accounts Receivable	Supplies	Furniture	Equipment				Accounts Payable	Nathaniel H. Spencer, Capital	Nathaniel H. Spencer, Drawing	Service Revenue	Advertising Expense	Rent Expense
Transaction #1	\$ 35,000								\$ 35,000					
Transaction #2	\$ (20,000)				\$ 20,000									
Transaction #3			\$ 500	\$ 1,000		\$ 1,500								

Using the Accounting Equation

Accounting provides a manner in which individual business events, and the cumulative impact of those events, can be expressed. This is important not only so that a business can keep track of its own activity, but also so that this activity may be summarized for individuals outside of the business. Outside parties who may be interested in this information include potential investors, bankers, and governmental agencies.

NOTE! A single business event, such as the purchase of an item, is referred to as a **Transaction**.

The most fundamental accounting concept that you will learn is the **Accounting Equation**. The accounting equation is defined as follows:

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

Assets represent items of value within the business. Examples include cash, accounts receivable (monies owed to the business from a customer), supplies, equipment, and land.

Liabilities represent the portion of the assets that are owed to entities outside of the business. Examples include outstanding loans, mortgages, and monies received in advance of services rendered (for example, a sports team receiving season ticket revenue before the actual games are played has not yet earned the money, and therefore it owes entertainment to its fans).

Owner's Equity represents the portion of the assets that are not owed to entities outside of the business. As a result, the owner(s) of the business can lay claim to this portion of the assets. For example, an owner could lay claim to an investment he/she has made in the business, and therefore this would represent owner's equity.

So, stated in different terms, the accounting equation dictates that all items of value (assets) equal the portion of the assets owed to others (liabilities), plus the portion of the assets not owed to others (owner's equity).

TIP! Another perspective on the accounting equation is that money is raised to purchase assets in two ways. It can either be borrowed from individuals outside of the business (liabilities), or contributed by the owners of the business (owner's equity). This is why assets must automatically equal liabilities plus owner's equity.

A Closer LOOK

What Are the Differences Between Business Types?

Businesses can be formed as one of three different primary types of legal entities: sole proprietorships, partnerships, and corporations.

A sole proprietorship is owned by one individual. One benefit of a sole proprietorship is that the owner may make decisions without consulting others. Another primary benefit is that the profits from the business are only taxed once, on the owner's individual tax return. A third benefit is that a sole proprietorship is a simpler form of business, and therefore easier to start. One significant drawback is that the owner has unlimited liability, which means that his/her personal assets could be jeopardized in a legal proceeding. Another drawback is that the owner must rely entirely on his own experience to effectively run the business. A small business such as Nathan's Donut School could be organized as a sole proprietorship.

A partnership is owned by two or more individuals. A partnership is similar to a sole proprietorship in that its profits are taxed once, and its owners have unlimited liability. However, as there are multiple owners, decisions must be agreed upon by each of them, and profits must be shared. In spite of this, the benefits of having multiple owners, each with a particular expertise, can outweigh the previously-listed drawbacks.

A corporation issues shares of stock to its owners, and can be either public (any investor may purchase an ownership stake) or private (only certain investors are permitted to purchase an ownership stake; these are often family-owned). The primary benefit of corporations is that they offer limited liability to each owner. Although an owner's investment in the corporation could be lost if the business fails, each owner's personal assets are fully protected. The primary drawback of corporations is that they are subject to double-taxation. The profits from a corporation are taxed first on the business tax return, and once again on individual tax returns when they are distributed to the owners in the form of dividends. 

Case In Point 1-1

Manipulate the Accounting Equation

Throughout this textbook you will be provided with examples that illustrate the use of recently-introduced concepts. In this example, we will determine the missing amount within each independent accounting equation.

1. Assets = \$7,500, Liabilities = \$3,000, Owner's Equity = \$X.

The accounting equation dictates that $7,500 = 3,000 + X$. Subtract \$3,000 from both sides of the equation to arrive at $4,500 = X$. Owner's Equity equals \$4,500 in this example.

The accounting equation is nothing more than a basic algebraic equation. In these examples, you are simply solving for "X."

2. Assets = \$13,000, Liabilities = \$X, Owner's Equity = \$9,250.

In this example, $\$13,000 = \$X + \$9,250$. Subtract \$9,250 from both sides to arrive at $\$3,750 = \X . Liabilities equal \$3,750.

3. Assets = \$X, Liabilities = \$24,500, Owner's Equity = \$45,000.

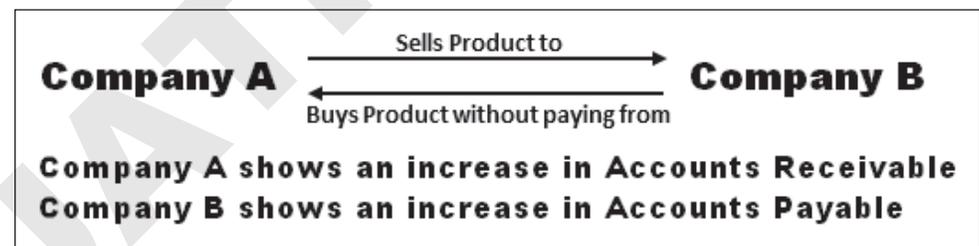
In this example, $\$X = \$24,500 + \$45,000$. Simply add together the components on the right side of the equation to arrive at $\$X = \$69,500$. Assets equal \$69,500.

Using Account Names and Descriptions

Within each category of the accounting equation can be found a variety of accounts. A number of asset accounts, such as Cash, Accounts Receivable, and Supplies, were listed above. Others include Prepaid Insurance, Buildings, and Patents.

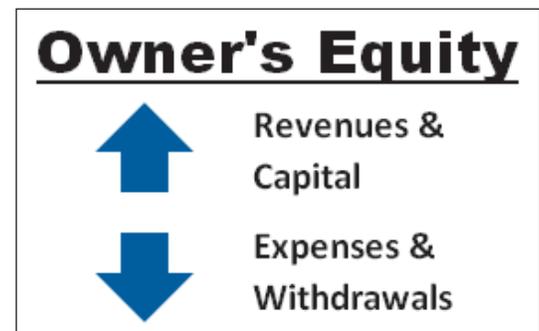
Liability accounts include Accounts Payable (monies owed for purchases usually made in the past few months), Notes Payable (similar to accounts payable; monies owed for which a formal document has been signed by both parties), and Salaries Payable (monies owed to employees).

When Company A sells a product to Company B (which doesn't immediately pay), accounts receivable is impacted for one company while accounts payable is impacted for the other company.



Owner's Equity accounts include expense accounts such as Rent Expense and Utilities Expense (costs of doing business), revenue accounts such as Sales Revenue (monies earned from the sale of goods as part of the typical operations of the business) and Service Revenue (monies earned from providing services as part of the typical operations of the business), and Drawing (withdrawals made by the owner).

While revenues and capital increase owner's equity, expenses and withdrawals decrease it.



Listing of Common Accounts

Assets	Liabilities	Owner's Equity
Cash	Accounts Payable	Sales Revenue
Accounts Receivable	Notes Payable	Service Revenue
Supplies	Salaries Payable	Rent Expense
Prepaid Insurance	Unearned Revenue	Utilities Expense
Inventory	Mortgage Payable	Telephone Expense
Equipment		John Doe, Capital
Buildings		John Doe, Drawing
Land		

TIP! Different companies utilize different account names. Although the overall list of account names is far too long to memorize (or even identify), you'll find that there is a core list of accounts that are used in the majority of transactions.

When a transaction occurs, it is important that the correct accounts be identified. Therefore, you should focus heavily on understanding what each account represents.

Case In Point 1-2

Identify the Account Type

In this example, we will determine whether each account listed is an Asset, Liability, or Owner's Equity account.

1. Rent Revenue

This account represents revenue earned from renting out a facility. All revenue accounts are **Owner's Equity** accounts.

2. Buildings

This account represents the cost of all buildings that have been purchased. Buildings are valuable to a business, and therefore this is an **Asset** account.

3. Accounts Receivable

This account represents monies that are owed to a business, and that are due to be paid in the short term (typically within a few months). Accounts receivables are typically generated when goods are sold, or services are provided, and payment is not immediately made. As an Accounts Receivable is valuable to a business, it is an **Asset** account.

NOTE! The Notes Receivable account operates in a similar manner to Accounts Receivable. However, it is due to be paid at least 12 months later (long-term), and is associated with a formal document signed by both parties (buyer and seller).

4. Telephone Expense

This account represents expenses incurred for telephone usage. All Expense accounts are **Owner's Equity** accounts.

5. Accounts Payable

This account represents monies that are owed to others by the business, and that are due to be paid in the short term (typically within a few months). Accounts Payables are typically generated when goods are bought, or services are received, and payment is not immediately made. As an account payable is an amount that is owed to others, it is a **Liability** account.

6. Nathaniel H. Spencer, Drawing

This account represents monies that were withdrawn from the business by the owner. Similar to revenues and expenses, all drawing accounts are **Owner's Equity** accounts.

7. Supplies

This account represents the cost of unused supplies currently held by the business. Because supplies are valuable to the business, this is an **Asset** account.

Evaluating a Transaction

As you have seen, a transaction represents a single business event that has occurred. The purchase of a machine, the payment of a debt, and the withdrawal of cash for personal use would each comprise a single transaction. When a transaction takes place, the concept of **Double-Entry Bookkeeping** dictates that at least two accounts must be impacted. It is possible that many more accounts could be impacted by a single transaction, but in order for the accounting equation to remain in balance, there always must be at least two.

NOTE! A number of concepts, such as Double-Entry Bookkeeping, will be introduced throughout this book. All of these approaches are mandated by **Generally Accepted Accounting Principles (GAAP)**, which are currently established by the **Financial Accounting Standards Board (FASB)**.

When evaluating a transaction, a three-step process should be undertaken:

- **Step 1:** Determine which accounts have been impacted. For example, if a company purchases equipment for cash, then the two accounts impacted are Cash and Equipment.

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- **Step 2:** Determine whether the balance (expressed in terms of monetary value) in each account has increased or decreased. In the above example, equipment was purchased, therefore the equipment account balance has increased. Cash was paid out, therefore the cash account balance has decreased.
- **Step 3:** Determine by how much each account has been impacted. If there are only two accounts that are affected, then they will both be affected by the same amount. However, if there are more than two accounts affected, you will need to look more closely to determine by how much each account has changed.

When evaluating a transaction, be certain to always view the transaction from the perspective of your business. In the above example, cash was received by another company, but for our purposes this has no consequence. We are only concerned with the fact that our business now has less cash than it did before, therefore our cash account balance has decreased.

An illustration of the approach you should take when evaluating a transaction in which \$1,500 of furniture is purchased for cash is as follows:

Accounts Impacted	Increase or Decrease?	Dollar Amount
Furniture	Increase	\$1,500
Cash	Decrease	\$1,500

Case In Point 1-3

Determine the Impact on Accounts

In this example, we will determine which accounts have been impacted by each transaction, and by how much they have either increased or decreased.

1. Nathaniel invests \$35,000 to open Nathan's Donut School.

Step 1: Cash was invested in the business, and since none of the \$35,000 is owed to anybody, Nathaniel can claim ownership of the entire amount. Therefore, the **Cash** account and the **Nathaniel H. Spencer, Capital** account (which represents Nathaniel's share of the equity), are impacted.

Step 2: As a result of the investment, the company has more cash than it did before. Nathaniel's ownership interest has also increased, as he is now the owner of more assets. Therefore, both accounts have **increased**.

Step 3: Since \$35,000 was invested by Nathaniel, both the cash account and the **Nathaniel H. Spencer, Capital** account have increased by **\$35,000**.

Assets = Liabilities + Owner's Equity				
+ \$35,000	=	\$0	+	+ \$35,000

2. Nathan's Donut School pays \$20,000 for baking equipment.

Step 1: Cash was paid to complete the purchase, and baking equipment was obtained. Therefore, the **Cash** and **Equipment** accounts are impacted.

Step 2: Nathan's Donut School now has less cash than it did before, but it has more equipment. Therefore, the cash account has **decreased** and the equipment account has **increased**.

Step 3: Since \$20,000 was paid to obtain the baking equipment, the cash account decreases by **\$20,000**, while the equipment account increases by **\$20,000**.

Assets = Liabilities + Owner's Equity			
+ \$20,000	=	\$0	+ \$0
- \$20,000			
\$0			

NOTE! As seen in this transaction, it is possible for all affected accounts to appear on only one side of the accounting equation.

- The company purchases \$500 of supplies and \$1,000 of furniture on account.

NOTE! When an asset is purchased on account, cash is not paid when the asset is acquired, but instead is owed.

Step 1: Both supplies and furniture were obtained, and cash was not paid. As a result, the **Supplies**, **Furniture**, and **Accounts Payable** (an amount owed to others) accounts are all impacted.

Step 2: The Company now has more supplies and furniture. In addition, Nathan's Donut School owes more money than it did before the transaction. Therefore, all three accounts have **increased**.

Step 3: In this transaction, each account is impacted by a different amount. Supplies increased by **\$500**, furniture increased by **\$1,000**, and because the total amount is owed, Accounts Payable increased by **\$1,500**.

Assets = Liabilities + Owner's Equity			
+ \$500	=	+ \$1,500	+ \$0
+ \$1,000			

- Nathan's Donut School opens for business, and on its first day earns \$850. As of now, the company only accepts cash payments.

Step 1: The Company received cash in exchange for services, and in doing so has earned revenue. Therefore, the **Cash** account and **Service Revenue** account were impacted.

Step 2: The Company has more cash than it did before, and has now earned more revenue than it had previously. Therefore, both accounts have **increased**.

Step 3: As \$850 was both earned and received for these services, both accounts increased by **\$850**.

Assets = Liabilities + Owner's Equity			
+ \$850	=	\$0	+ \$850

- The company pays off the \$1,500 that was owed from the purchase of supplies and furniture. This represents a cash payment on account.

Step 1: Cash has been paid out, and an amount owed to others has been paid off, so the **Cash** account and the **Accounts Payable** account have been impacted.

Step 2: The Company now has less cash, and owes less than it did before, so both accounts have **decreased**.

Step 3: Since \$1,500 was paid out to reduce the liability, both accounts are reduced by **\$1,500**.

Assets = Liabilities + Owner's Equity				
-\$1,500	=	-\$1,500	+	\$0

TIP! Over time you will not need to work through each step independently, as practice will improve your ability to quickly analyze a transaction. Your speed will also increase as you commit to memory whether each account is an asset, liability, or owner's equity account.

Recording Transactions

The benefit to recording transactions is that a company can maintain a running balance of the value in each account. This allows the company to review its financial position at any point in time. To calculate these account balances, we must combine the impact of every transaction. This may be done by creating a chart in which all active accounts are listed on top, and a row is created for each transaction.

When listing transactions, accounts are displayed within each section of the accounting equation.

Assets					=	Liabilities	+
	Cash	Accounts Receivable	Supplies	Furniture	Equipment	Accounts Payable	
Owner's Equity							
Nathaniel H. Spencer, Capital	Nathaniel H. Spencer, Drawing	Service Revenue	Advertising Expense	Rent Expense			

Case In Point 1-4 Record Transactions

In this example, we will record transactions and calculate the ending balances for each account.

- Nathaniel invests \$35,000 to open Nathan's Donut School.

		Assets					=	Liabilities	+
		Cash	Accounts Receivable	Supplies	Furniture	Equipment			
								Accounts Payable	
Transaction #1		\$ 35,000							

		Owner's Equity				
Nathaniel H. Spencer, Capital	Nathaniel H. Spencer, Drawing	Service Revenue	Advertising Expense			Rent Expense
\$ 35,000						

- Nathan's Donut School pays \$20,000 for baking equipment.

		Assets					=	Liabilities	+
		Cash	Accounts Receivable	Supplies	Furniture	Equipment			
								Accounts Payable	
Transaction #2		\$ (20,000)				\$ 20,000			

		Owner's Equity				
Nathaniel H. Spencer, Capital	Nathaniel H. Spencer, Drawing	Service Revenue	Advertising Expense			Rent Expense

Parentheses surrounding an amount indicate that it is a negative number.

- The company purchases \$500 of supplies and \$1,000 of furniture from Office Space on account.

The result of this transaction is that the company has more supplies, more furniture, and more accounts payable than it did before, therefore all of the amounts displayed are positive (each account is increasing).

		Assets					=	Liabilities	+
		Cash	Accounts Receivable	Supplies	Furniture	Equipment			
								Accounts Payable	
Transaction #3				\$ 500	\$ 1,000			\$ 1,500	

		Owner's Equity				
Nathaniel H. Spencer, Capital	Nathaniel H. Spencer, Drawing	Service Revenue	Advertising Expense			Rent Expense

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4. Nathan’s Donut School opens for business, and on its first day earns \$850 cash.

		Assets					=	Liabilities	+	
		Cash	Accounts Receivable	Supplies	Furniture	Equipment				
Transaction #4		\$ 850					Accounts Payable			
		Owner's Equity								
		Nathaniel H. Spencer, Capital	Nathaniel H. Spencer, Drawing	Service Revenue	Advertising Expense	Rent Expense				
				\$ 850						

5. The company pays off the \$1,500 that was owed from the purchase of supplies and furniture.

		Assets					=	Liabilities	+	
		Cash	Accounts Receivable	Supplies	Furniture	Equipment				
Transaction #5		\$ (1,500)					Accounts Payable		\$ (1,500)	
		Owner's Equity								
		Nathaniel H. Spencer, Capital	Nathaniel H. Spencer, Drawing	Service Revenue	Advertising Expense	Rent Expense				

6. On its second day of operations, Nathan’s Donut School earns \$2,500 on account from SportCo.

NOTE! Although companies typically earn revenue consistently throughout a given month, for simplicity you will not examine any further revenue transactions for the current month of operations of Nathan’s Donut School.

		Assets					=	Liabilities	+	
		Cash	Accounts Receivable	Supplies	Furniture	Equipment				
Transaction #6			\$ 2,500				Accounts Payable			
		Owner's Equity								
		Nathaniel H. Spencer, Capital	Nathaniel H. Spencer, Drawing	Service Revenue	Advertising Expense	Rent Expense				
				\$ 2,500						

7. The company purchases advertising in local newspapers for \$250.

		Assets					=	Liabilities	+	
		Cash	Accounts Receivable	Supplies	Furniture	Equipment				
Transaction #7		\$ (250)					Accounts Payable			
		Owner's Equity								
		Nathaniel H. Spencer, Capital	Nathaniel H. Spencer, Drawing	Service Revenue	Advertising Expense	Rent Expense				
					\$ (250)					

Both expenses and withdrawals reduce owner's equity, as they result in fewer assets to which the owner can lay claim. As a result, an increase in either expense or withdrawal accounts is expressed as a negative amount.

8. The company receives \$300 on account (in partial payment for the previously-earned revenue).

		Assets					=	Liabilities	+	
		Cash	Accounts Receivable	Supplies	Furniture	Equipment				
Transaction #8		\$ 300	\$ (300)				Accounts Payable			
		Owner's Equity								
		Nathaniel H. Spencer, Capital	Nathaniel H. Spencer, Drawing	Service Revenue	Advertising Expense	Rent Expense				

Although the company was owed \$2,500 from the transaction in step 6, only a portion of that amount is paid here. Regardless of the amount paid, this transaction type always leads to an increase in cash and a decrease in accounts receivable.

9. Nathan's Donut School pays rent of \$1,700 for the month.

		Assets					=	Liabilities	+	
		Cash	Accounts Receivable	Supplies	Furniture	Equipment				
Transaction #9		\$ (1,700)					Accounts Payable			
		Owner's Equity								
		Nathaniel H. Spencer, Capital	Nathaniel H. Spencer, Drawing	Service Revenue	Advertising Expense	Rent Expense				
						\$ (1,700)				

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10. Nathaniel withdraws \$400 from the business for his own personal use.

		Assets					=	Liabilities	+
		Cash	Accounts Receivable	Supplies	Furniture	Equipment			
								Accounts Payable	
Transaction #10		\$ (400)							
Owner's Equity									
		Nathaniel H. Spencer, Capital	Nathaniel H. Spencer, Drawing	Service Revenue	Advertising Expense	Rent Expense			
			\$ (400)						

11. Based on the above transactions, determine the ending balances for each account.

		Assets					=	Liabilities	+	
		Cash	Accounts Receivable	Supplies	Furniture	Equipment				
								Accounts Payable		
Transaction #1		\$ 35,000								
Transaction #2		\$ (20,000)				\$ 20,000				
Transaction #3				\$ 500	\$ 1,000		\$ 1,500			
Transaction #4		\$ 850								
Transaction #5		\$ (1,500)					\$ (1,500)			
Transaction #6			\$ 2,500							
Transaction #7		\$ (250)								
Transaction #8		\$ 300	\$ (300)							
Transaction #9		\$ (1,700)								
Transaction #10		\$ (400)								
Ending Balance		\$ 12,300	\$ 2,200	\$ 500	\$ 1,000	\$ 20,000	\$ -			
		\$36,000						\$0		
Owner's Equity										
		Nathaniel H. Spencer, Capital	Nathaniel H. Spencer, Drawing	Service Revenue	Advertising Expense	Rent Expense				
		\$ 35,000								
				\$ 850						
				\$ 2,500						
					\$ (250)					
						\$ (1,700)				
			\$ (400)							
		\$ 35,000	\$ (400)	\$ 3,350	\$ (250)	\$ (1,700)				
		\$36,000								

Notice that the final totals displayed below the accounting equation have remained in balance.

A Closer LOOK**How Would a Company Handle the Sale of a Product?**

As Nathan's Donut School is a culinary school, it does not sell a product, but instead provides a service (baking lessons) to its clients. For a company that does sell a product, a slightly more complicated approach to the transaction is required.

Transactions in which inventory is sold are unique, in that they are recorded by using two sets of accounts instead of one as you have seen in all prior examples. This is because when selling inventory, the company must both remove the inventory from its books and add the revenue earned to its books.

Therefore, not only do the revenue and cash (or accounts receivable, if the customer has not yet paid) accounts increase, but the Cost of Goods Sold expense account increases (to account for the money the seller originally paid for the item), and the Inventory account decreases (as the seller now has less inventory).

NOTE! Cost of Goods Sold is an expense account that represents the original cost to a business of inventory that is sold. Don't confuse this with the sales price that a business charges, which is typically higher than the original cost of the inventory. 📌

Concepts Review

To check your knowledge of the key concepts introduced in this chapter, complete the Concepts Review quiz by choosing the appropriate access option below.

If you are...	Then access the quiz by...
Using eLab	Logging in, choosing Content, and navigating to the Concepts Review quiz for this chapter
Not using eLab	Going to the Student Resource Center for this book

Putting It Together

PIT 1-1 Record the Transactions

Amber's Lacrosse Emporium offers sporting goods for all sports, with an emphasis on lacrosse, and is owned and operated by Amber Stein. In this exercise, using a worksheet based on the accounting equation, you will record the following transactions that took place during the first month of operations.

- Amber invests \$75,000 to open Amber's Lacrosse Emporium.

Assets							=	Liabilities	+
Cash	Accounts Receivable	Supplies	Inventory	Furniture	Equipment		Accounts Payable		
Transaction #1	\$ 75,000								

Owner's Equity								
Amber Stein, Capital	Amber Stein, Drawing	Sales Revenue	Cost of Goods Sold	Advertising Expense	Rent Expense	Wages Expense	Telephone Expense	Utilities Expense
\$ 75,000								

- Amber's Lacrosse Emporium pays \$15,000 for sporting goods inventory.

Assets							=	Liabilities	+
Cash	Accounts Receivable	Supplies	Inventory	Furniture	Equipment		Accounts Payable		
Transaction #2	\$ (15,000)		\$ 15,000						

Owner's Equity								
Amber Stein, Capital	Amber Stein, Drawing	Sales Revenue	Cost of Goods Sold	Advertising Expense	Rent Expense	Wages Expense	Telephone Expense	Utilities Expense

3. The company purchases display equipment for \$12,000 in cash.

		Assets						=	Liabilities		+
		Cash	Accounts Receivable	Supplies	Inventory	Furniture	Equipment			Accounts Payable	
Transaction #3		\$ (12,000)					\$ 12,000				
		Owner's Equity									
Amber Stein, Capital	Amber Stein, Drawing	Sales Revenue	Cost of Goods Sold	Advertising Expense	Rent Expense	Wages Expense	Telephone Expense	Utilities Expense			

4. Amber pays rent on the company's retail location of \$1,500.

		Assets						=	Liabilities		+
		Cash	Accounts Receivable	Supplies	Inventory	Furniture	Equipment			Accounts Payable	
Transaction #4		\$ (1,500)									
		Owner's Equity									
Amber Stein, Capital	Amber Stein, Drawing	Sales Revenue	Cost of Goods Sold	Advertising Expense	Rent Expense	Wages Expense	Telephone Expense	Utilities Expense			
					\$ (1,500)						

5. The company purchases \$750 of supplies and \$2,000 of furniture on account.

		Assets						=	Liabilities		+
		Cash	Accounts Receivable	Supplies	Inventory	Furniture	Equipment			Accounts Payable	
Transaction #5				\$ 750		\$ 2,000				\$ 2,750	
		Owner's Equity									
Amber Stein, Capital	Amber Stein, Drawing	Sales Revenue	Cost of Goods Sold	Advertising Expense	Rent Expense	Wages Expense	Telephone Expense	Utilities Expense			

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6. Amber’s Lacrosse Emporium opens for business, and on its first day sells \$2,400 of sporting goods for cash. The cost of the goods sold is \$1,350.

		Assets						=	Liabilities		+
		Cash	Accounts Receivable	Supplies	Inventory	Furniture	Equipment			Accounts Payable	
Transaction #6		\$ 2,400									
Transaction #6					\$ (1,350)						

Owner's Equity								
Amber Stein, Capital	Amber Stein, Drawing	Sales Revenue	Cost of Goods Sold	Advertising Expense	Rent Expense	Wages Expense	Telephone Expense	Utilities Expense
		\$ 2,400						
			\$ (1,350)					

Remember that transactions involving inventory require the altering of two different sets of accounts. The first pair of accounts impacted (Cash & Sales Revenue) recognize the revenue earned, while the second pair of accounts impacted (Inventory & Cost of Goods Sold) recognize the expense incurred in order to sell these goods.

7. The company pays the \$2,750 that was owed from the purchase of supplies and furniture.

		Assets						=	Liabilities		+
		Cash	Accounts Receivable	Supplies	Inventory	Furniture	Equipment			Accounts Payable	
Transaction #7		\$ (2,750)								\$ (2,750)	

Owner's Equity								
Amber Stein, Capital	Amber Stein, Drawing	Sales Revenue	Cost of Goods Sold	Advertising Expense	Rent Expense	Wages Expense	Telephone Expense	Utilities Expense

8. On its second day of operations, Amber’s Lacrosse Emporium sells \$1,450 of sporting goods for cash. It also sells another \$3,000 of sporting goods to a local school district on account. The cost of all the goods sold is \$2,100.

		Assets						=	Liabilities		+
		Cash	Accounts Receivable	Supplies	Inventory	Furniture	Equipment			Accounts Payable	
Transaction #8		\$ 1,450	\$ 3,000								
Transaction #8					\$ (2,100)						

Owner's Equity								
Amber Stein, Capital	Amber Stein, Drawing	Sales Revenue	Cost of Goods Sold	Advertising Expense	Rent Expense	Wages Expense	Telephone Expense	Utilities Expense
		\$ 4,450						
			\$ (2,100)					

9. The company purchases advertising in local newspapers for \$600.

		Assets						=	Liabilities		+
		Cash	Accounts Receivable	Supplies	Inventory	Furniture	Equipment			Accounts Payable	
Transaction #9		\$ (600)									
		Owner's Equity									
Amber Stein, Capital	Amber Stein, Drawing	Sales Revenue	Cost of Goods Sold	Advertising Expense	Rent Expense	Wages Expense	Telephone Expense	Utilities Expense			
				\$ (600)							

10. The company receives \$2,100 in partial payment for the sporting goods previously sold to the local school district on account.

		Assets						=	Liabilities		+
		Cash	Accounts Receivable	Supplies	Inventory	Furniture	Equipment			Accounts Payable	
Transaction #10		\$ 2,100	\$ (2,100)								
		Owner's Equity									
Amber Stein, Capital	Amber Stein, Drawing	Sales Revenue	Cost of Goods Sold	Advertising Expense	Rent Expense	Wages Expense	Telephone Expense	Utilities Expense			

11. Amber's Lacrosse Emporium pays wages of \$1,600 to its employees.

		Assets						=	Liabilities		+
		Cash	Accounts Receivable	Supplies	Inventory	Furniture	Equipment			Accounts Payable	
Transaction #11		\$ (1,600)									
		Owner's Equity									
Amber Stein, Capital	Amber Stein, Drawing	Sales Revenue	Cost of Goods Sold	Advertising Expense	Rent Expense	Wages Expense	Telephone Expense	Utilities Expense			
						\$ (1,600)					

12. The company pays its telephone bill of \$135.

		Assets						=	Liabilities		+
		Cash	Accounts Receivable	Supplies	Inventory	Furniture	Equipment			Accounts Payable	
Transaction #12		\$ (135)									
		Owner's Equity									
Amber Stein, Capital	Amber Stein, Drawing	Sales Revenue	Cost of Goods Sold	Advertising Expense	Rent Expense	Wages Expense	Telephone Expense	Utilities Expense			
							\$ (135)				

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13. The company pays \$200 for monthly utilities.

Assets							=	Liabilities	+	
Cash	Accounts Receivable	Supplies	Inventory	Furniture	Equipment					
								Accounts Payable		
Transaction #13	\$	(200)								
Owner's Equity										
Amber Stein, Capital	Amber Stein, Drawing	Sales Revenue	Cost of Goods Sold	Advertising Expense	Rent Expense	Wages Expense	Telephone Expense	Utilities Expense		
								\$	(200)	

14. Amber's Lacrosse Emporium buys an additional \$2,000 of sporting equipment inventory on account.

Assets							=	Liabilities	+	
Cash	Accounts Receivable	Supplies	Inventory	Furniture	Equipment					
								Accounts Payable		
Transaction #14			\$	2,000				\$	2,000	
Owner's Equity										
Amber Stein, Capital	Amber Stein, Drawing	Sales Revenue	Cost of Goods Sold	Advertising Expense	Rent Expense	Wages Expense	Telephone Expense	Utilities Expense		

15. Amber withdraws \$600 from the business.

Assets							=	Liabilities	+	
Cash	Accounts Receivable	Supplies	Inventory	Furniture	Equipment					
								Accounts Payable		
Transaction #15	\$	(600)								
Owner's Equity										
Amber Stein, Capital	Amber Stein, Drawing	Sales Revenue	Cost of Goods Sold	Advertising Expense	Rent Expense	Wages Expense	Telephone Expense	Utilities Expense		
	\$	(600)								

Knowledge Check A

KCa 1-1 Manipulate the Accounting Equation

Determine the missing amount within each independent circumstance, based on the accounting equation. These represent different month-end balances for Molly's Modeling Agency. Molly W. Virginia owns the company, which provides representation and guidance for aspiring models. An Excel template, in which your answer(s) may be entered, can be found in the Student Resource Center.

1. Assets = \$15,750, Liabilities = \$6,250, Owner's Equity = \$X.
2. Assets = \$158,000, Liabilities = \$X, Owner's Equity = \$102,000.
3. Assets = \$X, Liabilities = \$2,500, Owner's Equity = \$5,000.

KCa 1-2 Determine Ending Accounting Equation Balances

Examine three independent circumstances, and determine the ending balances for assets, liabilities, and owner's equity, based on the information provided below.

1. Beginning of year: Assets = \$27,000, Liabilities = \$19,000, Owner's Equity = \$X.
During the year: Assets increase by \$2,000, Liabilities decrease by \$4,000.
2. Beginning of year: Assets = \$X, Liabilities = \$5,500, Owner's Equity = \$10,000.
During the year: Assets decrease by \$1,500, Owner's Equity decreases by \$950.
3. Beginning of year: Assets = \$59,000, Liabilities = \$X, Owner's Equity = \$41,000.
During the year: Liabilities increase by \$6,500, Owner's Equity decreases by \$2,250.

KCa 1-3 Advanced Accounting Equation Work

Determine the first year beginning balances for each accounting equation element after examining two years of activity.

1. End of second year: Assets = \$138,500, Liabilities = \$49,000, Owner's Equity = \$X.
During the second year: Assets decrease by \$12,000, Liabilities decrease by \$3,500.
During the first year: Liabilities decrease by \$7,500, Owner's Equity increases by \$500.
2. End of second year: Assets = \$X, Liabilities = \$21,000, Owner's Equity = \$68,000.
During the second year: Assets increase by \$4,500, Owner's Equity decreases by \$900.
During the first year: Assets decrease by \$2,200, Liabilities decrease by \$7,500.

3. End of second year: Assets = \$6,600, Liabilities = \$X, Owner's Equity = \$2,700.

During the second year: Liabilities increase by \$1,900, Owner's Equity increases by \$300.

During the first year: Assets increase by \$1,100, Owner's Equity decreases by \$200.

KCa 1-4 Identify the Account Type

Determine whether each account listed is an Asset, Liability, or Owner's Equity account.

1. Cash: _____
2. John Doe, Capital: _____
3. Rent Expense: _____
4. Sales Revenue: _____
5. Notes Receivable: _____
6. Supplies Expense: _____
7. Furniture: _____

KCa 1-5 Distinguish Between Different Accounts

Write one or two sentences describing the difference between the two listed accounts.

1. Accounts Receivable and Accounts Payable

2. Rent Revenue and Rent Expense

3. John Doe, Capital and John Doe, Drawing

4. Accounts Receivable and Notes Receivable

5. John Doe, Capital, and Cash

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KCa 1-6 Determine the Impact on Accounts

Determine which accounts have been impacted by each transaction, and by how much they have either increased or decreased.

1. William Martin invests \$150,000 to open his new company.

2. The company purchased a building for \$65,000 cash, and furniture for \$12,000 cash.

3. The company earned revenue of \$2,500 for services rendered. It is paid \$1,500 now, and is owed the remaining \$1,000.

4. The company purchased \$4,500 of equipment on account.

5. The company paid \$2,100 of the \$4,500 that it owed for the previously purchased equipment.

6. The company paid \$250 for telephone expenses.

7. The company paid \$825 for weekly employee salaries.

8. The company is paid the remaining \$1,000 it is owed from the previously rendered services.

9. The company purchased \$600 of supplies on account.

10. William Martin withdrew \$13,000 from the company for his own personal use.

KCa 1-7 Record Transactions

Record transactions and calculate the ending balances for each account. An Excel template, in which your answer(s) may be entered, can be found in the Student Resource Center.

1. Martin Johnson invests \$425,000 to open his new appliance repair business.
2. The company pays \$150,000 for land and \$70,000 for a building.
3. Martin repairs appliances for three customers. Two of these paid cash totaling \$825, while the third customer was billed \$300, but has not yet paid.
4. The company purchases radio advertisements for \$3,000 cash.
5. The company purchases a car for \$23,000 by taking out a no-interest automobile loan.
6. Martin repairs appliances for two customers, receiving a total of \$500 in cash.
7. The company makes its first automobile loan payment of \$475.
8. The company pays \$350 for utilities expense.
9. The company pays \$2,000 for employee salaries.
10. Martin withdraws \$10,000 from the business.
11. Based on the above transactions, determine the ending balances for each account.

Knowledge Check B

KCb 1-1 Manipulate the Accounting Equation

Determine the missing amount within each independent circumstance, based on the accounting equation. These represent different month-end balances for Heart Breaker Records. Samuel Collins owns the company, which produces albums in a wide variety of musical genres.

1. Assets = \$325,000, Liabilities = \$92,000, Owner's Equity = \$X.
2. Assets = \$49,000, Liabilities = \$X, Owner's Equity = \$43,000.
3. Assets = \$X, Liabilities = \$32,000, Owner's Equity = \$197,000.

KCb 1-2 Determine Ending Accounting Equation Balances

Examine three independent circumstances, and determine the ending balances for assets, liabilities, and owner's equity, based on the information provided below.

1. Beginning of year: Assets = \$15,000, Liabilities = \$4,000, Owner's Equity = \$X.
During the year: Assets decrease by \$600, Liabilities decrease by \$1,300.
2. Beginning of year: Assets = \$X, Liabilities = \$28,500, Owner's Equity = \$50,000.
During the year: Assets decrease by \$9,200, Owner's Equity increases by \$1,350.
3. Beginning of year: Assets = \$140,000, Liabilities = \$X, Owner's Equity = \$99,000.
During the year: Liabilities decrease by \$14,000, Owner's Equity increases by \$8,400.

KCb 1-3 Advanced Accounting Equation Work

For each independent circumstance, determine the first year beginning balances for each accounting equation element after examining two years of activity.

1. End of second year: Assets = \$61,000, Liabilities = \$13,000, Owner's Equity = \$X.
During the second year: Assets decrease by \$8,000, Liabilities decrease by \$800.
During the first year: Liabilities increase by \$2,100, Owner's Equity decreases by \$5,000.
2. End of second year: Assets = \$X, Liabilities = \$6,000, Owner's Equity = \$24,000.
During the second year: Assets decrease by \$3,200, Owner's Equity increases by \$200.
During the first year: Assets increase by \$6,300, Liabilities increase by \$4,100.
3. End of second year: Assets = \$188,200, Liabilities = \$X, Owner's Equity = \$155,000.
During the second year: Liabilities decrease by \$18,400, Owner's Equity decreases by \$9,200.
During the first year: Assets increase by \$5,700, Owner's Equity increases by \$9,300.

KCb 1-4 Identify the Account Type

Determine whether each account listed is an Asset, Liability, or Owner's Equity account.

1. Wages Expense: _____
2. Interest Revenue: _____
3. Land: _____
4. Loan Payable: _____
5. John Doe, Drawing: _____
6. Utilities Expense: _____
7. Supplies: _____

KCb 1-5 Distinguish Between Different Accounts

Write one or two sentences describing the difference between the two listed accounts.

1. Interest Revenue and Interest Expense

2. Loans Receivable and Loans Payable

3. John Doe, Withdrawals and Rent Expense

4. Notes Payable and Accounts Payable

5. Telephone Expense and Utilities Expense

KCb 1-6 Determine the Impact on Accounts

Determine which accounts have been impacted by each transaction, and by how much they have either increased or decreased.

1. Maximillian Smith invests \$70,000 to open his new company.

2. The company purchased a truck for \$32,000 cash.

3. Prior to performing any services, the company purchases \$2,400 of insurance for the first year of operations.

NOTE! Insurance purchased in advance of its use is an asset (it is valuable to a company) and is referred to as *Prepaid Insurance*.

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4. Maximillian performed \$1,100 of services, and was paid in full.

5. The company paid \$825 for office expenses.

6. Maximillian performed \$1,400 of services. The customer paid for half of the services, and owes the remainder.

7. The company paid \$425 for employee wages.

8. The company received \$300 of the amount owed for previously performed services.

9. The company purchased \$2,200 of equipment on account.

10. Maximillian withdrew \$1,000 from the company.

KCb 1-7 Record Transactions

Record transactions and calculate the ending balances for each account. An Excel template, in which your answer(s) may be entered, can be found in the Student Resource Center.

1. Katherine Johnson invests \$200,000 to open her new antique shop.
2. The company pays \$35,000 for inventory.
3. The company purchases supplies on account for \$650.
4. On its first day of operations, the company sells \$1,850 of merchandise for cash. The cost of the merchandise sold is \$775.
5. The company pays off the full amount owed for the previously purchased supplies.
6. The company pays \$110 for telephone expense.
7. On its second day of operations, the company sells \$2,300 of merchandise for cash. The cost of the merchandise sold is \$1,115.
8. The company sells \$6,200 of merchandise to a local business on account. The cost of the merchandise sold is \$4,000.
9. The company pays \$1,250 for employee wages.
10. Katherine withdraws \$5,500 from the business.
11. Based on the above transactions, determine the ending balances for each account.