After studying this chapter, you should be able to:

1. Analyze the effect of business transactions on the basic accounting equation.
2. Explain what an account is and how it helps in the recording process.
3. Define debits and credits and explain how they are used to record business transactions.
4. Identify the basic steps in the recording process.
5. Explain what a journal is and how it helps in the recording process.
6. Explain what a ledger is and how it helps in the recording process.
7. Explain what posting is and how it helps in the recording process.
8. Explain the purposes of a trial balance.
9. Classify cash activities as operating, investing, or financing.
How organized are you financially? Take a short quiz. Answer yes or no to each question:

- Does your wallet contain so many cash machine receipts that you’ve been declared a walking fire hazard?
- Is your wallet such a mess that it is often faster to fish for money in the crack of your car seat than to dig around in your wallet?
- Was Steve Nash playing high school basketball the last time you balanced your bank account?
- Have you ever been tempted to burn down your house so you don’t have to try to find all of the receipts and records that you need to fill out your tax returns?

If you think it is hard to keep track of the many transactions that make up your life, imagine what it is like for a major corporation like Fidelity Investments. Fidelity is one of the largest mutual fund management firms in the world. If you had your life savings invested at Fidelity Investments, you might be just slightly displeased if, when you called to find out your balance, the representative said, “You know, I kind of remember someone with a name like yours sending us some money—now what did we do with that?”

To ensure the accuracy of your balance and the security of your funds, Fidelity Investments, like all other companies large and small, relies on a sophisticated accounting information system. That’s not to say that Fidelity or any other company is error-free. In fact, if you’ve ever really messed up your checkbook register, you may take some comfort from one accountant’s mistake at Fidelity Investments. The accountant failed to include a minus sign while doing a calculation, making what was actually a $1.3 billion loss look like a $1.3 billion gain—yes, billion! Fortunately, like most accounting errors, it was detected before any real harm was done.

No one expects that kind of mistake at a company like Fidelity, which has sophisticated computer systems and top investment managers. In explaining the mistake to shareholders, a spokesperson wrote, “Some people have asked how, in this age of technology, such a mistake could be made. While many of our processes are computerized, accounting systems are complex and dictate that some steps must be handled manually by our managers and accountants, and people can make mistakes.”
The Accounting Information System

As indicated in the Feature Story, a reliable information system is a necessity for any company. The purpose of this chapter is to explain and illustrate the features of an accounting information system. The organization and content of the chapter are as follows.

**The Accounting Information System**

- **Accounting Transactions**
  - Analyzing transactions
  - Summary of transactions
- **The Account**
  - Debits and credits
  - Debit and credit procedures
  - Stockholders’ equity relationships
  - Summary of debit/credit rules
- **Steps in the Recording Process**
  - The journal
  - The ledger
  - Chart of accounts
  - Posting
- **The Recording Process Illustrated**
  - Summary illustration of journalizing and posting
- **The Trial Balance**
  - Limitations of a trial balance

**The Accounting Information System**

The system of collecting and processing transaction data and communicating financial information to decision makers is known as the accounting information system. Factors that shape these systems include: the nature of the company’s business, the types of transactions, the size of the company, the volume of data, and the information demands of management and others.

Most businesses use computerized accounting systems—sometimes referred to as electronic data processing (EDP) systems. These systems handle all the steps involved in the recording process, from initial data entry to preparation of the financial statements. In order to remain competitive, companies continually improve their accounting systems to provide accurate and timely data for decision making. For example, in a recent annual report, Tootsie Roll states, “We also invested in additional processing and data storage hardware during the year. We view information technology as a key strategic tool, and are committed to deploying leading edge technology in this area.” In addition, many companies have upgraded their accounting information systems in response to the requirements of Sarbanes-Oxley.

In this chapter, we focus on a manual accounting system because the accounting concepts and principles do not change whether a system is computerized or manual, and manual systems are easier to illustrate.

**Accounting Transactions**

To use an accounting information system, you need to know which economic events to recognize (record). Not all events are recorded and reported in the financial statements. For example, suppose General Motors hired a new employee or purchased a new computer. Are these events entered in its accounting records? The first event would not be recorded, but the second event would. We call economic events that require recording in the financial statements accounting transactions.

An accounting transaction occurs when assets, liabilities, or stockholders’ equity items change as a result of some economic event. The purchase of a
computer by General Motors, the payment of rent by Microsoft, and the sale of a multi-day guided trip by Sierra Corporation are examples of events that change a company’s assets, liabilities, or stockholders’ equity. Illustration 3-1 summarizes the decision process companies use to decide whether or not to record economic events.

**Illustration 3-1**
Transaction identification process

<table>
<thead>
<tr>
<th>Events</th>
<th>Criterion</th>
<th>Record/Don’t Record</th>
</tr>
</thead>
<tbody>
<tr>
<td>Purchase computer</td>
<td>Is the financial position (assets, liabilities, or stockholders’ equity) of the company changed?</td>
<td>Record</td>
</tr>
<tr>
<td>Discuss guided trip options with potential customer</td>
<td></td>
<td>Don’t record</td>
</tr>
<tr>
<td>Pay rent</td>
<td>IsValid the financial position (assets, liabilities, or stockholders’ equity) of the company changed?</td>
<td>Record</td>
</tr>
</tbody>
</table>

**ANALYZING TRANSACTIONS**

In Chapter 1, you learned the basic accounting equation:

\[
\text{Assets} = \text{Liabilities} + \text{Stockholders' Equity}
\]

In this chapter, you will learn how to analyze transactions in terms of their effect on assets, liabilities, and stockholders’ equity. **Transaction analysis** is the process of identifying the specific effects of economic events on the accounting equation.

The accounting equation must always balance. Each transaction has a dual (double-sided) effect on the equation. For example, if an individual asset is increased, there must be a corresponding:

- Decrease in another asset, or
- Increase in a specific liability, or
- Increase in stockholders’ equity.

Two or more items could be affected when an asset is increased. For example, if a company purchases a computer for $10,000 by paying $6,000 in cash and signing a note for $4,000, one asset (equipment) increases $10,000, another asset (cash) decreases $6,000, and a liability (notes payable) increases $4,000.
The result is that the accounting equation remains in balance—assets increased by a net $4,000 and liabilities increased by $4,000, as shown below.

\[
\begin{array}{ccc}
\text{Assets} & = & \text{Liabilities} + \text{Stockholders’ Equity} \\
+10,000 & = & +4,000 \\
-6,000 & & \\
\hline \\
4,000 & = & 4,000 \\
\end{array}
\]

Chapter 1 presented the financial statements for Sierra Corporation for its first month. You should review those financial statements (on page 17) at this time. To illustrate how economic events affect the accounting equation, we will examine events affecting Sierra Corporation during its first month.

In order to analyze the transactions for Sierra Corporation, we will expand the basic accounting equation. This will allow us to better illustrate the impact of transactions on stockholders’ equity. Recall from the balance sheets in Chapters 1 and 2 that stockholders’ equity is comprised of two parts: common stock and retained earnings. Common stock is affected when the company issues new shares of stock in exchange for cash. Retained earnings is affected when the company earns revenue, incurs expenses, or pays dividends. Illustration 3-2 shows the expanded equation.

Illustration 3-2 Expanded accounting equation

If you are tempted to skip ahead after you’ve read a few of the following transaction analyses, don’t do it. Each has something unique to teach, something you’ll need later. (We assure you that we’ve kept them to the minimum needed!)

**EVENT (1). INVESTMENT OF CASH BY STOCKHOLDERS.** On October 1, cash of $10,000 is invested in the business by investors (primarily your friends and family) in exchange for $10,000 of common stock. This event is an accounting transaction because it results in an increase in both assets and stockholders’ equity.

<table>
<thead>
<tr>
<th>Basic Analysis</th>
<th>Equation Analysis</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>The asset Cash is increased $10,000, and stockholders’ equity (specifically Common Stock) is increased $10,000.</strong></td>
<td><strong>Assets</strong> = <strong>Liabilities</strong> + <strong>Stockholders’ Equity</strong></td>
</tr>
<tr>
<td><strong>Cash</strong> = <strong>$10,000</strong></td>
<td><strong>Common Stock</strong> = <strong>$10,000</strong> <strong>Issued stock</strong></td>
</tr>
</tbody>
</table>

(1)
The equation is in balance after the issuance of common stock. Keeping track of the source of each change in stockholders’ equity is essential for later accounting activities. In particular, items recorded in the revenue and expense columns are used for the calculation of net income.

**EVENT (2). NOTE ISSUED IN EXCHANGE FOR CASH.** On October 1, Sierra borrowed $5,000 from Castle Bank by signing a 3-month, 12%, $5,000 note payable. This transaction results in an equal increase in assets and liabilities. The specific effect of this transaction and the cumulative effect of the first two transactions are:

<table>
<thead>
<tr>
<th>Basic Analysis</th>
<th>Equation Analysis</th>
</tr>
</thead>
<tbody>
<tr>
<td>The asset Cash is increased $5,000, and the liability Notes Payable is increased $5,000.</td>
<td></td>
</tr>
</tbody>
</table>

The asset Cash is increased $5,000, and the liability Notes Payable is increased $5,000.

\[
\begin{align*}
\text{Assets} & = \text{Liabilities} + \text{Stockholders’ Equity} \\
\text{Cash} & = \text{Notes Payable} + \text{Common Stock} \\
$10,000 & = +$5,000 + $10,000 \\
\end{align*}
\]

Total assets are now $15,000, and liabilities plus stockholders’ equity also total $15,000.

**EVENT (3). PURCHASE OF OFFICE EQUIPMENT FOR CASH.** On October 2, Sierra purchased equipment by paying $5,000 cash to Superior Equipment Sales Co. This event is a transaction because an equal increase and decrease in Sierra’s assets occur.

<table>
<thead>
<tr>
<th>Basic Analysis</th>
<th>Equation Analysis</th>
</tr>
</thead>
<tbody>
<tr>
<td>The asset Equipment is increased $5,000; the asset Cash is decreased $5,000.</td>
<td></td>
</tr>
</tbody>
</table>

The asset Equipment is increased $5,000; the asset Cash is decreased $5,000.

\[
\begin{align*}
\text{Assets} & = \text{Liabilities} + \text{Stockholders’ Equity} \\
\text{Cash} + \text{Equipment} & = \text{Notes Payable} + \text{Common Stock} \\
$15,000 & = +$5,000 + $10,000 \\
\end{align*}
\]

The total assets are now $15,000, and liabilities plus stockholders’ equity also total $15,000.

**EVENT (4). RECEIPT OF CASH IN ADVANCE FROM CUSTOMER.** On October 2, Sierra received a $1,200 cash advance from R. Knox, a client. This event is a transaction because Sierra received cash (an asset) for guide services for multi-day trips that are expected to be completed by Sierra in the future. Although Sierra received cash, it does not record revenue until it has performed the work. In some industries, such as the magazine and airline industries, customers are expected to prepay. These companies have a liability to the customer until they deliver the magazines or provide the flight. When the company eventually provides the product or service, it records the revenue.
Later, when Sierra collects the $10,000 from the customer, Accounts Receivable declines by $10,000, and Cash increases by $10,000.

Since Sierra received cash prior to performance of the service, Sierra has a liability for the work due.

EVENT (5). SERVICES PROVIDED FOR CASH. On October 3, Sierra received $10,000 in cash from Copa Company for guide services performed for a corporate event. This event is a transaction because Sierra received an asset (cash) in exchange for services.

Guide service is the principal revenue-producing activity of Sierra. Revenue increases stockholders’ equity. This transaction, then, increases both assets and stockholders’ equity.

The asset Cash is increased $10,000; the revenue Service Revenue is increased $10,000.

Often companies provide services “on account.” That is, they provide service for which they are paid at a later date. Revenue, however, is earned when services are performed. Therefore, revenues would increase when services are performed, even though cash has not been received. Instead of receiving cash, the company receives a different type of asset, an account receivable. Accounts receivable represent the right to receive payment at a later date. Suppose that Sierra had provided these services on account rather than for cash. This event would be reported using the accounting equation as:

Later, when Sierra collects the $10,000 from the customer, Accounts Receivable declines by $10,000, and Cash increases by $10,000.
Note that in this case, revenues are not affected by the collection of cash. Instead we record an exchange of one asset (Accounts Receivable) for a different asset (Cash).

**EVENT (6). PAYMENT OF RENT.** On October 3, Sierra Corporation paid its office rent for the month of October in cash, $900. This rent payment is a transaction because it results in a decrease in an asset, cash.

Rent is an expense incurred by Sierra Corporation in its effort to generate revenues. **Expenses decrease stockholders’ equity.** Sierra records the rent payment by decreasing cash and increasing expenses to maintain the balance of the accounting equation.

**EVENT (7). PURCHASE OF INSURANCE POLICY FOR CASH.** On October 4, Sierra paid $600 for a one-year insurance policy that will expire next year on September 30. Payments of expenses that will benefit more than one accounting period are identified as assets called prepaid expenses or prepayments.

The balance in total assets did not change; one asset account decreased by the same amount that another increased.
EVENT (8). PURCHASE OF SUPPLIES ON ACCOUNT. On October 5, Sierra purchased supplies on account from Aero Supply for $2,500. In this case, “on account” means that the company receives goods or services that it will pay for at a later date.

The asset Supplies is increased $2,500; the liability Accounts Payable is increased $2,500.

EVENT (9). HIRING OF NEW EMPLOYEES. On October 9, Sierra hired four new employees to begin work on October 15. Each employee will receive a weekly salary of $500 for a five-day work week, payable every two weeks. Employees will receive their first paychecks on October 26. On the date Sierra hires the employees, there is no effect on the accounting equation because the assets, liabilities, and stockholders' equity of the company have not changed.

An accounting transaction has not occurred. There is only an agreement that the employees will begin work on October 15. (See Event (11) for the first payment.)

EVENT (10). PAYMENT OF DIVIDEND. On October 20, Sierra paid a $500 dividend. Dividends are a reduction of stockholders’ equity but not an expense. Dividends are not included in the calculation of net income. Instead, a dividend is a distribution of the company’s assets to its stockholders.

The dividends account is increased $500; the asset Cash is decreased $500.

EVENT (11). PAYMENT OF CASH FOR EMPLOYEE SALARIES. Employees have worked two weeks, earning $4,000 in salaries, which were paid on October 26.
Salaries Expense is an expense that reduces stockholders’ equity. This event is a transaction because assets and stockholders’ equity are affected.

**Basic Analysis**

The asset Cash is decreased $4,000; the expense account Salaries Expense is increased $4,000.

**Equation Analysis**

\[
\begin{align*}
\text{Assets} & = \text{Liabilities} + \text{Stockholders’ Equity} \\
\text{Cash} + \text{Sup} + \text{Prepd} + \text{Equipment} & = \text{Notes} + \text{Accts} + \text{Unearned} + \text{Common} + \text{Retained Earnings} \\
\$19,200 + \$2,500 + \$600 + \$5,000 & = \$5,000 + \$2,500 + \$1,200 + \$10,000 + \$10,000 \\
-4,000 & = -4,000 \\
\$15,200 + \$2,500 + \$600 + \$5,000 & = \$5,000 + \$2,500 + \$1,200 + \$10,000 + \$10,000 - \$4,900 - \$500 \\
$23,300 & = $23,300
\end{align*}
\]

**Salaries Expense**

**Investor Insight**

**Why Accuracy Matters**

While most companies record transactions very carefully, the reality is that mistakes still happen. For example, bank regulators fined Bank One Corporation (now Chase) $1.8 million because they felt that the unreliability of the bank’s accounting system caused it to violate regulatory requirements.

Also, in recent years Fannie Mae, the government-chartered mortgage association, announced a series of large accounting errors. These announcements caused alarm among investors, regulators, and politicians because they fear that the errors may suggest larger, undetected problems. This is important because the home-mortgage market depends on Fannie Mae to buy hundreds of billions of dollars of mortgages each year from banks, thus enabling the banks to issue new mortgages.

Finally, before a major overhaul of its accounting system, the financial records of Waste Management Company were in such disarray that of the company’s 57,000 employees, 10,000 were receiving pay slips that were in error.

The Sarbanes-Oxley Act of 2002 was created to minimize the occurrence of errors like these by increasing every employee’s responsibility for accurate financial reporting.

In order for these companies to prepare and issue financial statements, their accounting equations (debits and credits) must have been in balance at year-end. How could these errors or misstatements have occurred? (See page 158.)

**SUMMARY OF TRANSACTIONS**

Illustration 3-3 (page 110) summarizes the transactions of Sierra Corporation to show their cumulative effect on the basic accounting equation. It includes the transaction number in the first column on the left. The right-most column shows the specific effect of any transaction that affects stockholders’ equity. Remember that Event (9) did not result in a transaction, so no entry is included for that event. The illustration demonstrates three important points:

1. Each transaction is analyzed in terms of its effect on assets, liabilities, and stockholders’ equity.
2. The two sides of the equation must always be equal.
3. The cause of each change in stockholders’ equity must be indicated.
### Illustration 3-3  
Summary of transactions

<table>
<thead>
<tr>
<th>Assets</th>
<th>Liabilities</th>
<th>Stockholders' Equity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>Supplies</td>
<td>Prepaid</td>
</tr>
<tr>
<td></td>
<td>Insur.</td>
<td>Equipment</td>
</tr>
<tr>
<td></td>
<td>Notes</td>
<td>Accrs.</td>
</tr>
<tr>
<td></td>
<td>Unearned</td>
<td>Serv. Rev.</td>
</tr>
<tr>
<td>+$10,000</td>
<td>+$5,000</td>
<td>+$1,200</td>
</tr>
<tr>
<td>+$10,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>+$5,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>+$5,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>$32,150</td>
<td>+$7,000</td>
<td>=</td>
</tr>
<tr>
<td>$39,150</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Common Stock</th>
<th>Rev.</th>
<th>Exp.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Retained Earnings</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Stockholders' Equity</th>
<th>Issued stock</th>
</tr>
</thead>
<tbody>
<tr>
<td>Service Revenue</td>
<td>$10,000</td>
</tr>
<tr>
<td>Rent Expense</td>
<td>$900</td>
</tr>
<tr>
<td>Dividends</td>
<td>$500</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Stockholders' Equity</th>
<th>Issued stock</th>
</tr>
</thead>
<tbody>
<tr>
<td>Service Revenue</td>
<td>$10,000</td>
</tr>
<tr>
<td>Rent Expense</td>
<td>$900</td>
</tr>
<tr>
<td>Dividends</td>
<td>$500</td>
</tr>
</tbody>
</table>

### DECISION TOOLKIT

**DECISION CHECKPOINTS**
- Has an accounting transaction occurred?
- Details of the event
- Accounting equation
- If the event affected assets, liabilities, or stockholders’ equity, then record as a transaction.

**INFO NEEDED FOR DECISION**
- Accounting equation

**TOOL TO USE FOR DECISION**
- Accounting equation

**HOW TO EVALUATE RESULTS**
- Keep the accounting equation in balance.
- Remember that a change in an asset will require a change in another asset, a liability, or in stockholders’ equity.

### Before you go on...

**Do it!**

A tabular analysis of the transactions made by Roberta Mendez & Co., a certified public accounting firm, for the month of August is shown below. Each increase and decrease in stockholders’ equity is explained.

<table>
<thead>
<tr>
<th>Assets</th>
<th>Liabilities</th>
<th>Stockholders’ Equity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>Equipment</td>
<td>Accounts</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Payable</td>
</tr>
<tr>
<td>+$25,000</td>
<td>+$7,000</td>
<td>+$7,000</td>
</tr>
<tr>
<td>+$25,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>+$8,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>−$850</td>
<td></td>
<td></td>
</tr>
<tr>
<td>$32,150</td>
<td>+$7,000</td>
<td>=</td>
</tr>
<tr>
<td>$39,150</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Common Stock</th>
<th>Revenue</th>
<th>Expenses</th>
</tr>
</thead>
<tbody>
<tr>
<td>Retained Earnings</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Stockholders' Equity</th>
<th>Issued stock</th>
</tr>
</thead>
<tbody>
<tr>
<td>Service Revenue</td>
<td>$10,000</td>
</tr>
<tr>
<td>Rent Expense</td>
<td>$900</td>
</tr>
<tr>
<td>Dividends</td>
<td>$500</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Common Stock</th>
<th>Revenue</th>
<th>Expenses</th>
</tr>
</thead>
<tbody>
<tr>
<td>Retained Earnings</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

### Action Plan
- Analyze the tabular analysis to determine the nature and effect of each transaction.
- Keep the accounting equation in balance.
- Remember that a change in an asset will require a change in another asset, a liability, or in stockholders’ equity.

### Solution

1. The company issued shares of stock to stockholders for $25,000 cash.
2. The company purchased $7,000 of equipment on account.
3. The company received $8,000 of cash in exchange for services performed.
4. The company paid $850 for this month’s rent.

Related exercise material: **BE3-1, BE3-2, BE3-3, Do it! 3-1, E3-1, E3-2, E3-3, and E3-4.**
The Account

Rather than using a tabular summary like the one in Illustration 3-3 for Sierra Corporation, an accounting information system uses accounts. An **account** is an individual accounting record of increases and decreases in a specific asset, liability, stockholders’ equity, revenue, or expense item. For example, Sierra Corporation has separate accounts for Cash, Accounts Receivable, Accounts Payable, Service Revenue, Salaries Expense, and so on. (Note that whenever we are referring to a specific account, we capitalize the name.)

In its simplest form, an account consists of three parts: (1) the title of the account, (2) a left or debit side, and (3) a right or credit side. Because the alignment of these parts of an account resembles the letter T, it is referred to as a **T account**. The basic form of an account is shown in Illustration 3-4.

We use this form of account often throughout this book to explain basic accounting relationships.

**DEBITS AND CREDITS**

The term **debit** indicates the left side of an account, and **credit** indicates the right side. They are commonly abbreviated as Dr. for debit and Cr. for credit. They do not mean increase or decrease, as is commonly thought. We use the terms debit and credit repeatedly in the recording process to describe where entries are made in accounts. For example, the act of entering an amount on the left side of an account is called debiting the account. Making an entry on the right side is crediting the account.

When comparing the totals of the two sides, an account shows a **debit balance** if the total of the debit amounts exceeds the credits. An account shows a **credit balance** if the credit amounts exceed the debits. Note the position of the debit side and credit side in Illustration 3-4.

The procedure of recording debits and credits in an account is shown in Illustration 3-5 for the transactions affecting the Cash account of Sierra Corporation. The data are taken from the Cash column of the tabular summary in Illustration 3-3.
Every positive item in the tabular summary represents a receipt of cash; every negative amount represents a payment of cash. Notice that in the account form we record the increases in cash as debits, and the decreases in cash as credits. For example, the $10,000 receipt of cash (in red) is debited to Cash, and the −$5,000 payment of cash (in blue) is credited to Cash.

Having increases on one side and decreases on the other reduces recording errors and helps in determining the totals of each side of the account as well as the account balance. The balance is determined by netting the two sides (subtracting one amount from the other). The account balance, a debit of $15,200, indicates that Sierra had $15,200 more increases than decreases in cash. That is, since it started with a balance of zero, it has $15,200 in its Cash account.

DEBIT AND CREDIT PROCEDURES

Each transaction must affect two or more accounts to keep the basic accounting equation in balance. In other words, for each transaction, debits must equal credits. The equality of debits and credits provides the basis for the double-entry accounting system.

Under the double-entry system, the two-sided effect of each transaction is recorded in appropriate accounts. This system provides a logical method for recording transactions. The double-entry system also helps to ensure the accuracy of the recorded amounts and helps to detect errors such as those at Fidelity Investments as discussed in the Feature Story. If every transaction is recorded with equal debits and credits, then the sum of all the debits to the accounts must equal the sum of all the credits. The double-entry system for determining the equality of the accounting equation is much more efficient than the plus/minus procedure used earlier.

Dr./Cr. Procedures for Assets and Liabilities

In Illustration 3-5 for Sierra Corporation, increases in Cash—an asset—were entered on the left side, and decreases in Cash were entered on the right side. We know that both sides of the basic equation (Assets = Liabilities + Stockholders’ Equity) must be equal. It therefore follows that increases and decreases in liabilities will have to be recorded opposite from increases and decreases in assets. Thus, increases in liabilities must be entered on the right or credit side, and decreases in liabilities must be entered on the left or debit side. The effects that debits and credits have on assets and liabilities are summarized in Illustration 3-6.

<table>
<thead>
<tr>
<th>Debits</th>
<th>Credits</th>
</tr>
</thead>
<tbody>
<tr>
<td>Increase assets</td>
<td>Decrease assets</td>
</tr>
<tr>
<td>Decrease liabilities</td>
<td>Increase liabilities</td>
</tr>
</tbody>
</table>

Asset accounts normally show debit balances. That is, debits to a specific asset account should exceed credits to that account. Likewise, liability accounts normally show credit balances. That is, credits to a liability account should exceed debits to that account. The normal balances may be diagrammed as in Illustration 3-7.

<table>
<thead>
<tr>
<th>Assets</th>
<th>Liabilities</th>
</tr>
</thead>
<tbody>
<tr>
<td>Debit for increase</td>
<td>Debit for decrease</td>
</tr>
<tr>
<td>Normal balance</td>
<td>Normal balance</td>
</tr>
<tr>
<td>Credit for decrease</td>
<td>Credit for increase</td>
</tr>
</tbody>
</table>

International Note: Rules for accounting for specific events sometimes differ across countries. For example, European companies rely less on historical cost and more on fair value than U.S. companies. Despite the differences, the double-entry accounting system is the basis of accounting systems worldwide.
Knowing which is the normal balance in an account may help when you are trying to identify errors. For example, a credit balance in an asset account, such as Land, or a debit balance in a liability account, such as Salaries Payable, usually indicates errors in recording. Occasionally, however, an abnormal balance may be correct. The Cash account, for example, will have a credit balance when a company has overdrawn its bank balance (written a check that “bounced”). In automated accounting systems, the computer is programmed to flag violations of the normal balance and to print out error or exception reports. In manual systems, careful visual inspection of the accounts is required to detect normal balance problems.

**Dr./Cr. Procedures for Stockholders’ Equity**

In Chapter 1, we indicated that stockholders’ equity is comprised of two parts: common stock and retained earnings. In the transaction events earlier in this chapter, you saw that revenues, expenses, and the payment of dividends affect retained earnings. Therefore, the subdivisions of stockholders’ equity are: common stock, retained earnings, dividends, revenues, and expenses.

**COMMON STOCK.** Common stock is issued to investors in exchange for the stockholders’ investment. The common stock account is increased by credits and decreased by debits. For example, when cash is invested in the business, cash is debited and common stock is credited. The effects of debits and credits on the common stock account are shown in Illustration 3-8.

<table>
<thead>
<tr>
<th>Debits</th>
<th>Credits</th>
</tr>
</thead>
<tbody>
<tr>
<td>Decrease Common Stock</td>
<td>Increase Common Stock</td>
</tr>
</tbody>
</table>

The normal balance in the Common Stock account may be diagrammed as in Illustration 3-9.

**RETAINED EARNINGS.** Retained earnings is net income that is retained in the business. It represents the portion of stockholders’ equity that has been accumulated through the profitable operation of the company. Retained earnings is increased by credits (for example, by net income) and decreased by debits (for example, by a net loss), as shown in Illustration 3-10.

<table>
<thead>
<tr>
<th>Debits</th>
<th>Credits</th>
</tr>
</thead>
<tbody>
<tr>
<td>Decrease Retained Earnings</td>
<td>Increase Retained Earnings</td>
</tr>
</tbody>
</table>

Helpful Hint: The normal balance is the side where increases in the account are recorded.
The normal balance for Retained Earnings may be diagrammed as in Illustration 3-11.

**Illustration 3-11** Normal balance—Retained Earnings

<table>
<thead>
<tr>
<th>Retained Earnings</th>
</tr>
</thead>
<tbody>
<tr>
<td>Debit for decrease</td>
</tr>
<tr>
<td>Credit for increase</td>
</tr>
</tbody>
</table>

**DIVIDENDS.** A dividend is a distribution by a corporation to its stockholders. The most common form of distribution is a cash dividend. Dividends result in a reduction of the stockholders’ claims on retained earnings. Because dividends reduce stockholders’ equity, increases in the Dividends account are recorded with debits. As shown in Illustration 3-12, the Dividends account normally has a debit balance.

**Illustration 3-12** Normal balance—Dividends

<table>
<thead>
<tr>
<th>Dividends</th>
</tr>
</thead>
<tbody>
<tr>
<td>Debit for increase</td>
</tr>
<tr>
<td>Credit for decrease</td>
</tr>
</tbody>
</table>

**REVENUES AND EXPENSES.** When a company earns revenues, stockholders’ equity is increased. Revenue accounts are increased by credits and decreased by debits.

**Expenses decrease stockholders’ equity.** Thus, expense accounts are increased by debits and decreased by credits. The effects of debits and credits on revenues and expenses are shown in Illustration 3-13.

**Illustration 3-13** Debit and credit effects—revenues and expenses

<table>
<thead>
<tr>
<th>Debits</th>
<th>Credits</th>
</tr>
</thead>
<tbody>
<tr>
<td>Decrease revenue</td>
<td>Increase revenue</td>
</tr>
<tr>
<td>Increase expenses</td>
<td>Decrease expenses</td>
</tr>
</tbody>
</table>

Credits to revenue accounts should exceed debits; debits to expense accounts should exceed credits. Thus, **revenue accounts normally show credit balances, and expense accounts normally show debit balances.** The normal balances may be diagrammed as in Illustration 3-14.

**Illustration 3-14** Normal balances—revenues and expenses

<table>
<thead>
<tr>
<th>Expenses</th>
<th>Revenues</th>
</tr>
</thead>
<tbody>
<tr>
<td>Debit for increase</td>
<td>Credit for increase</td>
</tr>
<tr>
<td>Credit for decrease</td>
<td>Debit for decrease</td>
</tr>
</tbody>
</table>
STOCKHOLDERS’ EQUITY RELATIONSHIPS
Companies report the subdivisions of stockholders’ equity in various places in the financial statements:

- Common stock and retained earnings: in the stockholders’ equity section of the balance sheet.
- Dividends: on the retained earnings statement.
- Revenues and expenses: on the income statement.

Dividends, revenues, and expenses are eventually transferred to retained earnings at the end of the period. As a result, a change in any one of these three items affects stockholders’ equity. Illustration 3-15 shows the relationships of the accounts affecting stockholders’ equity.

**Illustration 3-15**
Stockholders’ equity relationships

**Investor Insight**
Keeping Score
The Chicago Cubs baseball team has these major revenue and expense accounts:

<table>
<thead>
<tr>
<th>Revenues</th>
<th>Expenses</th>
</tr>
</thead>
<tbody>
<tr>
<td>Admissions (ticket sales)</td>
<td>Players' salaries</td>
</tr>
<tr>
<td>Concessions</td>
<td>Administrative salaries</td>
</tr>
<tr>
<td>Television and radio</td>
<td>Travel</td>
</tr>
<tr>
<td>Advertising</td>
<td>Ballpark maintenance</td>
</tr>
</tbody>
</table>

Do you think that the Chicago Bears football team would be likely to have the same major revenue and expense accounts as the Cubs? (See page 158.)
SUMMARY OF DEBIT/CREDIT RULES

Illustration 3-16 summarizes the debit/credit rules and effects on each type of account. Study this diagram carefully. It will help you understand the fundamentals of the double-entry system. No matter what the transaction, total debits must equal total credits in order to keep the accounting equation in balance.

Illustration 3-16 Summary of debit/credit rules

<table>
<thead>
<tr>
<th>Basic Equation</th>
<th>Assets = Liabilities + Stockholders' Equity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Expanded Basic Equation</td>
<td>Assets = Liabilities + Common Stock + Retained Earnings - Dividends + Revenues - Expenses</td>
</tr>
</tbody>
</table>

Debit / Credit Rules

- **Assets**
  - Dr. +
  - Cr. -
- **Liabilities**
  - Dr. -
  - Cr. +
- **Common Stock**
  - Dr. -
  - Cr. +
- **Retained Earnings**
  - Dr. -
  - Cr. +
- **Dividends**
  - Dr. +
  - Cr. -
- **Revenues**
  - Dr. +
  - Cr. -
- **Expenses**
  - Dr. -
  - Cr. +

**before you go on...**

**Do it!**

Kate Browne, president of Hair It Is Inc., has just rented space in a shopping mall for the purpose of opening and operating a beauty salon. Long before opening day and before purchasing equipment, hiring assistants, and remodeling the space, Kate was strongly advised to set up a double-entry set of accounting records in which to record all of her business transactions.

Identify the balance sheet accounts that Hair It Is Inc. will likely need to record the transactions necessary to establish and open for business. Also, indicate whether the normal balance of each account is a debit or a credit.

**Solution**

Hair It Is Inc. would likely need the following accounts in which to record the transactions necessary to establish and ready the beauty salon for opening day: Cash (debit balance); Equipment (debit balance); Supplies (debit balance); Accounts Payable (credit balance); Notes Payable (credit balance), if the business borrows money; and Common Stock (credit balance).

Related exercise material: BE3-4, BE3-5, **Do it** 3-2, and E3-7.

**Steps in the Recording Process**

Although it is possible to enter transaction information directly into the accounts, few businesses do so. Practically every business uses these basic steps in the recording process:

1. Analyze each transaction in terms of its effect on the accounts.
2. Enter the transaction information in a journal.
3. Transfer the journal information to the appropriate accounts in the ledger.
The actual sequence of events begins with the transaction. Evidence of the transaction comes in the form of a source document, such as a sales slip, a check, a bill, or a cash register tape. This evidence is analyzed to determine the effect of the transaction on specific accounts. The transaction is then entered in the journal. Finally, the journal entry is transferred to the designated accounts in the ledger. The sequence of events in the recording process is shown in Illustration 3-17.

**The Journal**

Transactions are initially recorded in chronological order in journals before they are transferred to the accounts. For each transaction the journal shows the debit and credit effects on specific accounts. (In a computerized system, journals are kept as files, and accounts are recorded in computer databases.)

Companies may use various kinds of journals, but every company has at least the most basic form of journal, a general journal. The journal makes three significant contributions to the recording process:

1. It discloses in one place the complete effect of a transaction.
2. It provides a chronological record of transactions.
3. It helps to prevent or locate errors because the debit and credit amounts for each entry can be readily compared.

Entering transaction data in the journal is known as journalizing. To illustrate the technique of journalizing, let’s look at the first three transactions of Sierra Corporation in equation form.

On October 1, Sierra issued common stock in exchange for $10,000 cash:

<table>
<thead>
<tr>
<th>Assets</th>
<th>Liabilities + Stockholders’ Equity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash = $10,000</td>
<td>Common Stock = $10,000 Issued stock</td>
</tr>
</tbody>
</table>

**Ethics Note** Business documents provide evidence that transactions actually occurred. International Outsourcing Services, LLC, was accused of submitting fraudulent documents (store coupons) to companies such as Kraft Foods and PepsiCo for reimbursement of as much as $250 million. Ensuring that all recorded transactions are backed up by proper business documents reduces the likelihood of fraudulent activity.
On October 1, Sierra borrowed $5,000 by signing a note:

\[
\begin{array}{c|c|c}
\text{Assets} & = & \text{Liabilities} + \text{Stockholders' Equity} \\
\hline
\text{Cash} & +$5,000 & \text{Notes Payable} & +$5,000 \\
\hline
\end{array}
\]

On October 2, Sierra purchased equipment for $5,000:

\[
\begin{array}{c|c|c}
\text{Assets} & = & \text{Liabilities} + \text{Stockholders' Equity} \\
\hline
\text{Cash} & -$5,000 & \text{Equipment} & +$5,000 \\
\hline
\end{array}
\]

Sierra makes separate journal entries for each transaction. A complete entry consists of: (1) the date of the transaction, (2) the accounts and amounts to be debited and credited, and (3) a brief explanation of the transaction. These transactions are journalized in Illustration 3-18.

### Illustration 3-18
Recording transactions in journal form

<table>
<thead>
<tr>
<th>Date</th>
<th>Account Titles and Explanation</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>2012</td>
<td>Oct. 1 Cash</td>
<td>10,000</td>
<td>10,000</td>
</tr>
<tr>
<td></td>
<td>Common Stock</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(Issued stock for cash)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1</td>
<td>Cash</td>
<td>5,000</td>
<td>5,000</td>
</tr>
<tr>
<td></td>
<td>Notes Payable</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(Issued 3-month, 12% note payable for cash)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>Equipment</td>
<td>5,000</td>
<td>5,000</td>
</tr>
<tr>
<td></td>
<td>Cash</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(Purchased equipment for cash)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Note the following features of the journal entries.

1. The date of the transaction is entered in the Date column.
2. The account to be debited is entered first at the left. The account to be credited is then entered on the next line, indented under the line above. The indentation differentiates debits from credits and decreases the possibility of switching the debit and credit amounts.
3. The amounts for the debits are recorded in the Debit (left) column, and the amounts for the credits are recorded in the Credit (right) column.
4. A brief explanation of the transaction is given.

**It is important to use correct and specific account titles in journalizing.** Errors make account titles lead to incorrect financial statements. Some flexibility exists initially in selecting account titles. The main criterion is that each title must appropriately describe the content of the account. For example, a company could use any of these account titles for recording the cost of delivery trucks: Equipment, Delivery Equipment, Delivery Trucks, or Trucks. Once the company chooses the specific title to use, however, it should record under that account title all subsequent transactions involving the account.
THE LEDGER

The entire group of accounts maintained by a company is referred to collectively as the ledger. The ledger keeps in one place all the information about changes in specific account balances.

Companies may use various kinds of ledgers, but every company has a general ledger. A general ledger contains all the assets, liabilities, stockholders' equity, revenue, and expense accounts, as shown in Illustration 3-19 (page 120). Whenever we use the term ledger in this textbook without additional specification, it will mean the general ledger.
The number and type of accounts used differ for each company, depending on the size, complexity, and type of business. For example, the number of accounts depends on the amount of detail desired by management. The management of one company may want one single account for all types of utility expense. Another may keep separate expense accounts for each type of utility expenditure, such as gas, electricity, and water. A small corporation like Sierra Corporation will not have many accounts compared with a corporate giant like Ford Motor Company. Sierra may be able to manage and report its activities in 20 to 30 accounts, whereas Ford requires thousands of accounts to keep track of its worldwide activities.

Most companies list the accounts in a chart of accounts. They may create new accounts as needed during the life of the business. Illustration 3-20 shows the chart of accounts for Sierra Corporation in the order that they are typically listed (assets, liabilities, stockholders’ equity, revenues, and expenses). Accounts shown in red are used in this chapter; accounts shown in black are explained in later chapters.

The procedure of transferring journal entry amounts to ledger accounts is called posting. This phase of the recording process accumulates the effects of journalized transactions in the individual accounts. Posting involves these steps:

1. In the ledger, enter in the appropriate columns of the debited account(s) the date and debit amount shown in the journal.
2. In the ledger, enter in the appropriate columns of the credited account(s) the date and credit amount shown in the journal.

Illustrations 3-21 through 3-31 on the following pages show the basic steps in the recording process using the October transactions of Sierra Corporation. Sierra's accounting period is a month. A basic analysis and a debit-credit analysis precede the journalizing and posting of each transaction. Study these transaction

CHART OF ACCOUNTS

POSTING
analyses carefully. **The purpose of transaction analysis is first to identify the type of account involved and then to determine whether a debit or a credit to the account is required.** You should always perform this type of analysis before preparing a journal entry. Doing so will help you understand the journal entries discussed in this chapter as well as more complex journal entries to be described in later chapters.

**Illustration 3-21**

Investment of cash by stockholders

On October 1, stockholders invest $10,000 cash in an outdoor guide service company to be known as Sierra Corporation.

The asset Cash is increased $10,000, and stockholders’ equity (specifically Common Stock) is increased $10,000.

\[
\text{Assets} = \text{Liabilities} + \text{Stockholders' Equity}
\]

\[
\begin{align*}
\text{Cash} & = +$10,000 \\
\text{Common Stock} & = +$10,000 \text{ Issued stock}
\end{align*}
\]

Debits increase assets: debit Cash $10,000. Credits increase stockholders' equity: credit Common Stock $10,000.

**Accounting Cycle Tutorial**

The diagrams in Illustrations 3-21 to 3-31 review the accounting cycle. If you would like additional practice, an Accounting Cycle Tutorial is available on WileyPLUS. The illustration to the left is an example of a screen from the tutorial.
Illustration 3-22  Issue of note payable

**Event 2**

On October 1, Sierra borrows cash of $5,000 by signing a 3-month, 12%, $5,000 note payable.

**Basic Analysis**

The asset **Cash** is increased $5,000, and the liability **Notes Payable** is increased $5,000.

**Equation Analysis**

\[
\begin{align*}
\text{Assets} & = \text{Liabilities} + \text{Stockholders' Equity} \\
\text{Cash} & = \text{Notes Payable} \\
+5,000 & +5,000
\end{align*}
\]

(2)

**Debit–Credit Analysis**

Debits increase assets: debit **Cash** $5,000.

Credits increase liabilities: credit **Notes Payable** $5,000.

**Journal Entry**

\[
\begin{align*}
\text{Cash} & \quad \text{Oct. 1} \quad 5,000 \\
\text{Notes Payable} & \quad \text{(Issued 3-month, 12% note payable for cash)} \quad 5,000
\end{align*}
\]

**Posting**

\[
\begin{array}{|c|c|}
\hline
\text{Oct. 1} & \text{Oct. 1} \\
\text{Cash} & \text{Notes Payable} \\
10,000 & 5,000 \\
5,000 & 5,000 \\
\hline
\end{array}
\]

Illustration 3-23  Purchase of equipment

**Event 3**

On October 2, Sierra used $5,000 cash to purchase equipment.

**Basic Analysis**

The asset **Equipment** is increased $5,000; the asset **Cash** is decreased $5,000.

**Equation Analysis**

\[
\begin{align*}
\text{Assets} & = \text{Liabilities} + \text{Stockholders' Equity} \\
\text{Cash} & + \text{Equipment} \\
-5,000 & +5,000
\end{align*}
\]

(3)

**Debit–Credit Analysis**

Debits increase assets: debit **Equipment** $5,000.

Credits decrease assets: credit **Cash** $5,000.

**Journal Entry**

\[
\begin{align*}
\text{Equipment} & \quad \text{Oct. 2} \quad 5,000 \\
\text{Cash} & \quad \text{(Purchased equipment for cash)} \quad 5,000
\end{align*}
\]

**Posting**

\[
\begin{array}{|c|c|}
\hline
\text{Oct. 2} & \text{Oct. 2} \\
\text{Cash} & \text{Equipment} \\
10,000 & 5,000 \\
5,000 & 5,000 \\
\hline
\end{array}
\]
Event 4

On October 2, Sierra received a $1,200 cash advance from R. Knox, a client, for guide services for multi-day trips that are expected to be completed in the future.

The asset Cash is increased $1,200; the liability Unearned Service Revenue is increased $1,200 because the service has not been provided yet. That is, when an advance payment is received, an unearned revenue (a liability) should be recorded in order to recognize the obligation that exists.

Debit–Credit Analysis
Debits increase assets: debit Cash $1,200.
Credits increase liabilities: credit Unearned Service Revenue $1,200.

Journal Entry
Oct. 2 Cash 5,000
Unearned Service Revenue 1,200
(Received advance from R. Knox for future service)

Event 5
On October 3, Sierra received $10,000 in cash from Copa Company for guide services provided in October.

The asset Cash is increased $10,000; the revenue Service Revenue is increased $10,000.

Debit–Credit Analysis
Debits increase assets: debit Cash $10,000.
Credits increase revenues: credit Service Revenue $10,000.

Journal Entry
Oct. 3 Cash 10,000
Service Revenue 10,000
(Received cash for services provided)

Helpful Hint
Many liabilities have the word “payable” in their title. But, note that Unearned Service Revenue is considered a liability even though the word payable is not used.

Illustration 3-24
Receipt of cash in advance from customer

Illustration 3-25
Services provided for cash
**Illustration 3-26**

Payment of rent with cash

**Event 6**

On October 3, Sierra paid office rent for October in cash, $900.

**Basic Analysis**

The expense account Rent Expense is increased $900 because the payment pertains only to the current month; the asset Cash is decreased $900.

**Equation Analysis**

\[
\begin{align*}
\text{Assets} & = \text{Liabilities} + \text{Stockholders' Equity} \\
\text{Cash} & = -\text{Rent Expense} \\
& = -900
\end{align*}
\]

**Debit–Credit Analysis**

Debits increase expenses: debit Rent Expense $900.

Credits decrease assets: credit Cash $900.

**Journal Entry**

Oct. 3

<table>
<thead>
<tr>
<th>Rent Expense</th>
<th>900</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>900</td>
</tr>
</tbody>
</table>

**Posting**

<table>
<thead>
<tr>
<th>Date</th>
<th>Cash</th>
<th>Rent Expense</th>
</tr>
</thead>
<tbody>
<tr>
<td>Oct. 1</td>
<td>10,000</td>
<td></td>
</tr>
<tr>
<td>Oct. 2</td>
<td>5,000</td>
<td></td>
</tr>
<tr>
<td>Oct. 3</td>
<td>10,000</td>
<td></td>
</tr>
</tbody>
</table>

**Illustration 3-27**

Purchase of insurance policy with cash

**Event 7**

On October 4, Sierra paid $600 for a 1-year insurance policy that will expire next year on September 30.

**Basic Analysis**

The asset Cash is decreased $600. Payments of expenses that will benefit more than one accounting period are identified as prepaid expenses or prepayments. When a payment is made, an asset account is debited in order to show the service or benefit that will be received in the future. Therefore, the asset Prepaid Insurance is increased $600.

**Equation Analysis**

\[
\begin{align*}
\text{Assets} & = \text{Liabilities} + \text{Stockholders' Equity} \\
\text{Cash} & = \text{Prepaid Insurance} + \text{Rent Expense} \\
& = -600 + 600
\end{align*}
\]

**Debit–Credit Analysis**

Debits increase assets: debit Prepaid Insurance $600.

Credits decrease assets: credit Cash $600.

**Journal Entry**

Oct. 4

<table>
<thead>
<tr>
<th>Prepaid Insurance</th>
<th>600</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>600</td>
</tr>
</tbody>
</table>

**Posting**

<table>
<thead>
<tr>
<th>Date</th>
<th>Cash</th>
<th>Prepaid Insurance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Oct. 1</td>
<td>10,000</td>
<td></td>
</tr>
<tr>
<td>Oct. 2</td>
<td>5,000</td>
<td></td>
</tr>
<tr>
<td>Oct. 3</td>
<td>10,000</td>
<td></td>
</tr>
<tr>
<td>Oct. 4</td>
<td>600</td>
<td></td>
</tr>
</tbody>
</table>
**Event 8**

On October 5, Sierra purchased an estimated 3 months of supplies on account from Aero Supply for $2,500.

- **Basic Analysis**
  - The asset Supplies is increased $2,500; the liability Accounts Payable is increased $2,500.

- **Equation Analysis**
  - \[ \text{Assets} = \text{Liabilities} + \text{Stockholders' Equity} \]
  - \[ \text{Supplies} = \text{Accounts Payable} \]
  - \[ +$2,500 = +$2,500 \] (8)

- **Debit–Credit Analysis**
  - Debits increase assets: debit Supplies $2,500.
  - Credits increase liabilities: credit Accounts Payable $2,500.

- **Journal Entry**
  - Oct. 5 Supplies 2,500
  - Oct. 5 Accounts Payable 2,500

- **Posting**
  - Oct. 5 Supplies 2,500
  - Oct. 5 Accounts Payable 2,500

**Event 9**

On October 9, Sierra hired four employees to begin work on October 15. Each employee will receive a weekly salary of $500 for a 5-day work week, payable every 2 weeks—first payment made on October 26.

- **Basic Analysis**
  - An accounting transaction has not occurred. There is only an agreement that the employees will begin work on October 15. Thus, a debit–credit analysis is not needed because there is no accounting entry. (See transaction of October 26 (Event II) for first payment.)

**Illustration 3-28**

Purchase of supplies on account

**Illustration 3-29**

Hiring of new employees
Illustration 3-30  Payment of dividend

Event 10  On October 20, Sierra paid a $500 cash dividend to stockholders.

Basic Analysis
The Dividends account is increased $500; the asset Cash is decreased $500.

Equation Analysis
\[
\begin{align*}
\text{Assets} & = \text{Liabilities} + \text{Stockholders' Equity} \\
\text{Cash} & = \text{Dividends} \\
& = -500
\end{align*}
\]

Debit–Credit Analysis
Debits increase dividends: debit Dividends $500.
Credits decrease assets: credit Cash $500.

Journal Entry
Oct. 20  
\begin{align*}
\text{Dividends} & \hspace{1cm} 500 \\
\text{Cash} & \hspace{1cm} 500
\end{align*}
\]

Posting
\begin{align*}
\text{Cash} & \hspace{1cm} \begin{array}{l}
\text{Oct. 1: } 10,000 \\
\text{1: } 5,000 \\
\text{2: } 1,200 \\
\text{3: } 10,000 \\
\text{Oct. 2: } 5,000 \\
\text{3: } 900 \\
\text{4: } 600 \\
\text{20: } 500 \\
\text{26: } 4,000 \\
\end{array} \\
\text{Dividends} & \hspace{1cm} \begin{array}{l}
\text{Oct. 20: } 500 \\
\end{array}
\end{align*}

Illustration 3-31  Payment of cash for employee salaries

Event 11  On October 26, Sierra paid employee salaries of $4,000 in cash. (See October 9 event.)

Basic Analysis
The expense account Salaries Expense is increased $4,000; the asset Cash is decreased $4,000.

Equation Analysis
\[
\begin{align*}
\text{Assets} & = \text{Liabilities} + \text{Stockholders' Equity} \\
\text{Cash} & = \text{Expenses} + \text{Salaries Expense} \\
& = -4,000 + -4,000
\end{align*}
\]

Debit–Credit Analysis
Debits increase expenses: debit Salaries Expense $4,000.
Credits decrease assets: credit Cash $4,000.

Journal Entry
Oct. 26  
\begin{align*}
\text{Salaries Expense} & \hspace{1cm} 4,000 \\
\text{Cash} & \hspace{1cm} 4,000
\end{align*}
\]

Posting
\begin{align*}
\text{Cash} & \hspace{1cm} \begin{array}{l}
\text{Oct. 1: } 10,000 \\
\text{1: } 5,000 \\
\text{2: } 1,200 \\
\text{3: } 10,000 \\
\text{Oct. 2: } 5,000 \\
\text{3: } 900 \\
\text{4: } 600 \\
\text{20: } 500 \\
\text{26: } 4,000 \\
\end{array} \\
\text{Salaries Expense} & \hspace{1cm} \begin{array}{l}
\text{Oct. 26: } 4,000 \\
\end{array}
\end{align*}

**SUMMARY ILLUSTRATION OF JOURNALIZING AND POSTING**

The journal for Sierra Corporation for the month of October is summarized in Illustration 3-32. The ledger is shown in Illustration 3-33 (on page 128) with all balances highlighted in red.

<table>
<thead>
<tr>
<th>Date</th>
<th>Account Titles and Explanation</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>2012</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Oct.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Cash</td>
<td>10,000</td>
<td>10,000</td>
</tr>
<tr>
<td></td>
<td>Common Stock</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(Issued stock for cash)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Cash</td>
<td>5,000</td>
<td>5,000</td>
</tr>
<tr>
<td></td>
<td>Notes Payable</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(Issued 3-month, 12% note payable for cash)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Equipment</td>
<td>5,000</td>
<td>5,000</td>
</tr>
<tr>
<td></td>
<td>Cash</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(Purchased equipment for cash)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2</td>
<td></td>
<td>1,200</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Cash</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Unearned Service Revenue</td>
<td></td>
<td>1,200</td>
</tr>
<tr>
<td></td>
<td>(Received advance from R. Knox for future service)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>3</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Cash</td>
<td>10,000</td>
<td>10,000</td>
</tr>
<tr>
<td></td>
<td>Service Revenue</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(Received cash for services provided)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>3</td>
<td></td>
<td>900</td>
<td>900</td>
</tr>
<tr>
<td></td>
<td>Rent Expense</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Cash</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(Paid cash for October office rent)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>4</td>
<td></td>
<td>600</td>
<td>600</td>
</tr>
<tr>
<td></td>
<td>Prepaid Insurance</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Cash</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(Paid 1-year policy; effective date October 1)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>5</td>
<td></td>
<td>2,500</td>
<td>2,500</td>
</tr>
<tr>
<td></td>
<td>Supplies</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Accounts Payable</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(Purchased supplies on account from Aero Supply)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>20</td>
<td></td>
<td>500</td>
<td>500</td>
</tr>
<tr>
<td></td>
<td>Dividends</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Cash</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(Paid a cash dividend)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>26</td>
<td></td>
<td>4,000</td>
<td>4,000</td>
</tr>
<tr>
<td></td>
<td>Salaries Expense</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Cash</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(Paid salaries to date)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Selected transactions from the journal of Faital Inc. during its first month of operations are presented below. Post these transactions to T accounts.

<table>
<thead>
<tr>
<th>Date</th>
<th>Account Titles</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>July 1</td>
<td>Cash</td>
<td>30,000</td>
<td>30,000</td>
</tr>
<tr>
<td></td>
<td>Common Stock</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Accounts Receivable</td>
<td>6,000</td>
<td>6,000</td>
</tr>
<tr>
<td></td>
<td>Service Revenue</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Cash</td>
<td>4,000</td>
<td>4,000</td>
</tr>
<tr>
<td></td>
<td>Accounts Receivable</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Related exercise material: BE3-10, BE3-11, and E3-11.
The Trial Balance

A trial balance lists accounts and their balances at a given time. A company usually prepares a trial balance at the end of an accounting period. The accounts are listed in the order in which they appear in the ledger. Debit balances are listed in the left column and credit balances in the right column. The totals of the two columns must be equal.

The trial balance proves the mathematical equality of debits and credits after posting. Under the double-entry system this equality occurs when the sum of the debit account balances equals the sum of the credit account balances. A trial balance may also uncover errors in journalizing and posting. For example, a trial balance may well have detected the error at Fidelity Investments discussed in the Feature Story. In addition, a trial balance is useful in the preparation of financial statements.

These are the procedures for preparing a trial balance:

1. List the account titles and their balances.
2. Total the debit column and total the credit column.
3. Verify the equality of the two columns.

Illustration 3-34 presents the trial balance prepared from the ledger of Sierra Corporation. Note that the total debits, $28,700, equal the total credits, $28,700.

### SIERRA CORPORATION

**Trial Balance**

October 31, 2012

<table>
<thead>
<tr>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>$15,200</td>
</tr>
<tr>
<td>Supplies</td>
<td>2,500</td>
</tr>
<tr>
<td>Prepaid Insurance</td>
<td>600</td>
</tr>
<tr>
<td>Equipment</td>
<td>5,000</td>
</tr>
<tr>
<td>Notes Payable</td>
<td>$ 5,000</td>
</tr>
<tr>
<td>Accounts Payable</td>
<td>2,500</td>
</tr>
<tr>
<td>Unearned Service Revenue</td>
<td>1,200</td>
</tr>
<tr>
<td>Common Stock</td>
<td>10,000</td>
</tr>
<tr>
<td>Dividends</td>
<td>500</td>
</tr>
<tr>
<td>Service Revenue</td>
<td>10,000</td>
</tr>
<tr>
<td>Salaries Expense</td>
<td>4,000</td>
</tr>
<tr>
<td>Rent Expense</td>
<td>900</td>
</tr>
<tr>
<td></td>
<td><strong>$28,700</strong></td>
</tr>
<tr>
<td></td>
<td><strong>$28,700</strong></td>
</tr>
</tbody>
</table>

**LIMITATIONS OF A TRIAL BALANCE**

A trial balance does not prove that all transactions have been recorded or that the ledger is correct. Numerous errors may exist even though the trial balance column totals agree. For example, the trial balance may balance even when any of the following occurs: (1) a transaction is not journalized, (2) a correct journal entry is not posted, (3) a journal entry is posted twice, (4) incorrect accounts are used in journalizing or posting, or (5) offsetting errors are made in recording the amount of a transaction. In other words, as long as equal debits and credits are posted, even to the wrong account or in the wrong amount, the total debits will equal the total credits. Nevertheless, despite these limitations, the trial balance is a useful screen for finding errors and is frequently used in practice.

**Ethics Note**

An error is the result of an unintentional mistake; it is neither ethical nor unethical. An irregularity is an intentional misstatement, which is viewed as unethical.
The Cash account shown below reflects all of the inflows and outflows of cash that occurred during October. We have also provided a description of each transaction that affected the Cash account.

<table>
<thead>
<tr>
<th>Date</th>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Oct. 1</td>
<td>Issued stock for $10,000</td>
<td>10,000</td>
</tr>
<tr>
<td>1</td>
<td>Issued note payable for $5,000</td>
<td>5,000</td>
</tr>
<tr>
<td>2</td>
<td>Purchased equipment for $5,000</td>
<td>5,000</td>
</tr>
<tr>
<td>3</td>
<td>Received $1,200 cash in advance from customer</td>
<td>1,200</td>
</tr>
<tr>
<td>4</td>
<td>Received $10,000 cash for services provided</td>
<td>10,000</td>
</tr>
<tr>
<td>5</td>
<td>Paid $900 cash for October rent</td>
<td>900</td>
</tr>
<tr>
<td>6</td>
<td>Paid $600 cash for one-year insurance policy</td>
<td>600</td>
</tr>
<tr>
<td>7</td>
<td>Paid $500 cash dividend to stockholders</td>
<td>500</td>
</tr>
<tr>
<td>8</td>
<td>Paid $4,000 cash salaries</td>
<td>4,000</td>
</tr>
<tr>
<td>9</td>
<td>Paid $400 cash salaries</td>
<td>400</td>
</tr>
</tbody>
</table>

The Cash account and the related cash transactions indicate why cash changed during October. However, to make this information useful for analysis, it is summarized in a statement of cash flows. The statement of cash flows classifies each transaction as an operating activity, an investing activity, or a financing activity. A user of this statement can then determine the amount of cash provided by operations, the amount of cash used for investing purposes, and the amount of cash provided by financing activities.

**Operating activities** are the types of activities the company performs to generate profits. Sierra Corporation is an outdoor guide business, so its operating activities involve providing guide services. Activities 4, 5, 6, 7, and 9 relate to cash received or spent to directly support its guide services.

**Investing activities** include the purchase or sale of long-lived assets used in operating the business, or the purchase or sale of investment securities (stocks and bonds of companies other than Sierra). Activity 3, the purchase of equipment, is an investment activity.

The primary types of **financing activities** are borrowing money, issuing shares of stock, and paying dividends. The financing activities of Sierra Corporation are activities 1, 2, and 8.

The Kansas Farmers’ Vertically Integrated Cooperative, Inc. (K-VIC) was formed by over 200 northeast Kansas farmers in the late 1980s. Its purpose is to use raw materials, primarily grain and meat products grown by K-VIC’s members, to process this material into end-user food products, and to distribute the products nationally. Profits not needed for expansion or investment are returned to the members annually, on a pro-rata basis, according to the fair value of the grain and meat products received from each farmer.

Assume that the following trial balance was prepared for K-VIC.
KANSAS FARMERS’ VERTICALLY INTEGRATED COOPERATIVE, INC.

Trial Balance
December 31, 2012
(in thousands)

<table>
<thead>
<tr>
<th>Account</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounts Receivable</td>
<td>$ 712,000</td>
<td></td>
</tr>
<tr>
<td>Accounts Payable</td>
<td></td>
<td>$ 673,000</td>
</tr>
<tr>
<td>Buildings</td>
<td>365,000</td>
<td></td>
</tr>
<tr>
<td>Cash</td>
<td>32,000</td>
<td></td>
</tr>
<tr>
<td>Cost of Goods Sold</td>
<td>2,384,000</td>
<td></td>
</tr>
<tr>
<td>Notes Payable (due in 2013)</td>
<td></td>
<td>12,000</td>
</tr>
<tr>
<td>Inventory</td>
<td>1,291,000</td>
<td></td>
</tr>
<tr>
<td>Land</td>
<td>110,000</td>
<td></td>
</tr>
<tr>
<td>Mortgage Payable</td>
<td></td>
<td>873,000</td>
</tr>
<tr>
<td>Equipment</td>
<td>63,000</td>
<td></td>
</tr>
<tr>
<td>Retained Earnings</td>
<td></td>
<td>822,000</td>
</tr>
<tr>
<td>Sales Revenue</td>
<td></td>
<td>3,741,000</td>
</tr>
<tr>
<td>Salaries and Wages Payable</td>
<td></td>
<td>62,000</td>
</tr>
<tr>
<td>Salaries and Wages Expense</td>
<td>651,000</td>
<td></td>
</tr>
<tr>
<td>Maintenance and Repairs Expense</td>
<td>500,000</td>
<td></td>
</tr>
</tbody>
</table>

$6,108,000 $6,183,000

Because the trial balance is not in balance, you have checked with various people responsible for entering accounting data and have discovered the following.

1. The purchase of 35 new trucks, costing $7 million and paid for with cash, was not recorded.
2. A data entry clerk accidentally deleted the account name for an account with a credit balance of $472 million, so the amount was added to the Mortgage Payable account in the trial balance.
3. December cash sales revenue of $75 million was credited to the Sales Revenue account, but the other half of the entry was not made.
4. $50 million of salaries expenses were mistakenly charged to Maintenance and Repairs Expense.

Instructions

Answer these questions.

(a) Which mistake(s) have caused the trial balance to be out of balance?
(b) Should all of the items be corrected? Explain.
(c) What is the name of the account the data entry clerk deleted?
(d) Make the necessary corrections and prepare a correct trial balance with accounts listed in proper order.
(e) On your trial balance, write BAL beside the accounts that go on the balance sheet and INC beside those that go on the income statement.

Solution

(a) Only mistake #3 has caused the trial balance to be out of balance.
(b) All of the items should be corrected. The misclassification error (mistake #4) on the salaries expense would not affect bottom-line net income, but it does affect the amounts reported in the two expense accounts.
(c) There is no Common Stock account, so that must be the account that was deleted by the data entry clerk.
Summary of Study Objectives

1. **Analyze the effect of business transactions on the basic accounting equation.** Each business transaction must have a dual effect on the accounting equation. For example, if an individual asset is increased, there must be a corresponding (a) decrease in another asset, or (b) increase in a specific liability, or (c) increase in stockholders’ equity.

2. **Explain what an account is and how it helps in the recording process.** An account is an individual accounting record of increases and decreases in specific asset, liability, and stockholders’ equity items.

3. **Define debits and credits and explain how they are used to record business transactions.** The terms debit and credit are synonymous with left and right. Assets, dividends, and expenses are increased by debits and decreased by credits. Liabilities, common stock, retained earnings, and revenues are increased by credits and decreased by debits.

4. **Identify the basic steps in the recording process.** The basic steps in the recording process are: (a) analyze each transaction in terms of its effect on the accounts, (b) enter the transaction information in a journal, and (c) transfer the journal information to the appropriate accounts in the ledger.

5. **Explain what a journal is and how it helps in the recording process.** The initial accounting record of a transaction is entered in a journal before the data are entered in the accounts. A journal (a) discloses in one place the complete effect of a transaction, (b) provides a chronological record of transactions, and (c) prevents or locates errors because the debit and credit amounts for each entry can be readily compared.

6. **Explain what a ledger is and how it helps in the recording process.** The entire group of accounts maintained by a company is referred to collectively as a ledger. The ledger keeps in one place all the information about changes in specific account balances.

7. **Explain what posting is and how it helps in the recording process.** Posting is the procedure of transferring journal entries to the ledger accounts. This phase of the recording process accumulates the effects of journalized transactions in the individual accounts.

8. **Explain the purposes of a trial balance.** A trial balance is a list of accounts and their balances at a given time. The primary purpose of the trial balance is to prove the mathematical equality of debits and credits after posting. A trial balance also uncovers errors in journalizing and posting and is useful in preparing financial statements.
9 Classify cash activities as operating, investing, or financing. Operating activities are the types of activities the company uses to generate profits. Investing activities relate to the purchase or sale of long-lived assets used in operating the business, or to the purchase or sale of investment securities (stock and bonds of other companies). Financing activities are borrowing money, issuing shares of stock, and paying dividends.

Glossary

**Account** (p. 111) An individual accounting record of increases and decreases in specific asset, liability, stockholders’ equity, revenue or expense items.

**Accounting information system** (p. 102) The system of collecting and processing transaction data and communicating financial information to decision makers.

**Accounting transactions** (p. 102) Events that require recording in the financial statements because they affect assets, liabilities, or stockholders’ equity.

**Chart of accounts** (p. 120) A list of a company’s accounts.

**Credit** (p. 111) The right side of an account.

**Debit** (p. 111) The left side of an account.

**Double-entry system** (p. 112) A system that records the two-sided effect of each transaction in appropriate accounts.

**General journal** (p. 117) The most basic form of journal.

**General ledger** (p. 119) A ledger that contains all asset, liability, stockholders’ equity, revenue, and expense accounts.

**Journal** (p. 117) An accounting record in which transactions are initially recorded in chronological order.

**Journalizing** (p. 117) The procedure of entering transaction data in the journal.

**Ledger** (p. 119) The group of accounts maintained by a company.

**Posting** (p. 120) The procedure of transferring journal entry amounts to the ledger accounts.

**T account** (p. 111) The basic form of an account.

**Trial balance** (p. 129) A list of accounts and their balances at a given time.
The chart of accounts for the company is the same as for Sierra Corporation except for the following additional account: Advertising Expense.

**Instructions**

(a) Journalize the September transactions.

(b) Open ledger accounts and post the September transactions.

(c) Prepare a trial balance at September 30, 2012.

### Solution to Comprehensive  Do it!

#### (a) GENERAL JOURNAL

<table>
<thead>
<tr>
<th>Date</th>
<th>Account Titles and Explanation</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>2012</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sept. 1</td>
<td>Cash</td>
<td>20,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Common Stock</td>
<td></td>
<td>20,000</td>
</tr>
<tr>
<td></td>
<td>(Issued stock for cash)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>Rent Expense</td>
<td>1,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Cash</td>
<td></td>
<td>1,000</td>
</tr>
<tr>
<td></td>
<td>(Paid September rent)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>3</td>
<td>Equipment</td>
<td>25,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Cash</td>
<td></td>
<td>10,000</td>
</tr>
<tr>
<td></td>
<td>Notes Payable</td>
<td></td>
<td>15,000</td>
</tr>
<tr>
<td></td>
<td>(Purchased cleaning equipment for cash and 6-month, 12% note payable)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>4</td>
<td>Prepaid Insurance</td>
<td>1,200</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Cash</td>
<td></td>
<td>1,200</td>
</tr>
<tr>
<td></td>
<td>(Paid 1-year insurance policy)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>10</td>
<td>Advertising Expense</td>
<td>200</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Accounts Payable</td>
<td></td>
<td>200</td>
</tr>
<tr>
<td></td>
<td>(Received bill from <em>Daily News</em> for advertising)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>15</td>
<td>Accounts Receivable</td>
<td>6,200</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Service Revenue</td>
<td></td>
<td>6,200</td>
</tr>
<tr>
<td></td>
<td>(Services performed on account)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>20</td>
<td>Dividends</td>
<td>700</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Cash</td>
<td></td>
<td>700</td>
</tr>
<tr>
<td></td>
<td>(Declared and paid a cash dividend)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>30</td>
<td>Cash</td>
<td>5,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Accounts Receivable</td>
<td></td>
<td>5,000</td>
</tr>
<tr>
<td></td>
<td>(Collection of accounts receivable)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

#### (b) GENERAL LEDGER

**Cash**

<table>
<thead>
<tr>
<th>Date</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sept. 1</td>
<td>20,000</td>
<td></td>
</tr>
<tr>
<td>Sept. 30</td>
<td>5,000</td>
<td></td>
</tr>
<tr>
<td>Bal.</td>
<td>12,100</td>
<td></td>
</tr>
</tbody>
</table>

**Common Stock**

<table>
<thead>
<tr>
<th>Date</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sept. 1</td>
<td>20,000</td>
<td></td>
</tr>
</tbody>
</table>

**Accounts Receivable**

<table>
<thead>
<tr>
<th>Date</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sept. 15</td>
<td>6,200</td>
<td></td>
</tr>
<tr>
<td>Sept. 30</td>
<td>5,000</td>
<td></td>
</tr>
<tr>
<td>Bal.</td>
<td>1,200</td>
<td></td>
</tr>
</tbody>
</table>

**Dividends**

<table>
<thead>
<tr>
<th>Date</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sept. 20</td>
<td>700</td>
<td></td>
</tr>
<tr>
<td>Bal.</td>
<td>700</td>
<td></td>
</tr>
</tbody>
</table>
Self-Test Questions

1. The effects on the basic accounting equation of performing services for cash are to:
   (a) increase assets and decrease stockholders' equity.
   (b) increase assets and increase stockholders' equity.
   (c) increase assets and increase liabilities.
   (d) increase liabilities and increase stockholders' equity.

2. Genesis Company buys a $900 machine on credit.  (SO 1)
   This transaction will affect the:
   (a) income statement only.
   (b) balance sheet only.
   (c) income statement and retained earnings statement only.
   (d) income statement, retained earnings statement, and balance sheet.

Self-Test, Brief Exercises, Exercises, Problem Set A, and many more resources are available for practice in WileyPLUS
3. Which of the following events is not recorded in the accounting records?
   (a) Equipment is purchased on account.
   (b) An employee is terminated.
   (c) A cash investment is made into the business.
   (d) Company pays dividend to stockholders.

4. During 2012, Gibson Company assets decreased $50,000 and its liabilities decreased $90,000. Its stockholders’ equity therefore:
   (a) increased $40,000.
   (b) decreased $140,000.
   (c) decreased $40,000.
   (d) increased $140,000.

5. Which statement about an account is true?
   (a) In its simplest form, an account consists of two parts.
   (b) An account is an individual accounting record of increases and decreases in specific asset, liability, and stockholders’ equity items.
   (c) There are separate accounts for specific assets and liabilities but only one account for stockholders’ equity items.
   (d) The left side of an account is the credit or decrease side.

6. Debits:
   (a) increase both assets and liabilities.
   (b) decrease both assets and liabilities.
   (c) increase assets and decrease liabilities.
   (d) decrease assets and increase liabilities.

7. A revenue account:
   (a) is increased by debits.
   (b) is decreased by credits.
   (c) has a normal balance of a debit.
   (d) is increased by credits.

8. Which accounts normally have debit balances?
   (a) Assets, expenses, and retained earnings.
   (b) Assets, expenses, and dividends.
   (c) Assets, liabilities, and dividends.
   (d) Assets, dividends, and expenses.

9. Paying an account payable with cash affects the components of the accounting equation in the following way:
   (a) Decreases stockholders’ equity and decreases liabilities.
   (b) Increases assets and decreases liabilities.
   (c) Decreases assets and increases stockholders’ equity.
   (d) Decreases assets and decreases liabilities.

10. Which is not part of the recording process?
    (a) Analyzing transactions.
    (b) Preparing a trial balance.
    (c) Entering transactions in a journal.
    (d) Posting transactions.

11. Which of these statements about a journal is false?
    (a) It contains only revenue and expense accounts.
    (b) It provides a chronological record of transactions.
    (c) It helps to locate errors because the debit and credit amounts for each entry can be readily compared.
    (d) It discloses in one place the complete effect of a transaction.

12. A ledger:
    (a) contains only asset and liability accounts.
    (b) should show accounts in alphabetical order.
    (c) is a collection of the entire group of accounts maintained by a company.
    (d) provides a chronological record of transactions.

13. Posting:
    (a) normally occurs before journalizing.
    (b) transfers ledger transaction data to the journal.
    (c) is an optional step in the recording process.
    (d) transfers journal entries to ledger accounts.

14. A trial balance:
    (a) is a list of accounts with their balances at a given time.
    (b) proves that proper account titles were used.
    (c) will not balance if a correct journal entry is posted twice.
    (d) proves that all transactions have been recorded.

15. A trial balance will not balance if:
    (a) a correct journal entry is posted twice.
    (b) the purchase of supplies on account is debited to Supplies and credited to Cash.
    (c) a $100 cash dividend is debited to Dividends for $1,000 and credited to Cash for $100.
    (d) a $450 payment on account is debited to Accounts Payable for $45 and credited to Cash for $45.


Questions

1. Describe the accounting information system.

2. Can a business enter into a transaction that affects only the left side of the basic accounting equation? If so, give an example.

3. Are the following events recorded in the accounting records? Explain your answer in each case.

4. Indicate how each business transaction affects the basic accounting equation.
   (a) Paid cash for janitorial services.
   (b) Purchased equipment for cash.
(c) Issued common stock to investors in exchange for cash. 
(d) Paid an account payable in full.

5. Why is an account referred to as a T account?
6. The terms debit and credit mean “increase” and “decrease,” respectively. Do you agree? Explain.
7. James Quest, a fellow student, contends that the double-entry system means each transaction must be recorded twice. Is James correct? Explain.
8. Gayle Weir, a beginning accounting student, believes debit balances are favorable and credit balances are unfavorable. Is Gayle correct? Discuss.
9. State the rules of debit and credit as applied to (a) asset accounts, (b) liability accounts, and (c) the common stock account.
10. What is the normal balance for each of these accounts?  
   (a) Accounts Receivable.
   (b) Cash.
   (c) Dividends.
   (d) Accounts Payable.
   (e) Service Revenue.
   (f) Salaries and Wages Expense.
   (g) Common Stock.
11. Indicate whether each account is an asset, a liability, or a stockholders’ equity account, and whether it would have a normal debit or credit balance. 
   (a) Accounts Receivable.  (d) Dividends.
   (b) Accounts Payable.  (e) Supplies.
   (c) Equipment.
12. For the following transactions, indicate the account debited and the account credited. 
   (a) Supplies are purchased on account.
   (b) Cash is received on signing a note payable.
   (c) Employees are paid salaries in cash.
13. For each account listed here, indicate whether it generally will have debit entries only, credit entries only, or both debit and credit entries. 
   (a) Cash.
   (b) Accounts Receivable.
   (c) Dividends.
   (d) Accounts Payable.

**Brief Exercises**

**BE3-1** Presented below are three economic events. On a sheet of paper, list the letters (a), (b), and (c) with columns for assets, liabilities, and stockholders’ equity. In each column, indicate whether the event increased (+), decreased (−), or had no effect (NE) on assets, liabilities, and stockholders’ equity.
(a) Purchased supplies on account.
(b) Received cash for providing a service.
(c) Expenses paid in cash.

**BE3-2** During 2012, Gavin Corp. entered into the following transactions.
1. Borrowed $60,000 by issuing bonds.
2. Paid $9,000 cash dividend to stockholders.
3. Received $13,000 cash from a previously billed customer for services provided.
4. Purchased supplies on account for $3,100.
Using the following tabular analysis, show the effect of each transaction on the accounting equation. Put explanations for changes to Stockholders’ Equity in the right-hand margin. For Retained Earnings, use separate columns for Revenues, Expenses, and Dividends if necessary. Use Illustration 3-3 (page 110) as a model.

\[
\begin{align*}
\text{Assets} &\quad = \quad \text{Liabilities} \quad + \quad \text{Stockholders' Equity} \\
\text{Cash} + \text{Accounts Receivable} + \text{Supplies} &= \text{Accounts Payable} + \text{Bonds Payable} + \text{Common Stock} + \text{Retained Earnings}
\end{align*}
\]

**BE3-3** During 2012, Newberry Company entered into the following transactions.
1. Purchased equipment for $286,176 cash.
2. Issued common stock to investors for $137,590 cash.
3. Purchased inventory of $68,480 on account.

Using the following tabular analysis, show the effect of each transaction on the accounting equation. Put explanations for changes to Stockholders’ Equity in the right-hand margin. For Retained Earnings, use separate columns for Revenues, Expenses, and Dividends if necessary. Use Illustration 3-3 (page 110) as a model.

\[
\begin{align*}
\text{Assets} &\quad = \quad \text{Liabilities} + \text{Stockholders' Equity} \\
\text{Cash} + \text{Inventory} + \text{Equipment} &= \text{Accounts Payable} + \text{Common Stock} + \text{Retained Earnings}
\end{align*}
\]

**BE3-4** For each of the following accounts, indicate the effect of a debit or a credit on the account and the normal balance.
(a) Accounts Payable.  (d) Accounts Receivable.
(b) Advertising Expense.  (e) Retained Earnings.
(c) Service Revenue.    (f) Dividends.

**BE3-5** Transactions for Marlin Company for the month of June are presented below. Identify the accounts to be debited and credited for each transaction.

<table>
<thead>
<tr>
<th>Date</th>
<th>Account Title</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>June 1</td>
<td>Issues common stock to investors in exchange for $5,000 cash.</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Pays $740 to landlord for June rent.</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Bills Matt Wilfer $700 for welding work done.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**BE3-6** Use the data in BE3-5 and journalize the transactions. (You may omit explanations.)

**BE3-7** Eugenie Steckler, a fellow student, is unclear about the basic steps in the recording process. Identify and briefly explain the steps in the order in which they occur:

**BE3-8** Acker Corporation has the following transactions during August of the current year. Indicate (a) the basic analysis and (b) the debit-credit analysis illustrated on pages 121–126.

Aug. 1  Issues shares of common stock to investors in exchange for $10,000.
4    Pays insurance in advance for 3 months, $1,500.
16   Receives $900 from clients for services rendered.
27   Pays the secretary $620 salary.

**BE3-9** Use the data in BE3-8 and journalize the transactions. (You may omit explanations.)

**BE3-10** Selected transactions for Rojas Company are presented below in journal form (without explanations). Post the transactions to T accounts.

<table>
<thead>
<tr>
<th>Date</th>
<th>Account Title</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>May 5</td>
<td>Accounts Receivable</td>
<td>3,800</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Service Revenue</td>
<td></td>
<td>3,800</td>
</tr>
<tr>
<td>12</td>
<td>Cash</td>
<td>1,600</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Accounts Receivable</td>
<td></td>
<td>1,600</td>
</tr>
<tr>
<td>15</td>
<td>Cash</td>
<td>2,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Service Revenue</td>
<td></td>
<td>2,000</td>
</tr>
</tbody>
</table>
**BE3-11** From the ledger balances below, prepare a trial balance for Lyndon Company at June 30, 2012. All account balances are normal.

<table>
<thead>
<tr>
<th>Account</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounts Payable</td>
<td>$1,000</td>
<td></td>
</tr>
<tr>
<td>Cash</td>
<td>5,400</td>
<td></td>
</tr>
<tr>
<td>Common Stock</td>
<td>18,000</td>
<td></td>
</tr>
<tr>
<td>Dividends</td>
<td>1,200</td>
<td></td>
</tr>
<tr>
<td>Equipment</td>
<td>13,000</td>
<td></td>
</tr>
<tr>
<td>Service Revenue</td>
<td>$8,600</td>
<td></td>
</tr>
<tr>
<td>Salaries and Wages Expense</td>
<td>4,000</td>
<td></td>
</tr>
<tr>
<td>Rent Expense</td>
<td>1,000</td>
<td></td>
</tr>
<tr>
<td>Dividends</td>
<td>1,200</td>
<td></td>
</tr>
<tr>
<td>Retained Earnings</td>
<td>6,600</td>
<td></td>
</tr>
<tr>
<td>Common Stock</td>
<td>10,000</td>
<td></td>
</tr>
<tr>
<td>Prepaid Insurance</td>
<td>3,500</td>
<td></td>
</tr>
<tr>
<td>Accounts Receivable</td>
<td>3,000</td>
<td></td>
</tr>
<tr>
<td>Unearned Service Revenue</td>
<td>1,800</td>
<td></td>
</tr>
<tr>
<td>Rent Expense</td>
<td>2,600</td>
<td></td>
</tr>
<tr>
<td>Salaries and Wages Expense</td>
<td>14,600</td>
<td></td>
</tr>
</tbody>
</table>

**BE3-12** An inexperienced bookkeeper prepared the following trial balance that does not balance. Prepare a correct trial balance, assuming all account balances are normal.

**PELICAN COMPANY**

**Trial Balance**

**December 31, 2012**

<table>
<thead>
<tr>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash $20,800</td>
<td>$3,500</td>
</tr>
<tr>
<td>Prepaid Insurance</td>
<td>1,800</td>
</tr>
<tr>
<td>Accounts Payable</td>
<td>2,500</td>
</tr>
<tr>
<td>Common Stock</td>
<td>10,000</td>
</tr>
<tr>
<td>Retained Earnings</td>
<td>6,600</td>
</tr>
<tr>
<td>Dividends</td>
<td>5,000</td>
</tr>
<tr>
<td>Service Revenue</td>
<td>25,600</td>
</tr>
<tr>
<td>Salaries and Wages Expense</td>
<td>14,600</td>
</tr>
<tr>
<td>Rent Expense</td>
<td>2,600</td>
</tr>
<tr>
<td><strong>$37,200</strong></td>
<td><strong>$55,800</strong></td>
</tr>
</tbody>
</table>

**Do it! Review**

**Do it! 3-1** Transactions made by Leonardo Bloom Co. for the month of March are shown below. Prepare a tabular analysis that shows the effects of these transactions on the expanded accounting equation, similar to that shown in Illustration 3-3 (page 110).

1. The company provided $20,000 of services for customers on account.
2. The company received $20,000 in cash from customers who had been billed for services [in transaction (1)].
3. The company received a bill for $1,800 of advertising but will not pay it until a later date.
4. Leonardo Bloom Co. paid a cash dividend of $3,000.

**Do it! 3-2** Phil Eubanks has just rented space in a strip mall. In this space, he will open a photography studio, to be called Picture This! A friend has advised Phil to set up a double-entry set of accounting records in which to record all of his business transactions. Identify the balance sheet accounts that Phil will likely need to record the transactions needed to open his business (a corporation). Indicate whether the normal balance of each account is a debit or credit.

**Do it! 3-3** Phil Eubanks engaged in the following activities in establishing his photography studio, Picture This:

1. Opened a bank account in the name of Picture This! and deposited $8,000 of his own money into this account in exchange for common stock.
2. Purchased photography supplies at a total cost of $950. The business paid $400 in cash, and the balance is on account.
3. Obtained estimates on the cost of photography equipment from three different manufacturers.

In what form (type of record) should Phil record these three activities? Prepare the entries to record the transactions.
Phil Eubanks recorded the following transactions during the month of April.

<table>
<thead>
<tr>
<th>Date</th>
<th>Account</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Apr. 3</td>
<td>Cash</td>
<td>$3,400</td>
</tr>
<tr>
<td></td>
<td>Service Revenue</td>
<td>$3,400</td>
</tr>
<tr>
<td>16</td>
<td>Rent Expense</td>
<td>$500</td>
</tr>
<tr>
<td></td>
<td>Cash</td>
<td>$500</td>
</tr>
<tr>
<td>20</td>
<td>Salaries and Wages Expense</td>
<td>$300</td>
</tr>
<tr>
<td></td>
<td>Cash</td>
<td>$300</td>
</tr>
</tbody>
</table>

Post these entries to the Cash account of the general ledger to determine the ending balance in cash. The beginning balance in cash on April 1 was $1,900.

**Exercises**

**E3-1** Selected transactions for Arnett Advertising Company, Inc., are listed here.
1. Issued common stock to investors in exchange for cash received from investors.
2. Paid monthly rent.
3. Received cash from customers when service was provided.
4. Billed customers for services performed.
5. Paid dividend to stockholders.
6. Incurred advertising expense on account.
7. Received cash from customers billed in (4).
8. Purchased additional equipment for cash.
9. Purchased equipment on account.

**Instructions**
Describe the effect of each transaction on assets, liabilities, and stockholders' equity. For example, the first answer is: (1) Increase in assets and increase in stockholders' equity.

**E3-2** Delmont Company entered into these transactions during May 2012.
1. Purchased computers for office use for $30,000 from Dell on account.
2. Paid $4,000 cash for May rent on storage space.
3. Received $12,000 cash from customers for contracts billed in April.
4. Provided computer services to Lavton Construction Company for $5,000 cash.
5. Paid Southern States Power Co. $8,000 cash for energy usage in May.
6. Stockholders invested an additional $40,000 in the business for common stock of the company.
7. Paid Dell for the computers purchased in (1).
8. Incurred advertising expense for May of $1,300 on account.

**Instructions**
Using the following tabular analysis, show the effect of each transaction on the accounting equation. Put explanations for changes to Stockholders’ Equity in the right-hand margin. Use Illustration 3-3 (page 110) as a model.

<table>
<thead>
<tr>
<th>Assets</th>
<th>Liabilities</th>
<th>Stockholders’ Equity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounts</td>
<td>Accounts</td>
<td>Stock</td>
</tr>
<tr>
<td>Cash</td>
<td>Receivable</td>
<td>Payable</td>
</tr>
<tr>
<td>+ Equipment</td>
<td>+ Payable</td>
<td>+ Retained Earnings</td>
</tr>
<tr>
<td>=</td>
<td>=</td>
<td>=</td>
</tr>
</tbody>
</table>

**E3-3** During 2012, its first year of operations as a delivery service, Underwood Corp. entered into the following transactions.
1. Issued shares of common stock to investors in exchange for $100,000 in cash.
2. Borrowed $45,000 by issuing bonds.
3. Purchased delivery trucks for $60,000 cash.
4. Received $16,000 from customers for services provided.
5. Purchased supplies for $4,700 on account.
7. Performed services on account for $10,000.
8. Paid salaries of $28,000.
9. Paid a dividend of $11,000 to shareholders.

**Instructions**
Using the following tabular analysis, show the effect of each transaction on the accounting equation. Put explanations for changes to Stockholders’ Equity in the right-hand margin. Use Illustration 3-3 (page 110) as a model.

**E3-4** A tabular analysis of the transactions made during August 2012 by Nigel Company during its first month of operations is shown below. Each increase and decrease in stockholders’ equity is explained.

**Instructions**
(a) Describe each transaction.
(b) Determine how much stockholders’ equity increased for the month.
(c) Compute the net income for the month.

**E3-5** The tabular analysis of transactions for Nigel Company is presented in E3-4.

**Instructions**
Prepare an income statement and a retained earnings statement for August and a classified balance sheet at August 31, 2012.

**E3-6** Selected transactions for Home Place, an interior decorator corporation, in its first month of business, are as follows.

1. Issued stock to investors for $15,000 in cash.
2. Purchased used car for $10,000 cash for use in business.
3. Purchased supplies on account for $300.
4. Billed customers $3,700 for services performed.
5. Paid $200 cash for advertising start of the business.
6. Received $1,100 cash from customers billed in transaction (4).
7. Paid creditor $300 cash on account.
8. Paid dividends of $400 cash to stockholders.

**Instructions**
(a) For each transaction indicate (a) the basic type of account debited and credited (asset, liability, stockholders’ equity); (b) the specific account debited and credited (Cash, Rent Expense, Service Revenue, etc.); (c) whether the specific account is increased or decreased; and (d) the normal balance of the specific account. Use the format shown on page 142, in which transaction 1 is given as an example.
### E3-7
This information relates to Plunkett Real Estate Agency.

Oct. 1 Stockholders invest $30,000 in exchange for common stock of the corporation.
2 Hires an administrative assistant at an annual salary of $36,000.
3 Buys office furniture for $3,800, on account.
6 Sells a house and lot for M.E. Petty; commissions due from Petty, $10,800
   (not paid by Petty at this time).
10 Receives cash of $140 as commission for acting as rental agent renting an
   apartment.
27 Pays $700 on account for the office furniture purchased on October 3.
30 Pays the administrative assistant $3,000 in salary for October.

### Instructions
Prepare the debit–credit analysis for each transaction, as illustrated on pages 121–126.

### E3-8
Transaction data for Plunkett Real Estate Agency are presented in E3-7.

### Instructions
Journalize the transactions. Do not provide explanations.

### E3-9
The May transactions of StepAside Corporation were as follows.

May 4 Paid $700 due for supplies previously purchased on account.
7 Performed advisory services on account for $6,800.
8 Purchased supplies for $850 on account.
9 Purchased equipment for $1,000 in cash.
17 Paid employees $530 in cash.
22 Received bill for equipment repairs of $900.
29 Paid $1,200 for 12 months of insurance policy. Coverage begins June 1.

### Instructions
Journalize the transactions. Do not provide explanations.

### E3-10
Transaction data and journal entries for Plunkett Real Estate Agency are presented in E3-7 and E3-8.

### Instructions
(a) Post the transactions to T accounts.
(b) Prepare a trial balance at October 31, 2012.

### E3-11
Selected transactions for Charlotte Corporation during its first month in business
are presented below:

Sept. 1 Issued common stock in exchange for $20,000 cash received from investors.
5 Purchased equipment for $9,000, paying $3,000 in cash and the balance
   on account.
25 Paid $4,000 cash on balance owed for equipment.
30 Paid $500 cash dividend.

Charlotte's chart of accounts shows: Cash, Equipment, Accounts Payable, Common Stock, and Dividends.

### Instructions
(a) Prepare a tabular analysis of the September transactions. The column headings
should be: Cash + Equipment = Accounts Payable + Stockholders’ Equity. For trans-
actions affecting stockholders’ equity, provide explanations in the right margin, as
shown on page 110.
(b) Journalize the transactions. Do not provide explanations.
(c) Post the transactions to T accounts.

### E3-12
The T accounts on the next page summarize the ledger of McGregor Gardening
Company, Inc. at the end of the first month of operations.
Instructions
(a) Prepare in the order they occurred the journal entries (including explanations) that resulted in the amounts posted to the accounts.
(b) Prepare a trial balance at April 30, 2012. (Hint: Compute ending balances of T accounts first.)

E3-13 Selected transactions from the journal of Galaxy Inc. during its first month of operations are presented here.

<table>
<thead>
<tr>
<th>Date</th>
<th>Account Titles</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Apr. 1</td>
<td>Cash</td>
<td>15,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Accounts Receivable</td>
<td></td>
<td>700</td>
</tr>
<tr>
<td></td>
<td>Supplies</td>
<td>800</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Accounts Payable</td>
<td>3,500</td>
<td>5,200</td>
</tr>
<tr>
<td></td>
<td>Cash</td>
<td>800</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Service Revenue</td>
<td>700</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Cash</td>
<td>900</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Service Revenue</td>
<td>1,500</td>
<td>6,100</td>
</tr>
<tr>
<td></td>
<td>Notes Payable</td>
<td>1,200</td>
<td>5,000</td>
</tr>
<tr>
<td></td>
<td>Accounts Receivable</td>
<td>3,400</td>
<td>3,400</td>
</tr>
<tr>
<td></td>
<td>Supplies</td>
<td>600</td>
<td>600</td>
</tr>
</tbody>
</table>

Instructions
(a) Post the transactions to T accounts.
(b) Prepare a trial balance at August 31, 2012.

E3-14 Here is the ledger for Stampfer Co.

<table>
<thead>
<tr>
<th>Date</th>
<th>Account Titles</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Oct. 1</td>
<td>Cash</td>
<td>7,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Common Stock</td>
<td>8,000</td>
<td>8,000</td>
</tr>
<tr>
<td></td>
<td>Cash</td>
<td>1,700</td>
<td>1,700</td>
</tr>
<tr>
<td></td>
<td>Service Revenue</td>
<td>6,200</td>
<td>1,200</td>
</tr>
<tr>
<td></td>
<td>Equipment</td>
<td>1,200</td>
<td>5,000</td>
</tr>
<tr>
<td></td>
<td>Notes Payable</td>
<td>3,400</td>
<td>3,400</td>
</tr>
<tr>
<td></td>
<td>Accounts Receivable</td>
<td>600</td>
<td>600</td>
</tr>
<tr>
<td></td>
<td>Supplies</td>
<td>800</td>
<td>800</td>
</tr>
<tr>
<td></td>
<td>Accounts Payable</td>
<td>920</td>
<td>920</td>
</tr>
<tr>
<td>Oct. 4</td>
<td>Equipment</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Oct. 6</td>
<td>Notes Payable</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Oct. 10</td>
<td>Accounts Payable</td>
<td>2,000</td>
<td>3,000</td>
</tr>
<tr>
<td>Oct. 20</td>
<td>Dividends</td>
<td>300</td>
<td>300</td>
</tr>
<tr>
<td>Oct. 31</td>
<td>Service Revenue</td>
<td>800</td>
<td>10</td>
</tr>
<tr>
<td>Oct. 31</td>
<td>Salaries and Wages Expense</td>
<td>500</td>
<td>500</td>
</tr>
<tr>
<td>Oct. 31</td>
<td>Supplies Expense</td>
<td>180</td>
<td>180</td>
</tr>
<tr>
<td>Oct. 15</td>
<td>Rent Expense</td>
<td>250</td>
<td>250</td>
</tr>
</tbody>
</table>
Instructions
(a) Reproduce the journal entries for only the transactions that occurred on October 1, 10, and 20, and provide explanations for each.
(b) Prepare a trial balance at October 31, 2012. (Hint: Compute ending balances of T accounts first.)

E3-15 The bookkeeper for Bullwinkle Corporation made these errors in journalizing and posting.
1. A credit posting of $400 to Accounts Receivable was omitted.
2. A debit posting of $750 for Prepaid Insurance was debited to Insurance Expense.
3. A collection on account of $100 was journalized and posted as a debit to Cash $100 and a credit to Accounts Payable $100.
4. A credit posting of $300 to Property Taxes Payable was made twice.
5. A cash purchase of supplies for $250 was journalized and posted as a debit to Supplies $25 and a credit to Cash $25.
6. A debit of $395 to Advertising Expense was posted as $359.

Instructions
For each error, indicate (a) whether the trial balance will balance; if the trial balance will not balance, indicate (b) the amount of the difference, and (c) the trial balance column that will have the larger total. Consider each error separately. Use the following form, in which error 1 is given as an example.

<table>
<thead>
<tr>
<th>Error</th>
<th>(a) In Balance</th>
<th>(b) Difference</th>
<th>(c) Larger Column</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>No</td>
<td>$400</td>
<td>Debit</td>
</tr>
</tbody>
</table>

E3-16 The accounts in the ledger of Roshek Delivery Service contain the following balances on July 31, 2012.

- Accounts Receivable: $13,400
- Accounts Payable: $8,400
- Cash: $?
- Equipment: $59,360
- Maintenance and Repairs Expense: $1,958
- Insurance Expense: $900
- Notes Payable (due 2015): $28,450
- Prepaid Insurance: $2,200
- Service Revenue: $15,500
- Dividends: $700
- Common Stock: $40,000
- Salaries and Wages Expense: $7,428
- Salaries and Wages Payable: $820
- Retained Earnings: $5,200
- (July 1, 2012)

Instructions
(a) Prepare a trial balance with the accounts arranged as illustrated in the chapter, and fill in the missing amount for Cash.
(b) Prepare an income statement, a retained earnings statement, and a classified balance sheet for the month of July 2012.

E3-17 The following accounts, in alphabetical order, were selected from recent financial statements of Krispy Kreme Doughnuts, Inc.

- Accounts payable
- Accounts receivable
- Common stock
- Depreciation expense
- Interest expense
- Interest income
- Inventories
- Prepaid expenses
- Property and equipment
- Revenues

Instructions
For each account, indicate (a) whether the normal balance is a debit or a credit, and (b) the financial statement—balance sheet or income statement—where the account should be presented.

E3-18 Review the transactions listed in E3-1 for Arnett Advertising Company, and classify each transaction as either an operating activity, investing activity, or financing activity, or if no cash is exchanged, as a noncash event.

E3-19 Review the transactions listed in E3-3 for Underwood Corp. and classify each transaction as either an operating activity, investing activity, or financing activity, or if no cash is exchanged, as a noncash event.
Exercises: Set B and Challenge Exercises

Visit the book’s companion website, at www.wiley.com/college/kimmel, and choose the Student Companion site to access Exercise Set B and Challenge Exercises.

Problems: Set A

P3-1A On April 1, Vagabond Travel Agency Inc. was established. These transactions were completed during the month.

1. Stockholders invested $30,000 cash in the company in exchange for common stock.
2. Paid $900 cash for April office rent.
3. Purchased office equipment for $3,400 cash.
4. Purchased $200 of advertising in the Chicago Tribune, on account.
5. Paid $500 cash for office supplies.
6. Earned $12,000 for services provided: Cash of $3,000 is received from customers, and the balance of $9,000 is billed to customers on account.
7. Paid $400 cash dividends.
8. Paid Chicago Tribune amount due in transaction (4).
9. Paid employees’ salaries $1,800.
10. Received $9,000 in cash from customers billed previously in transaction (6).

Instructions

(a) Prepare a tabular analysis of the transactions using these column headings: Cash, Accounts Receivable, Supplies, Equipment, Accounts Payable, Common Stock, and Retained Earnings (with separate columns for Revenues, Expenses, and Dividends). Include margin explanations for any changes in Retained Earnings.

(b) From an analysis of the Retained Earnings columns, compute the net income or net loss for April.

P3-2A Susan Taylor started her own consulting firm, Taylor Made Consulting Inc., on May 1, 2012. The following transactions occurred during the month of May.

May 1 Stockholders invested $15,000 cash in the business in exchange for common stock.
2 Paid $600 for office rent for the month.
3 Purchased $500 of supplies on account.
5 Paid $150 to advertise in the County News.
9 Received $1,400 cash for services provided.
12 Paid $200 cash dividend.
15 Performed $4,200 of services on account.
17 Paid $2,500 for employee salaries.
20 Paid for the supplies purchased on account on May 3.
23 Received a cash payment of $1,200 for services provided on account on May 15.
26 Borrowed $5,000 from the bank on a note payable.
29 Purchased office equipment for $2,000 paying $200 in cash and the balance on account.
30 Paid $180 for utilities.

Instructions

(a) Show the effects of the previous transactions on the accounting equation using the following format. Assume the note payable is to be repaid within the year.
Include margin explanations for any changes in Retained Earnings.

(b) Prepare an income statement for the month of May 2012.

(c) Prepare a classified balance sheet at May 31, 2012.

**P3-3A** Robin Klann created a corporation providing legal services, Robin Klann Inc., on July 1, 2012. On July 31 the balance sheet showed: Cash $4,000; Accounts Receivable $2,500; Supplies $500; Equipment $5,000; Accounts Payable $4,200; Common Stock $6,200; and Retained Earnings $1,600. During August the following transactions occurred.

Aug. 1 Collected $1,100 of accounts receivable due from customers.
4 Paid $2,700 cash for accounts payable due.
9 Earned revenue of $5,400, of which $3,600 is collected in cash and the balance is due in September.
15 Purchased additional office equipment for $4,000, paying $700 in cash and the balance on account.
19 Paid salaries $1,400, rent for August $700, and advertising expenses $350.
23 Paid a cash dividend of $700.
26 Received $5,000 from Standard Federal Bank; the money was borrowed on a 4-month note payable.
31 Incurred utility expenses for the month on account $380.

**Instructions**

(a) Prepare a tabular analysis of the August transactions beginning with July 31 balances. The column heading should be: Cash + Accounts Receivable + Supplies + Equipment = Notes Payable + Accounts Payable + Common Stock + Retained Earnings + Revenues – Expenses – Dividends. Include margin explanations for any changes in Retained Earnings.

(b) Prepare an income statement for August, a retained earnings statement for August, and a classified balance sheet at August 31.

**P3-4A** Clear View Miniature Golf and Driving Range Inc. was opened on March 1 by Roger Prince. These selected events and transactions occurred during March.

Mar. 1 Stockholders invested $50,000 cash in the business in exchange for common stock of the corporation.
3 Purchased Arnie's Golf Land for $38,000 cash. The price consists of land $23,000, building $9,000, and equipment $6,000. (Record this in a single entry.)
5 Advertised the opening of the driving range and miniature golf course, paying advertising expenses of $1,200 cash.
6 Paid cash $2,400 for a 1-year insurance policy.
10 Purchased golf clubs and other equipment for $5,500 from Golden Bear Company, payable in 30 days.
18 Received golf fees of $1,600 in cash from customers for golf fees earned.
19 Sold 100 coupon books for $25 each in cash. Each book contains ten coupons that enable the holder to play one round of miniature golf or to hit one bucket of golf balls. (Hint: The revenue is not earned until the customers use the coupons.)
25 Paid a $500 cash dividend.
30 Paid salaries of $800.
30 Paid Golden Bear Company in full for equipment purchased on March 10.
31 Received $900 in cash from customers for golf fees earned.

The company uses these accounts: Cash, Prepaid Insurance, Land, Buildings, Equipment, Accounts Payable, Unearned Service Revenue, Common Stock, Retained Earnings, Dividends, Service Revenue, Advertising Expense, and Salaries and Wages Expense.

**Instructions**

Journalize the March transactions, including explanations. Clear View records golf fees as service revenue.
Problems: Set A

P3-5A  Towne Architects incorporated as licensed architects on April 1, 2012. During the first month of the operation of the business, these events and transactions occurred:

Apr. 1  Stockholders invested $18,000 cash in exchange for common stock of the corporation.
1   Hired a secretary-receptionist at a salary of $375 per week, payable monthly.
2   Paid office rent for the month $900.
3   Purchased architectural supplies on account from Spring Green Company $1,300.
10  Completed blueprints on a carport and billed client $1,900 for services.
11  Received $700 cash advance from J. Madison to design a new home.
20  Received $2,800 cash for services completed and delivered to M. Svetlana.
30  Paid secretary-receptionist for the month $1,500.
30  Paid $300 to Spring Green Company for accounts payable due.

The company uses these accounts: Cash, Accounts Receivable, Supplies, Accounts Payable, Unearned Service Revenue, Common Stock, Service Revenue, Salaries and Wages Expense, and Rent Expense.

Instructions
(a) Journalize the transactions, including explanations.
(b) Post to the ledger T accounts.
(c) Prepare a trial balance on April 30, 2012.

P3-6A  This is the trial balance of Mimosa Company on September 30.

MIMOSA COMPANY
Trial Balance
September 30, 2012

<table>
<thead>
<tr>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>8,200</td>
</tr>
<tr>
<td>Accounts Receivable</td>
<td>2,600</td>
</tr>
<tr>
<td>Supplies</td>
<td>2,100</td>
</tr>
<tr>
<td>Equipment</td>
<td>8,000</td>
</tr>
<tr>
<td>Accounts Payable</td>
<td>4,800</td>
</tr>
<tr>
<td>Unearned Service Revenue</td>
<td>1,100</td>
</tr>
<tr>
<td>Common Stock</td>
<td>15,000</td>
</tr>
<tr>
<td></td>
<td>$20,900</td>
</tr>
<tr>
<td></td>
<td>$20,900</td>
</tr>
</tbody>
</table>

The October transactions were as follows.

Oct. 5  Received $1,300 in cash from customers for accounts receivable due.
10  Billed customers for services performed $5,100.
15  Paid employee salaries $1,200.
17  Performed $600 of services for customers who paid in advance in August.
20  Paid $1,900 to creditors for accounts payable due.
29  Paid a $300 cash dividend.
31  Paid utilities $400.

Instructions
(a) Prepare a general ledger using T accounts. Enter the opening balances in the ledger accounts as of October 1. Provision should be made for these additional accounts: Dividends, Service Revenue, Salaries and Wages Expense, and Utilities Expense.
(b) Journalize the transactions, including explanations.
(c) Post to the ledger accounts.
(d) Prepare a trial balance on October 31, 2012.
P3-7A  This trial balance of Michels Co. does not balance.

<table>
<thead>
<tr>
<th>MICHELS CO.</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Trial Balance</strong></td>
<td></td>
<td>$19,256</td>
</tr>
<tr>
<td><strong>June 30, 2012</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash</td>
<td></td>
<td>$3,090</td>
</tr>
<tr>
<td>Accounts Receivable</td>
<td></td>
<td>3,190</td>
</tr>
<tr>
<td>Supplies</td>
<td></td>
<td>800</td>
</tr>
<tr>
<td>Equipment</td>
<td></td>
<td>3,000</td>
</tr>
<tr>
<td>Accounts Payable</td>
<td></td>
<td>3,686</td>
</tr>
<tr>
<td>Unearned Service Revenue</td>
<td></td>
<td>1,200</td>
</tr>
<tr>
<td>Common Stock</td>
<td></td>
<td>9,000</td>
</tr>
<tr>
<td>Dividends</td>
<td></td>
<td>800</td>
</tr>
<tr>
<td>Service Revenue</td>
<td></td>
<td>3,480</td>
</tr>
<tr>
<td>Salaries and Wages Expense</td>
<td></td>
<td>3,600</td>
</tr>
<tr>
<td>Utilities Expense</td>
<td></td>
<td>910</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>$13,500</td>
<td></td>
</tr>
<tr>
<td><strong>Grand Total</strong></td>
<td>$19,256</td>
<td></td>
</tr>
</tbody>
</table>

Each of the listed accounts has a normal balance per the general ledger. An examination of the ledger and journal reveals the following errors:

1. Cash received from a customer on account was debited for $780, and Accounts Receivable was credited for the same amount. The actual collection was for $870.
2. The purchase of a printer on account for $340 was recorded as a debit to Supplies for $340 and a credit to Accounts Payable for $340.
3. Services were performed on account for a client for $900. Accounts Receivable was debited for $90 and Service Revenue was credited for $900.
4. A debit posting to Salaries and Wages Expense of $700 was omitted.
5. A payment on account for $206 was credited to Cash for $206 and credited to Accounts Payable for $260.
6. Payment of a $600 cash dividend to Michels’ stockholders was debited to Salaries and Wages Expense for $600 and credited to Cash for $600.

Instructions
Prepare the correct trial balance. (Hint: All accounts have normal balances.)

P3-8A  The SciFi Theater Inc. was recently formed. It began operations in March 2012. The SciFi is unique in that it will show only triple features of sequential theme movies. On March 1, the ledger of The SciFi showed: Cash $16,000; Land $38,000; Buildings (concession stand, projection room, ticket booth, and screen) $22,000; Equipment $16,000; Accounts Payable $12,000; and Common Stock $80,000. During the month of March the following events and transactions occurred.

| Mar. | 2   | Rented the three Star Wars movies (Star Wars®, The Empire Strikes Back, and The Return of the Jedi) to be shown for the first three weeks of March. The film rental was $10,000; $2,000 was paid in cash and $8,000 will be paid on March 10. |
| 3    | Ordered the first three Star Trek movies to be shown the last 10 days of March. It will cost $500 per night. |
| 9    | Received $9,900 cash from admissions. |
| 10   | Paid balance due on Star Wars movies rental and $2,900 on March 1 accounts payable. |
| 11   | Hired J. Carne to operate the concession stand. Carne agrees to pay The SciFi Theater 15% of gross receipts, payable monthly. |
| 12   | Paid advertising expenses $500. |
| 20   | Received $8,300 cash from customers for admissions. |
| 31   | Received the Star Trek movies and paid rental fee of $5,000. |
| 31   | Paid salaries of $3,800. |
Problems: Set B

31 Received statement from J. Carne showing gross receipts from concessions of $10,000 and the balance due to The SciFi of $1,500 for March. Carne paid half the balance due and will remit the remainder on April 5.

31 Received $20,000 cash from customers for admissions.

In addition to the accounts identified above, the chart of accounts includes: Accounts Receivable, Service Revenue, Sales Revenue, Advertising Expense, Rent Expense, and Salaries and Wages Expense.

Instructions
(a) Using T accounts, enter the beginning balances to the ledger.
(b) Journalize the March transactions, including explanations. SciFi records admission revenue as service revenue, concession revenue as sales revenue, and film rental expense as rent expense.
(c) Post the March journal entries to the ledger.
(d) Prepare a trial balance on March 31, 2012.

P3-9A The bookkeeper for Fred Kelley’s dance studio made the following errors in journalizing and posting.

1. A credit to Supplies of $600 was omitted.
2. A debit posting of $300 to Accounts Payable was inadvertently debited to Accounts Receivable.
3. A purchase of supplies on account of $450 was debited to Supplies for $540 and credited to Accounts Payable for $540.
4. A credit posting of $680 to Interest Payable was posted twice.
5. A debit posting to Income Taxes Payable for $250 and a credit posting to Cash for $250 were made twice.
6. A debit posting for $1,200 of Dividends was inadvertently posted to Salaries and Wages Expense instead.
7. A credit to Service Revenue for $450 was inadvertently posted as a debit to Service Revenue.
8. A credit to Accounts Receivable of $250 was credited to Accounts Payable.

Instructions
For each error, indicate (a) whether the trial balance will balance; (b) the amount of the difference if the trial balance will not balance; and (c) the trial balance column that will have the larger total. Consider each error separately. Use the following form, in which error 1 is given as an example.

<table>
<thead>
<tr>
<th>Error</th>
<th>(a) In Balance</th>
<th>(b) Difference</th>
<th>(c) Larger Column</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>No</td>
<td>$600</td>
<td>Debit</td>
</tr>
</tbody>
</table>

Problems: Set B

P3-1B New Dawn Window Washing Inc. was started on May 1. Here is a summary of the May transactions.

1. Stockholders invested $20,000 cash in the company in exchange for common stock.
2. Purchased equipment for $9,000 cash.
3. Paid $700 cash for May office rent.
4. Paid $300 cash for supplies.
5. Purchased $750 of advertising in the Beacon News on account.
6. Received $7,200 in cash from customers for service.
7. Paid a $500 cash dividend.
8. Paid part-time employee salaries $1,700.
9. Paid utility bills $140.
10. Provided service on account to customers $1,000.
11. Collected cash of $650 for services billed in transaction (10).
Instructions
(a) Prepare a tabular analysis of the transactions using these column headings: Cash, Accounts Receivable, Supplies, Equipment, Accounts Payable, Common Stock, and Retained Earnings (with separate columns for Revenues, Expenses, and Dividends). Revenue is called Service Revenue. Include margin explanations for any changes in Retained Earnings.

(b) From an analysis of the Retained Earnings columns, compute the net income or net loss for May.

P3-2B Samuel Aldrich started his own delivery service, Aldrich Service Inc., on June 1, 2012. The following transactions occurred during the month of June.

June 1 Stockholders invested $15,000 cash in the business in exchange for common stock.
2 Purchased a used van for deliveries for $15,000. Samuel paid $2,000 cash and signed a note payable for the remaining balance.
3 Paid $600 for office rent for the month.
5 Performed $2,400 of services on account.
9 Paid $300 in cash dividends.
12 Purchased supplies for $240 on account.
15 Received a cash payment of $750 for services provided on June 5.
17 Received a bill for $200 to cover advertisements in Tri-State News.
20 Received a cash payment of $1,500 for services provided.
23 Made a cash payment of $500 on the note payable.
26 Paid $180 for utilities.
29 Paid for the supplies purchased on account on June 12.
30 Paid $750 for employee salaries.

Instructions
(a) Show the effects of the previous transactions on the accounting equation using the following format. Assume the note payable is to be repaid within the year.

(b) Prepare an income statement for the month of June.
(c) Prepare a classified balance sheet at June 30, 2012.

P3-3B Joy Tiede opened Tiede Company, a veterinary business in Neosho, Wisconsin, on August 1, 2012. On August 31, the balance sheet showed: Cash $9,000; Accounts Receivable $1,700; Supplies $600; Equipment $5,000; Accounts Payable $3,600; Common Stock $12,000; and Retained Earnings $700. During September, the following transactions occurred.

Sept. 2 Paid $3,400 cash for accounts payable due.
5 Received $1,200 from customers in payment of accounts receivable.
8 Purchased additional office equipment for $5,100, paying $1,000 in cash and the balance on account.
13 Earned revenue of $10,600, of which $2,300 is paid in cash and the balance is due in October.
17 Paid a $600 cash dividend.
22 Paid salaries $900, rent for September $1,100, and advertising expense $250.
26 Incurred utility expenses for the month on account $220.
30 Received $5,000 from Hilldale Bank on a 6-month note payable.

Instructions
(a) Prepare a tabular analysis of the September transactions beginning with August 31 balances. The column headings should be: Cash + Accounts Receivable + Supplies + Equipment = Notes Payable + Accounts Payable + Common Stock + Retained Earnings + Revenues − Expenses − Dividends. Include margin explanations for any changes in Retained Earnings.

(b) Prepare an income statement for September, a retained earnings statement for September, and a classified balance sheet at September 30, 2012.
RV Oasis was started on April 1 by Taras Dankert. These selected events and transactions occurred during April.

Apr.  1  Stockholders invested $70,000 cash in the business in exchange for common stock.
      4  Purchased land costing $50,000 for cash.
      8  Purchased advertising in local newspaper for $1,200 on account.
     11  Paid salaries to employees $2,700.
     12  Hired park manager at a salary of $3,600 per month, effective May 1.
     13  Paid $7,200 for a 1-year insurance policy.
     17  Paid $300 cash dividends.
     20  Received $6,000 in cash from customers for admission fees.
     25  Sold 100 coupon books for $90 each. Each book contains ten coupons that entitle the holder to one admission to the park. (Hint: The revenue is not earned until the coupons are used.)
     30  Received $7,900 in cash from customers for admission fees.

The company uses the following accounts: Cash, Prepaid Insurance, Land, Accounts Payable, Unearned Service Revenue, Common Stock, Dividends, Service Revenue, Advertising Expense, and Salaries and Wages Expense.

Instructions
Journalize the April transactions, including explanations. (Note: RV Oasis records admission revenue as service revenue.)

P3-5B  Troy Ridgell incorporated Ridgell Consulting, an accounting practice, on May 1, 2012. During the first month of operations, these events and transactions occurred.

May  1  Stockholders invested $40,000 cash in exchange for common stock of the corporation.
      2  Hired a secretary-receptionist at a salary of $2,000 per month.
      3  Purchased $800 of supplies on account from Fleming Supply Company.
      7  Paid office rent of $1,400 for the month.
     11  Completed a tax assignment and billed client $1,500 for services provided.
     12  Received $4,200 advance on a management consulting engagement.
     17  Received cash of $3,300 for services completed for Goodman Co.
     31  Paid secretary-receptionist $2,000 salary for the month.
     31  Paid 50% of balance due Fleming Supply Company.

The company uses the following chart of accounts: Cash, Accounts Receivable, Supplies, Accounts Payable, Unearned Service Revenue, Common Stock, Service Revenue, Salaries and Wages Expense, and Rent Expense.

Instructions
(a) Journalize the transactions, including explanations.
(b) Post to the ledger T accounts.
(c) Prepare a trial balance on May 31, 2012.

P3-6B  The trial balance of Kinnear Dry Cleaners on June 30 is given here.

<table>
<thead>
<tr>
<th></th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>$12,532</td>
<td></td>
</tr>
<tr>
<td>Accounts Receivable</td>
<td>10,536</td>
<td></td>
</tr>
<tr>
<td>Supplies</td>
<td>3,592</td>
<td></td>
</tr>
<tr>
<td>Equipment</td>
<td>25,950</td>
<td></td>
</tr>
<tr>
<td>Accounts Payable</td>
<td></td>
<td>$15,800</td>
</tr>
<tr>
<td>Unearned Service Revenue</td>
<td></td>
<td>1,810</td>
</tr>
<tr>
<td>Common Stock</td>
<td>35,000</td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$52,610</strong></td>
<td><strong>$52,610</strong></td>
</tr>
</tbody>
</table>
The July transactions were as follows.

July 8 Received $5,189 in cash on June 30 accounts receivable.
9 Paid employee salaries $2,100.
11 Received $7,320 in cash for services provided.
14 Paid creditors $9,810 of accounts payable.
17 Purchased supplies on account $720.
22 Billed customers for services provided $4,700.
30 Paid employee salaries $3,114, utilities $1,767, and repairs $386.
31 Paid $400 cash dividend.

Instructions
(a) Prepare a general ledger using T accounts. Enter the opening balances in the ledger accounts as of July 1. Provision should be made for the following additional accounts: Dividends, Service Revenue, Maintenance and Repairs Expense, Salaries and Wages Expense, and Utilities Expense.
(b) Journalize the transactions, including explanations.
(c) Post to the ledger accounts.
(d) Prepare a trial balance on July 31, 2012.

LAGERSTROM COMPANY
Trial Balance
May 31, 2012

<table>
<thead>
<tr>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>$ 6,340</td>
</tr>
<tr>
<td>Accounts Receivable</td>
<td>$ 2,750</td>
</tr>
<tr>
<td>Prepaid Insurance</td>
<td>700</td>
</tr>
<tr>
<td>Equipment</td>
<td>8,000</td>
</tr>
<tr>
<td>Accounts Payable</td>
<td>4,100</td>
</tr>
<tr>
<td>Income Taxes Payable</td>
<td>850</td>
</tr>
<tr>
<td>Common Stock</td>
<td>5,700</td>
</tr>
<tr>
<td>Retained Earnings</td>
<td>6,000</td>
</tr>
<tr>
<td>Service Revenue</td>
<td>7,690</td>
</tr>
<tr>
<td>Salaries and Wages Expense</td>
<td>4,200</td>
</tr>
<tr>
<td>Advertising Expense</td>
<td>1,100</td>
</tr>
<tr>
<td>Income Tax Expense</td>
<td>900</td>
</tr>
<tr>
<td>Tot. trial balance</td>
<td>$28,680</td>
</tr>
<tr>
<td>Tot. trial balance</td>
<td>$19,650</td>
</tr>
</tbody>
</table>

Your review of the ledger reveals that each account has a normal balance. You also discover the following errors.

1. The totals of the debit sides of Prepaid Insurance, Accounts Payable, and Income Tax Expense were each understated $100.
2. Transposition errors were made in Accounts Receivable and Service Revenue. Based on postings made, the correct balances were $2,570 and $7,960, respectively.
3. A debit posting to Salaries and Wages Expense of $500 was omitted.
4. A $600 cash dividend was debited to Common Stock for $600 and credited to Cash for $600.
5. A $350 purchase of supplies on account was debited to Equipment for $350 and credited to Cash for $350.
6. A cash payment of $490 for advertising was debited to Advertising Expense for $49 and credited to Cash for $49.
7. A collection from a customer for $240 was debited to Cash for $240 and credited to Accounts Payable for $240.

Instructions
Prepare the correct trial balance, assuming all accounts have normal balances. (Note: The chart of accounts also includes the following: Dividends and Supplies.)

Riviera Theater Inc. was recently formed. All facilities were completed on March 31. On April 1, the ledger showed: Cash $6,300; Land $10,000; Buildings (concession stand,
Problems: Set B 153

Journalize transactions, posting, and prepare a trial balance.
(SO 3, 5, 6, 7, 8), AP

GLS

P3-9B A first year co-op student working for Solutions.com recorded the transactions for the month. He wasn't exactly sure how to journalize and post, but he did the best he could. He had a few questions, however, about the following transactions.

1. Cash received from a customer on account was recorded as a debit to Cash of $360 and a credit to Accounts Receivable of $630, instead of $360.
2. A service provided for cash was posted as a debit to Cash of $2,000 and a credit to Service Revenue of $2,000.
3. A debit of $880 for services provided on account was neither recorded nor posted. The credit was recorded correctly.
4. The debit to record $1,000 of cash dividends was posted to the Salaries and Wages Expense account.
5. The purchase, on account, of a computer that cost $2,500 was recorded as a debit to Supplies and a credit to Accounts Payable.
6. A cash payment of $495 for salaries was recorded as a debit to Dividends and a credit to Cash.
7. Payment of month's rent was debited to Rent Expense and credited to Cash, $850.
8. Issue of $5,000 of common shares was credited to the Common Stock account, but no debit was recorded.

Instructions
(a) Indicate which of the above transactions are correct, and which are incorrect.
(b) For each error identified in (a), indicate (1) whether the trial balance will balance; (2) the amount of the difference if the trial balance will not balance; and (3) the trial balance column that will have the larger total. Consider each error separately. Use the following form, in which transaction 1 is given as an example.

<table>
<thead>
<tr>
<th>Error</th>
<th>(1) In Balance</th>
<th>(2) Difference</th>
<th>(3) Larger Column</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>No</td>
<td>$270</td>
<td>Credit</td>
</tr>
</tbody>
</table>
Problems: Set C

Visit the book’s companion website, at www.wiley.com/college/kimmel, and choose the Student Companion site to access Problem Set C.

Continuing Cookie Chronicle

(Note: This is a continuation of the Cookie Chronicle from Chapters 1 and 2.)

CCC3 In November 2011, after having incorporated Cookie Creations Inc., Natalie begins operations. She has decided not to pursue the offer to supply cookies to Biscuits. Instead, she will focus on offering cooking classes. The following events occur.

Nov. 8 Natalie cashes in her U.S. Savings Bonds and receives $520, which she deposits in her personal bank account.
8 Natalie opens a bank account for Cookie Creations Inc.
8 Natalie purchases $500 of Cookie Creations’ common stock.
11 Cookie Creations purchases paper and other office supplies for $95. (Use Supplies.)
14 Cookie Creations pays $125 to purchase baking supplies, such as flour, sugar, butter, and chocolate chips. (Use Supplies.)
15 Natalie starts to gather some baking equipment to take with her when teaching the cookie classes. She has an excellent top-of-the-line food processor and mixer that originally cost her $550. Natalie decides to start using it only in her new business. She estimates that the equipment is currently worth $300, and she transfers the equipment into the business in exchange for additional common stock.
16 The company needs more cash to sustain its operations. Natalie’s grandmother lends the company $2,000 cash, in exchange for a two-year, 9% note payable. Interest and the principal are repayable at maturity.
17 Cookie Creations pays $900 for additional baking equipment.
18 Natalie schedules her first class for November 29. She will receive $100 on the date of the class.
18 Natalie teaches her first class, booked on November 18, and collects the $100 cash.
25 Natalie’s brother develops a website for Cookie Creations Inc. that the company will use for advertising. He charges the company $600 for his work, payable at the end of December. (Because the website is expected to have a useful life of two years before upgrades are needed, it should be treated as an asset called Website.)
30 Cookie Creations pays $1,200 for a one-year insurance policy.
30 Natalie teaches a group of elementary school students how to make Santa Claus cookies. At the end of the class, Natalie leaves an invoice for $300 with the school principal. The principal says that he will pass it along to the business office and it will be paid some time in December.
30 Natalie receives a $50 invoice for use of her cell phone. She uses the cell phone exclusively for Cookie Creations Inc. business. The invoice is for services provided in November, and payment is due on December 15.

Instructions
(a) Prepare journal entries to record the November transactions.
(b) Post the journal entries to the general ledger accounts.
(c) Prepare a trial balance at November 30, 2011.
Financial Reporting and Analysis

FINANCIAL REPORTING PROBLEM: Tootsie Roll Industries Inc.

BYP3-1 The financial statements of Tootsie Roll in Appendix A at the back of this book contain the following selected accounts, all in thousands of dollars.

- Common Stock $ 24,862
- Accounts Payable 9,140
- Accounts Receivable 37,512
- Selling, Marketing, and Administrative Expenses 103,755
- Prepaid Expenses 8,562
- Net Property, Plant, and Equipment 220,721
- Net Product Sales 495,592

Instructions
(a) What is the increase and decrease side for each account? What is the normal balance for each account?
(b) Identify the probable other account in the transaction and the effect on that account when:
   (1) Accounts Receivable is decreased.
   (2) Accounts Payable is decreased.
   (3) Prepaid Expenses is increased.
(c) Identify the other account(s) that ordinarily would be involved when:
   (1) Interest Expense is increased.
   (2) Property, Plant, and Equipment is increased.

COMPARATIVE ANALYSIS PROBLEM: Tootsie Roll vs. Hershey

BYP3-2 The financial statements of The Hershey Company appear in Appendix B, following the financial statements for Tootsie Roll in Appendix A.

Instructions
(a) Based on the information contained in these financial statements, determine the normal balance for:

<table>
<thead>
<tr>
<th>Tootsie Roll Industries</th>
<th>The Hershey Company</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1) Accounts Receivable</td>
<td>(1) Inventories</td>
</tr>
<tr>
<td>(2) Net Property, Plant, and Equipment</td>
<td>(2) Provision for Income Taxes</td>
</tr>
<tr>
<td>(3) Accounts Payable</td>
<td>(3) Accrued Liabilities</td>
</tr>
<tr>
<td>(4) Retained Earnings</td>
<td>(4) Common Stock</td>
</tr>
<tr>
<td>(5) Net Product Sales</td>
<td>(5) Interest Expense</td>
</tr>
</tbody>
</table>

(b) Identify the other account ordinarily involved when:
   (1) Accounts Receivable is increased.
   (2) Notes Payable is decreased.
   (3) Machinery is increased.
   (4) Interest Revenue is increased.

RESEARCH CASE

BYP3-3 Sid Cato provides critiques of corporate annual reports. He maintains a website at www.sidcato.com that provides many useful resources for those who are interested in preparing or using annual reports.

Instructions
Go to the website and answer the following questions.
(a) Read the section, “What makes a good annual report?” and choose which three factors you think are most important. Explain why you think each item is important.
(b) For the most recent year presented, which companies were listed in the section "Producers of the best annuals for (most recent year)?"
(c) What potential benefits might a company gain by receiving a high rating from Sid Cato’s organization?
Chieftain International, Inc., is an oil and natural gas exploration and production company. A recent balance sheet reported $208 million in assets with only $4.6 million in liabilities, all of which were short-term accounts payable.

During the year, Chieftain expanded its holdings of oil and gas rights, drilled 37 new wells, and invested in expensive 3-D seismic technology. The company generated $19 million cash from operating activities and paid no dividends. It had a cash balance of $102 million at the end of the year.

Instructions
(a) Name at least two advantages to Chieftain from having no long-term debt. Can you think of disadvantages?
(b) What are some of the advantages to Chieftain from having this large a cash balance? What is a disadvantage?
(c) Why do you suppose Chieftain has the $4.6 million balance in accounts payable, since it appears that it could have made all its purchases for cash?

FINANCIAL ANALYSIS ON THE WEB

Purpose: This activity provides information about career opportunities for CPAs.
Address: www.icpas.org, or go to www.wiley.com/college/kimmel

Steps
1. Go to the address shown above and click on Students/Educators.
2. Click on High School, then CPA101 for parts a, b, and c.
3. Click College to answer part d.

Instructions
Answer the following questions.
(a) What does CPA stand for? Where do CPAs work?
(b) What is meant by "public accounting"?
(c) What skills does a CPA need?
(d) What is the salary range for a CPA at a large firm during the first three years? What is the salary range for chief financial officers and treasurers at large corporations?

Critical Thinking

DECISION MAKING ACROSS THE ORGANIZATION

Donna Dye operates Double D Riding Academy, Inc. The academy's primary sources of revenue are riding fees and lesson fees, which are provided on a cash basis. Donna also boards horses for owners, who are billed monthly for boarding fees. In a few cases, boarders pay in advance of expected use. For its revenue transactions, the academy maintains these accounts: Cash, Accounts Receivable, Unearned Revenue, Riding Revenue, Lesson Revenue, and Boarding Revenue.

The academy owns 10 horses, a stable, a riding corral, riding equipment, and office equipment. These assets are accounted for in the following accounts: Horses, Building, Riding Corral, Riding Equipment, and Office Equipment.

The academy employs stable helpers and an office employee, who receive weekly salaries. At the end of each month, the mail usually brings bills for advertising, utilities, and veterinary service. Other expenses include feed for the horses and insurance. For its expenses, the academy maintains the following accounts: Hay and Feed Supplies, Prepaid Insurance, Accounts Payable, Salaries Expense, Advertising Expense, Utilities Expense, Veterinary Expense, Hay and Feed Expense, and Insurance Expense.

Donna Dye's sole source of personal income is dividends from the academy. Thus, the corporation declares and pays periodic dividends. To account for stockholders' equity in the business and dividends, two accounts are maintained: Common Stock and Dividends.

During the first month of operations an inexperienced bookkeeper was employed. Donna Dye asks you to review the following eight entries of the 50 entries made during the month. In each case, the explanation for the entry is correct.
May 1  | Cash                          | 15,000  
      | Unearned Revenue              | 15,000  
      | (Issued common stock in exchange for $15,000 cash) |
5     | Cash                          | 250     
      | Lesson Revenue                | 250     
      | (Received $250 cash for lesson fees) |
7     | Cash                          | 500     
      | Boarding Revenue              | 500     
      | (Received $500 for boarding of horses beginning June 1) |
9     | Hay and Feed Expense          | 1,500   
      | Cash                          | 1,500   
      | (Purchased estimated 5 months’ supply of feed and hay for $1,500 on account) |
14    | Riding Equipment              | 80      
      | Cash                          | 800     
      | (Purchased desk and other office equipment for $800 cash) |
15    | Salaries Expense              | 400     
      | Cash                          | 400     
      | (Issued check to Donna Dye for personal use) |
20    | Cash                          | 145     
      | Riding Revenue                | 154     
      | (Received $154 cash for riding fees) |
31    | Veterinary Expense            | 75      
      | Accounts Receivable           | 75      
      | (Received bill of $75 from veterinarian for services provided) |

**Instructions**
With the class divided into groups, answer the following.
(a) For each journal entry that is correct, so state. For each journal entry that is incorrect, prepare the entry that should have been made by the bookkeeper.
(b) Which of the incorrect entries would prevent the trial balance from balancing?
(c) What was the correct net income for May, assuming the bookkeeper originally reported net income of $4,500 after posting all 50 entries?
(d) What was the correct cash balance at May 31, assuming the bookkeeper reported a balance of $12,475 after posting all 50 entries?

**COMMUNICATION ACTIVITY**

**BYP3-7** Clean Sweep Company offers home cleaning service. Two recurring transactions for the company are billing customers for services provided and paying employee salaries. For example, on March 15 bills totaling $6,000 were sent to customers, and $2,000 was paid in salaries to employees.

**Instructions**
Write a memorandum to your instructor that explains and illustrates the steps in the recording process for each of the March 15 transactions. Use the format illustrated in the text under the heading “The Recording Process Illustrated” (pp. 121–126).

**ETHICS CASES**

**BYP3-8** Courtney Delacey is the assistant chief accountant at BIT Company, a manufacturer of computer chips and cellular phones. The company presently has total sales of $20 million. It is the end of the first quarter and Courtney is hurriedly trying to prepare a general ledger trial balance so that quarterly financial statements can be prepared and released to management and the regulatory agencies. The total credits on the trial balance exceed the debits by $1,000.
In order to meet the 4 P.M. deadline, Courtney decides to force the debits and credits into balance by adding the amount of the difference to the Equipment account. She chose Equipment because it is one of the larger account balances; percentage-wise it will be the least misstated. Courtney plugs the difference! She believes that the difference is quite small and will not affect anyone’s decisions. She wishes that she had another few days to find the error but realizes that the financial statements are already late.

**Instructions**
(a) Who are the stakeholders in this situation?
(b) What ethical issues are involved?
(c) What are Courtney’s alternatives?

**BYP3-9** The July 28, 2007, issue of the *Wall Street Journal* includes an article by Kathryn Kranhold entitled “GE’s Accounting Draws Fresh Focus on News of Improper Sales Bookings.”

**Instructions**
Read the article and answer the following questions.
(a) What improper activity did the employees at GE engage in?
(b) Why might the employees have engaged in this activity?
(c) What were the implications for the employees who engaged in this activity?
(d) What does it mean to “restate” financial results? Why didn’t GE restate its results to correct for the improperly reported locomotive sales?

**“ALL ABOUT YOU” ACTIVITY**

**BYP3-10** In their annual reports to stockholders, companies must report or disclose information about all liabilities, including potential liabilities related to environmental clean-up. There are many situations in which you will be asked to provide personal financial information about your assets, liabilities, revenue, and expenses. Sometimes you will face difficult decisions regarding what to disclose and how to disclose it.

**Instructions**
Suppose that you are putting together a loan application to purchase a home. Based on your income and assets, you qualify for the mortgage loan, but just barely. How would you address each of the following situations in reporting your financial position for the loan application? Provide responses for each of the following questions.
(a) You signed a guarantee for a bank loan that a friend took out for $20,000. If your friend doesn’t pay, you will have to pay. Your friend has made all of the payments so far, and it appears he will be able to pay in the future.
(b) You were involved in an auto accident in which you were at fault. There is the possibility that you may have to pay as much as $50,000 as part of a settlement. The issue will not be resolved before the bank processes your mortgage request.
(c) The company at which you work isn’t doing very well, and it has recently laid off employees. You are still employed, but it is quite possible that you will lose your job in the next few months.

**Answers to Insight and Accounting Across the Organization Questions**

**p. 109 Why Accuracy Matters** **Q:** In order for these companies to prepare and issue financial statements, their accounting equations (debit and credits) must have been in balance at year-end. How could these errors or misstatements have occurred? **A:** A company’s accounting equation (its books) can be in balance yet its financial statements have errors or misstatements because of the following: entire transactions were not recorded; transactions were recorded at wrong amounts; transactions were recorded in the wrong accounts; transactions were recorded in the wrong accounting period. Audits of financial statements uncover some, but obviously not all, errors or misstatements.

**p. 115 Keeping Score** **Q:** Do you think that the Chicago Bears football team would be likely to have the same major revenue and expense accounts as the Cubs? **A:** Because their businesses are similar—professional sports—many of the revenue and expense accounts for the baseball and football teams might be similar.

**p. 119 Boosting Microsoft’s Profits** **Q:** In what ways is this Microsoft division using accounting to assist in its effort to become more profitable? **A:** The division has used accounting to set very strict sales, revenue, and profit goals. In addition, the managers in this division use accounting
to keep a tight reign on product costs. Also, accounting serves as the basis of communication so that the marketing managers and product designers can work with production managers, engineers, and accountants to create an exciting product within specified cost constraints.

**Answers to Self-Test Questions**

1. b  
2. b  
3. b  
4. $40,000  
5. b  
6. c  
7. d  
8. d  
9. d  
10. b  
11. a  
12. c  
13. d  
14. a  
15. c

---

**A Look at IFRS**

International companies use the same set of procedures and records to keep track of transaction data. Thus, the material in Chapter 3 dealing with the account, general rules of debit and credit, and steps in the recording process—the journal, ledger, and chart of accounts—is the same under both GAAP and IFRS.

**KEY POINTS**

- Transaction analysis is the same under IFRS and GAAP but, as you will see in later chapters, different standards sometimes impact how transactions are recorded.
- Rules for accounting for specific events sometimes differ across countries. For example, European companies rely less on historical cost and more on fair value than U.S. companies. Despite the differences, the double-entry accounting system is the basis of accounting systems worldwide.
- Both the IASB and FASB go beyond the basic definitions provided in this textbook for the key elements of financial statements, that is, assets, liabilities, equity, revenues, and expenses. The more substantive definitions, using the IASB definitional structure, are provided in the Chapter 1 A Look at IFRS discussion.
- A trial balance under IFRS follows the same format as shown in the textbook.
- As shown in the textbook, dollars signs are typically used only in the trial balance and the financial statements. The same practice is followed under IFRS, using the currency of the country that the reporting company is headquartered.
- In February 2010, the SEC expressed a desire to continue working toward a single set of high-quality standards. In deciding whether the United States should adopt IFRS, some of the issues the SEC said should be considered are:
  - Whether IFRS is sufficiently developed and consistent in application.
  - Whether the IASB is sufficiently independent.
  - Whether IFRS is established for the benefit of investors.
  - The issues involved in educating investors about IFRS.
  - The impact of a switch to IFRS on U.S. laws and regulations.
  - The impact on companies including changes to their accounting systems, contractual arrangements, corporate governance, and litigation.
  - The issues involved in educating accountants, so they can prepare statements under IFRS.

**LOOKING TO THE FUTURE**

The basic recording process shown in this textbook is followed by companies across the globe. It is unlikely to change in the future. The definitional structure of assets, liabilities, equity, revenues, and expenses may change over time as the IASB and FASB evaluate their overall conceptual framework for establishing accounting standards.
IFRS Self-Test Questions

1. Which statement is correct regarding IFRS?
   (a) IFRS reverses the rules of debits and credits, that is, debits are on the right and credits are on the left.
   (b) IFRS uses the same process for recording transactions as GAAP.
   (c) The chart of accounts under IFRS is different because revenues follow assets.
   (d) None of the above statements are correct.

2. The expanded accounting equation under IFRS is as follows:
   (a) Assets = Liabilities + Share Capital + Dividends + Revenues – Expenses.
   (b) Assets + Liabilities = Share Capital + Dividends + Revenues – Expenses.
   (c) Assets = Liabilities + Share Capital – Dividends + Revenues – Expenses.

3. A trial balance:
   (a) is the same under IFRS and GAAP.
   (b) proves that transactions are recorded correctly.
   (c) proves that all transactions have been recorded.
   (d) will not balance if a correct journal entry is posted twice.

4. One difference between IFRS and GAAP is that:
   (a) GAAP uses accrual-accounting concepts and IFRS uses primarily the cash basis of accounting.
   (b) IFRS uses a different posting process than GAAP.
   (c) IFRS uses more fair value measurements than GAAP.
   (d) the limitations of a trial balance are different between IFRS and GAAP.

5. The general policy for using proper currency signs (dollar, yen, pound, etc.) is the same for both IFRS and this textbook. This policy is as follows:
   (a) Currency signs only appear in ledgers and journal entries.
   (b) Currency signs are only shown in the trial balance.
   (c) Currency signs are shown for all compound journal entries.
   (d) Currency signs are shown in trial balances and financial statements.

IFRS Concepts and Application

IFRS3–1 Describe some of the issues the SEC must consider in deciding whether the United States should adopt IFRS.

INTERNATIONAL FINANCIAL REPORTING PROBLEM: Zetar plc

IFRS3–2 The financial statements of Zetar plc are presented in Appendix C. The company’s complete annual report, including the notes to its financial statements, is available at www.zetarplc.com.

Instructions
Describe in which statement each of the following items is reported, and the position in the statement (e.g., current asset).
   (a) Share capital.
   (b) Goodwill.
   (c) Borrowings and overdrafts.
   (d) Amortisation of intangible assets.
   (e) Derivative financial asset.

Answers to IFRS Self-Test Questions

1. b  2. c  3. a  4. c  5. d

Remember to go back to the navigator box on the chapter opening page and check off your completed work.