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Evaluating Transactions

LABYRINTH
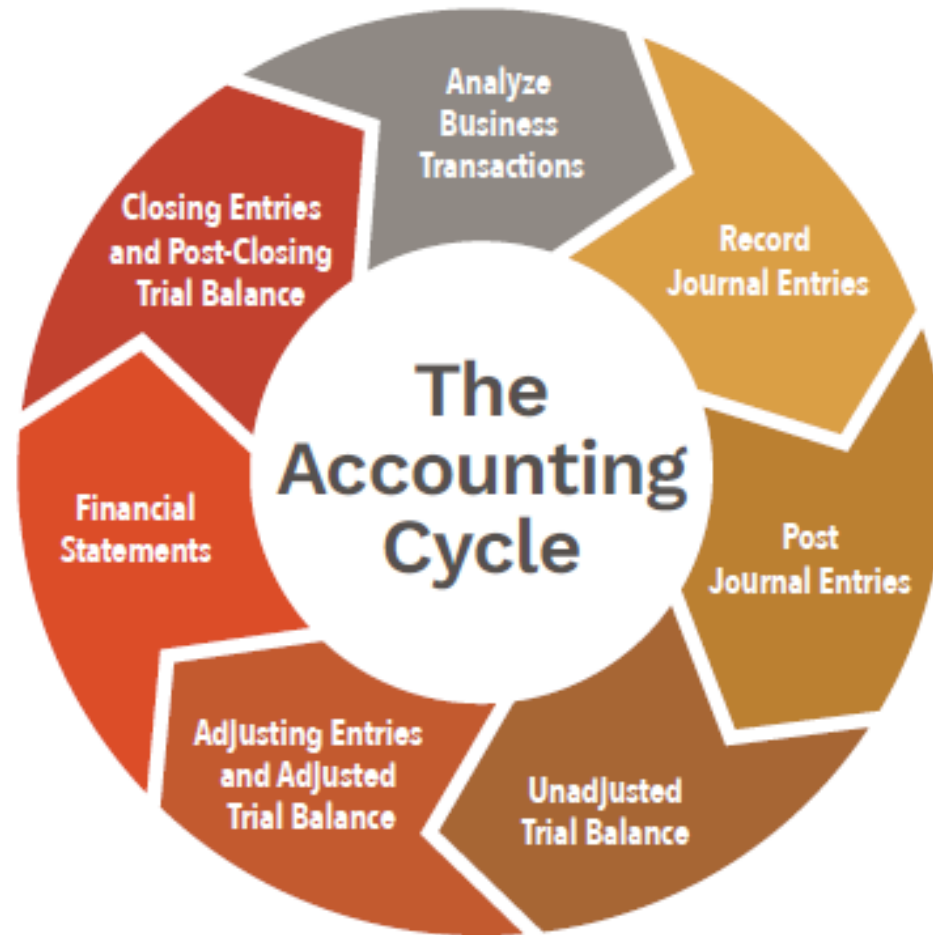LEARNING®

LEARNING OBJECTIVES

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

The Accounting Cycle

Duties of a Bookkeeper

- **Confidentiality:** Business information may only be disclosed with proper authority.

- **Security:** Corporate information must be protected and kept in confidence.

- **Integrity:** A bookkeeper must act in accordance with both applicable professional standards and all applicable laws.

Using the Accounting Equation

Assets = Liabilities + Owner's Equity

- **Assets:** Items of value within a business
- **Liabilities:** The portion of assets that are owed to entities outside the business
- **Owner's Equity:** The portion of assets that are not owed to entities outside the business

Business Types

- **Sole proprietorship:** Owned by one individual
- **Partnership:** Owned by two or more individuals
- **Corporation:** Issues shares of stock to their owners; can be public or private

Common Accounts

COMMON ACCOUNTS BY TYPE		
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
Merchandise Inventory	Mortgage Payable	Telephone Expense
Equipment		John Doe, Capital
Buildings		John Doe, Drawing
Land		

Evaluating Transactions

Evaluating a transaction is a three-step process:

- **Step #1:** Determine which accounts are impacted.
- **Step #2:** Determine whether the balance in each account increases or decreases.
- **Step #3:** Determine by how much each account is impacted.

Evaluating Transactions—Example

On its first day of business, Nathan's Donut School earns $850 in cash:

- **Step #1:** The *Cash* and *Service Revenue* accounts are impacted.
- **Step #2:** Both accounts have *increased*.
- **Step #3:** Both accounts are impacted by *$850*.

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

Recording Transactions

Recording Transactions—Example

On its first day of business, Nathan's Donut School earns $850 in cash:

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
$ 850										$ 850		

Recording Transactions—Example

Ending balances are calculated for each account:

	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					
Transaction #4	$ 850								$ 850		
Transaction #5	$ (1,500)					$ (1,500)					
Transaction #6	$ 2,500								$ 2,500		
Transaction #7	$ (250)									$ (250)	
Transaction #8	$ 300	$ (300)									
Transaction #9	$ (1,700)										$ (1,700)
Transaction #10	$ (400)							$ (400)		$ (250)	$ (1,700)
Ending Balance	$ 12,300	$ 2,200	$ 500	$ 1,000	$ 20,000	$ -	$ 35,000	$ (400)	$ 3,350		
	$ 36,000					= $0 +	$ 36,000				