

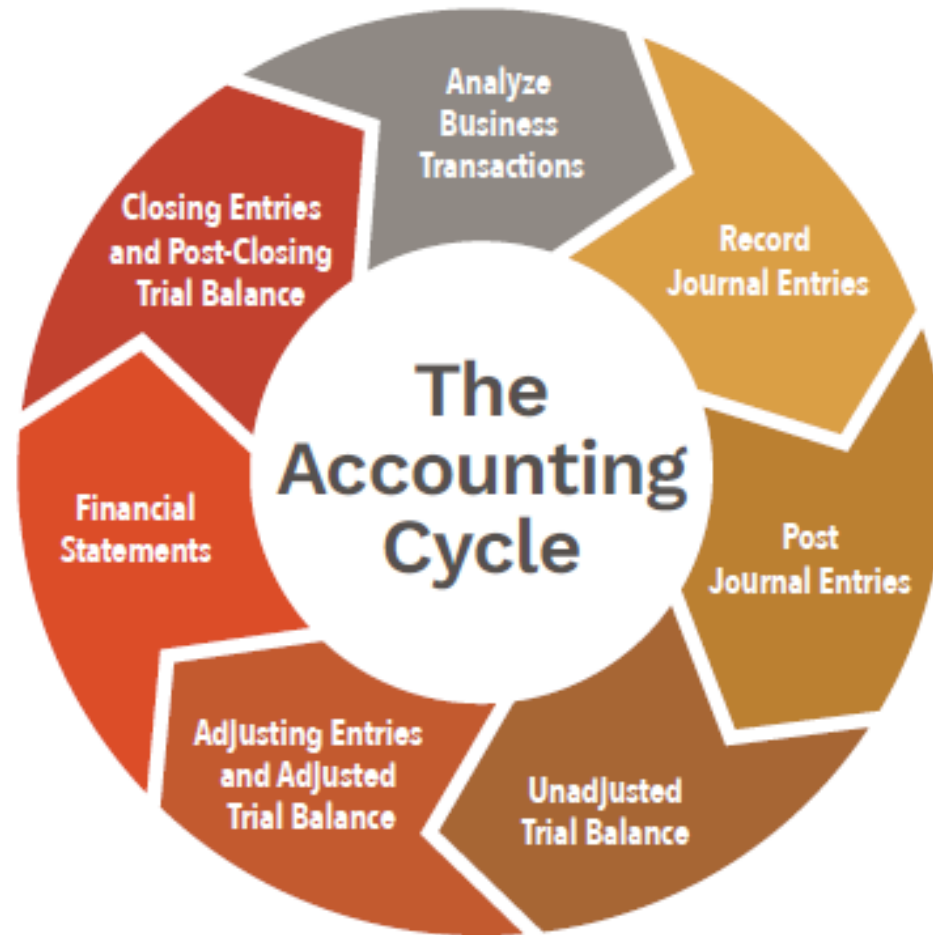
# 1

## Evaluating Transactions

# 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 for Sole Proprietorships 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

Three-step process:

1. Determine which accounts are impacted.
2. Determine whether the balance in each account increases or decreases.
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:

1. The *Cash* and *Service Revenue* accounts are impacted.
2. Both accounts have *increased*.
3. Both accounts are impacted by \$850.

|                 |          |                    |          |                       |
|-----------------|----------|--------------------|----------|-----------------------|
| <b>Assets</b>   | <b>=</b> | <b>Liabilities</b> | <b>+</b> | <b>Owner's Equity</b> |
| <b>\$35,000</b> |          | <b>\$0</b>         |          | <b>\$35,000</b>       |

# Recording Transactions

The accounting equation

Active company accounts, organized by account type (asset, liability, owner's equity)

|      |                     | 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 |  |
|      |                     |          |           |           |  |                  |                               |                               |                 |                     |              |  |
|      |                     |          |           |           |  |                  |                               |                               |                 |                     |              |  |
|      |                     |          |           |           |  |                  |                               |                               |                 |                     |              |  |
|      |                     |          |           |           |  |                  |                               |                               |                 |                     |              |  |

Transactions are listed across the rows.

# 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<br>Advertising Expense<br>Rent Expense |
| \$ 850 |                     |          |           |           |   |                  |   |                               |                               | \$ 850   |

# Recording Transactions Example

Ending balances are calculated for each account:

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