CHAPTER 2
THE BALANCE SHEET

Student Learning Objectives and Related Assignment Materials

Student Learning Objectives	*Mini-Exercises*	*Exercises*	*Coached Problems*	*Problems (Groups A & B)*	*Skills Development Cases*	*Continuing Case*
LO 2-1 – Identify financial effects of common business activities that affect the balance sheet.	4, 5, 6	1, 2, 3, 4*, 5, 9, 11, 13, 14			1, 2, 3, 4, 5, 6	1†
LO 2-2 – Apply transaction analysis to accounting transactions.	1, 2, 3, 7, 8, 9	1, 2, 4*, 5, 8, 9, 10, 12, 13, 15^	1, 2, 3	A1, A2, A3, B1, B2, B3	4, 7	1†
LO 2-3 – Use journal entries and T-accounts to show how business transactions affect the balance sheet.	1, 2, 3, 5, 6, 10, 11, 13*, 14, 15*, 16, 17*, 18, 19*^, 20	1, 3, 6*, 7, 8, 10, 11, 12, 13, 15^	2, 3	A2, A3, B2, B3		1†
LO 2-4 – Prepare a classified balance sheet.	4, 5, 6, 12, 21, 22	3, 9, 10, 12, 15	2, 3	A2, A3, B2, B3	1, 2, 3, 6	1†
LO 2-5 – Interpret the balance sheet using the current ratio and an understanding of the related concepts.	3, 22, 23, 24^, 25^	1, 2, 5, 7, 8, 11, 14, 15^	1, 2, 3	A1, A2, A3, B1, B2, B3	1, 2, 3, 4, 5, 6	1†

* Animated solution included in the PowerPoint Slides.

^ Particularly challenging; requires students to combine multiple concepts in order to advance to the next level of accounting knowledge.

† Continuing Case 2-1 builds on the story of Nicole's Getaway Spa, introduced in chapter 1. This case focuses on analyzing transactions, preparing and recording journal entries, posting to T-accounts, preparing a classified balance sheet, and interpreting the current ratio. This case will be extended in future chapters.

Overview

The entrepreneur from chapter 1 organizes his business as a corporation and completes business transactions to establish the business.

Students learn how to analyze and record business transactions that affect the balance sheet and then prepare and interpret a classified balance sheet.

Synopsis of Chapter Revisions

Focus Company: Pizza Aroma, Inc.

- Refocused discussion on the balance sheet, and its relationship to financing, investing, and select operating activities
- New Spotlight on Financial Reporting about the importance of meeting deadlines
- Updated data for contrast company (Papa John's)
- New Spotlight on Financial Reporting comparing current ratios before and after the 2008-09 financial crisis
- Revisions to end-of-chapter material: Streamlined account names to correspond to standardized chart of accounts for hypothetical companies; updated numerical data for 100 percent of real-world companies; revised annual report case to multiple-choice format; new challenging "level-up" exercises

PowerPoint Slides

Student Learning Objective	***PowerPoint® Slides***
LO 2-1 – Identify financial effects of common business activities that affect the balance sheet.	2-2 through 2-6
LO 2-2 – Apply transaction analysis to accounting transactions.	2-7 through 2-16
LO 2-3 – Use journal entries and T-accounts to show how business transactions affect the balance sheet.	2-17 through 2-30
LO 2-4 – Prepare a classified balance sheet.	2-31 through 2-31
LO 2-5 – Interpret the balance sheet using the current ratio and an understanding of the related concepts.	2-32 through 2-37

Animated Builds and Animated Solutions	***PowerPoint® Slides***
Mini-Exercise 2-13	2-39 through 2-40
Mini-Exercise 2-15	2-41 through 2-42
Mini-Exercise 2-17	2-43 through 2-44
Mini-Exercise 2-19	2-45 through 2-46
Exercise 2-4	2-47
Exercise 2-6	2-48 through 2-49

Summary of Related Video Programs

McGraw-Hill/Irwin Financial Accounting Video Series
Program #2 – Transaction Analysis (9:35)

This video program may be shown in connection with chapter 2 or chapter 3.

The video features Platinum Technology during its general discussion of transactions. The video begins by defining and providing examples of assets, liabilities, equity, revenue, and expense. Then, the term, business transaction, is explained. The distinction between what is and what isn't a transaction is stressed. Platinum Technology is a real world company that must determine whether given events should be recorded as transactions. After the accounting equation is illustrated, its similarity to the balance sheet is noted. Then, transaction analysis is performed for a number of transactions. Most, but not all, of the transactions illustrated affect the balance sheet.

Program #3 – Recording Transactions (11:13)

The video begins with a brief discussion of the nature of the ledger. Next, the usefulness of the T-account as a tool and the meanings of the terms debit and credit are explained. After illustrating the analysis of a single transaction in T-account format, the rules of debit and credit are explained and illustrated. Transaction analysis is illustrated (using a T-account format) for a number of transactions that affect the balance sheet. The effects on the accounting equation are included for the transactions. Then, the purpose of the journal is addressed and journal entries are illustrated for the first few transactions that were analyzed previously. The posting process is addressed briefly. After explaining the purpose of the trial balance, its preparation is illustrated. After in-depth illustrations of the preparation of the financial statements that summarize the transactions that were analyzed, a review of the entire process is provided.

Chapter Summary

LO 2-1 – Identify financial effects of common business activities that affect the balance sheet.

- Financing activities involve debt transactions with lenders (e.g., Notes Payable) or equity transactions with investors (e.g., Contributed Capital)
- Investing activities involve buying and selling long-term assets (e.g., Buildings, Equipment).

LO 2-2 – Apply transaction analysis to accounting transactions.

- Transactions include external exchanges and internal events.
- Transaction analysis is based on the duality of effects and the basic accounting equation. Duality of effects means that every transaction affects at least two accounts.
- Transaction analysis follows a systematic approach of picturing the documented business activity; naming the assets, liabilities, or stockholders' equity that are exchanged; and analyzing the financial effects on the basic accounting equation.

Chapter Summary, continued

LO 2-3 – Use journal entries and T-accounts to show how transactions affect the balance sheet.

- Debit means left and credit means right.
- Debits increase assets and decrease liabilities and stockholders' equity.
- Credits decrease assets and increase liabilities and stockholders' equity.
- Journal entries express, in debits-equal-credits form, the effects of a transaction on various asset, liability, and stockholders' equity accounts. Journal entries are used to record financial information in the accounting system, which is later summarized by accounts in the ledger (T-accounts).
- T-accounts are a simplified version of the ledger, which summarizes transaction effects for each account. T-accounts show increases on the left (debit) side for assets, which are on the left side of the accounting equation. T-accounts show increases on the right (credit) side for liabilities and stockholders' equity, which are on the right side of the accounting equation.

LO 2-4 – Prepare a classified balance sheet.

- A classified balance sheet separately classifies assets as current if they will be used up or turned into cash within one year. Liabilities are classified as current if they will be paid, settled, or fulfilled within one year.

LO 2-5 – Interpret the balance sheet using the current ratio and an understanding of related concepts.

- The current ratio divides current assets by current liabilities to determine the extent to which current assets are likely to be sufficient for paying current liabilities.
- Because accounting is transaction-based, the balance sheet does not necessarily represent the current value of a business.
- Some assets are not recorded because they do not arise from transactions.
- The amounts recorded for assets and liabilities may not represent current values because under the cost principle they generally are recorded at cost, using the exchange amounts established at the time of the initial transaction.

Accounting Decision Tools

Current Ratio = Current Assets ÷ Current Liabilities

- It tells you whether current assets are sufficient to pay current liabilities.
- A higher ratio means better ability to pay.

Chapter Outline	Teaching Notes
I. Understand the Business	

LO 2-1 – Identify financial effects of common business activities that affect the balance sheet.

A. Building a Balance Sheet 1. **Assets** – Resources presently owned by a business that generate future economic benefits. 2. **Liabilities** – Amounts presently owed by a business 3. **Stockholders' equity -** Amount invested and reinvested in a company by its stockholders.	*In this chapter, the Retained Earnings account has a zero balance because there have been no operating transactions.*
B. Financing and Investing Activities 1. Key activity for any start-up company is to obtain financing. a. Equity financing – Money obtained through owners' contributions and reinvestments of profit; documents called stock certificates are given to owners to evidence ownership. b. Debt financing – Money obtained through loans. 2. After obtaining initial financing, company will start investing in assets that will be used when business opens. 3. Features important for understanding how accounting works; a company always: a. Documents its activities. b. Receives something and gives something (basic feature of all business activities). c. Determines a dollar amount for each exchange based on value of items given and exchanged.	
i. Exchange is either to earn a profit immediately or obtain resources that will allow it to earn a profit later. ii. Any exchange that affects company's assets, liabilities, or stockholders' equity must be captured in and reported by the accounting system. iii. A dollar amount is determined for each exchange based on the value (cost) of items given and received. iv. **Cost principle** – At the time of a transaction, assets and liabilities should be recorded at their original cost to the company.	*Fundamental idea of business is to create value through exchange.*
4. Accounting for business activities: a. Picture the documented activity.	Illustrated in Exhibit 2.3
b. Name what's exchanged c. Analyze the financial affects – Building on the last step, show how the costs cause elements of the accounting equation to increase and/or decrease.	*Ultimate goal – capture financial effects so that they can be reported in financial statements.*

Chapter Outline	**Teaching Notes**
C. Transactions and Other Activities 1. **Transaction** – Has a direct and measurable financial effect on the assets, liabilities, or stockholders' equity of a business. 2. Transactions include two types of events: a. **External exchanges** – Exchanges involving assets, liabilities, and/or stockholders' equity that you can see between the company and someone else. b. **Internal events** – Events that do not involve exchanges with others outside the business, but rather occur within the company itself. 3. Exchange of only promises is not an accounting transaction. a. Documents are created to indicate activities occurred. b. Later, when promises result in actually receiving or giving an asset or services, they will become transactions captured by the accounting system. II. Study the Accounting Methods	
LO 2-2 – Apply transaction analysis to accounting transactions.	
A. Step 1 – Analyze Transactions 1. Once a transaction is identified, it must be analyzed carefully to determine its financial effects. Two simple ideas are used when analyzing transactions: a. **Duality of effects** – Every transaction has at least two effects on the basic accounting equation. b. The dollar amount for assets must always equal that for liabilities plus stockholders' equity for every accounting transaction. A = L + SE. c. As part of transaction analysis, name (or account title) is given to each item exchanged.	❖ Video Program #2 *Analyze transactions from the standpoint of the business, not its owners.*
d. **Chart of accounts** – Summary of all account names (and corresponding account numbers) used to record financial results in the accounting system. i. Ensures account titles are used consistently. ii. Tailored to each company's business. iii. Many account titles are common across all companies; others may be used only by a particular company.	Illustrated in Exhibit 2.4. *Chart of accounts shown in Chapter 2 includes only balance sheet accounts.*

Chapter Outline	Teaching Notes
2. Pizza Aroma's Business Activities (a) Issue Stock to Owners - Mauricio Rosa incorporates Pizza Aroma Inc., on August 1. The company issues stock to Mauricio and his wife as evidence of their contribution of \$50,000 cash, which is deposited in the company's bank account. • Name: Pizza Aroma has received \$50,000 cash. Pizza Aroma gave \$50,000 of stock (contributed capital). • Analyze: Assets = Liabilities + Stockholders' Equity Cash (A) + 50,000 = Contributed Capital (SE) + 50,000 (b) Invest in Equipment – Pizza Aroma pays \$42,000 cash to buy restaurant booths and other equipment. • Name: Pizza Aroma has received \$42,000 of equipment. Pizza Aroma gave \$42,000 cash. • Analyze: Assets = Liabilities + Stockholders' Equity Cash (A) – 42,000; Equipment (A) + 42,000 = 0	*Stress <u>that students should not skip this section</u> with the plan of coming back to it later; the next part of the chapter builds on this part.*
(c) Obtain Loan from Bank – Pizza Aroma borrows \$20,000 from a bank, depositing those funds in its bank account and signing a formal agreement to repay the loan in two years (on September 1, 2015). • Name: Pizza Aroma has received \$20,000 cash. Pizza Aroma gave a note, payable to the bank for \$20,000. • Analyze: Assets = Liabilities + Stockholders' Equity Cash (A) + 20,000 = Note Payable (L) + 20,000 (d) Invest in Equipment – Pizza Aroma purchases \$18,000 in pizza ovens and other restaurant equipment, paying \$16,000 in cash and giving an informal promise to pay \$2,000 at the end of the month. • Name: Pizza Aroma has received \$18,000 of equipment. Pizza Aroma gave \$16,000 cash and a promise to pay \$2,000 on account. • Analyze: Assets = Liabilities + Stockholders' Equity Cash (A) – 16,000; Equipment (A) + 18,000 = Accounts Payable +2,000	*Notes payable are like accounts payable except that they: (a) charge interest, (b) can be outstanding for periods longer than one year, and (c) are documented using formal documents called notes.*

Chapter Outline	**Teaching Notes**
(e) Order Cookware – Pizza Aroma orders $630 of pans, dishes, and other cookware. None have been received yet.	
• Name: An exchange of only promises is not a transaction. This does not affect the accounting equation.	*Not all business activities are considered accounting transactions.*
• Analyze: Assets = Liabilities + Stockholders' Equity No change = No change	
(f) Pay Supplier – Pizza Aroma pays $2,000 to the equipment supplier in (d).	
• Name: Pizza Aroma has received back its $2,000 promise to pay on account. Pizza Aroma gave $2,000 cash.	
• Analyze: Assets = Liabilities + Stockholders' Equity Cash – 2,000 = Accounts Payable – 2,000	
(g) Receive Cookware – Pizza Aroma receives $630 of the cookware ordered in (e) and promises to pay for it next month.	
• Name: Pizza Aroma has received cookware costing $630. Pizza Aroma gave a promise to pay $630 on account.	
• Analyze: Assets = Liabilities + Stockholders' Equity Cookware (A) + 630 = Accounts Payable (L) + 630	✓ Supplemental Enrichment Activity (Activity) #1 ✓ Activity #2
B. Steps 2 and 3: Record and Summarize	❖ Video Program #3
1. One method for recording and summarizing the financial effects of accounting transactions is to prepare a spreadsheet.	Illustrated in Exhibit 2.5
a. By summing each spreadsheet column, the new balances can be computed at the end of the month and reported on a balance sheet.	
b. This method is impractical for most large organizations.	
2. Most companies use computerized accounting systems, which can handle a large number of transactions.	
a. These systems follow a cycle, called the accounting cycle, which is repeated month-after-month and year-after-year.	Illustrated in Exhibit 2.6
b. Three-step analyze-record-summarize process is applied to daily transactions and then to adjustments and closing processes at the end of each accounting period.	*Focus here is on applying the three-step process during the period to activities that affect only balance sheet accounts.*

Chapter Outline	**Teaching Notes**
3. Transactions are analyzed, and their financial effects are entered into journals each day they occur. Later, these journal entries are summarized in ledger accounts that keep track of the financial effects on each account. a. **Journal** – Organized by date, and are used to record the effects of each day's transactions. b. **Ledger** – Organized by account and is used to summarize the effects of journal entries on each account.	

LO 2-3 – Use journal entries and T-accounts to show how business transactions affect the balance sheet.

C. The Debit/Credit Framework	✓ Activity #3 ✓ Activity #4
1. The accounting equation (A = L + SE) can be thought of as a scale that tips at the equals sign. a. Assets are put on the left side of the scale and liabilities and stockholders' equity accounts are put on the right. b. Liabilities and stockholders' equity accounts are put on the right. 2. Likewise, each individual account has two sides, with one side used for increases and the other for decreases. 3. Accounts increase on the same side as they appear in A = L + SE: a. Assets increase on the left side of the account. b. Liabilities increase on the right side of the account. c. Stockholders' equity accounts increase on the right side of the account. 4. Decreases are the opposite. 5. **Debit** (dr) means left. **Credit** (cr) means right. 6. When combined with how increases and decreases are entered into accounts, the following rules emerge:	
a. Use debits for increases in assets (and for decreases in liabilities and stockholders' equity accounts).	Illustrated in Exhibit 2.7
b. Use credits for increases in liabilities and stockholders' equity accounts (and for decreases in assets). 7. In addition to requiring that A = L + SE, the double-entry system also requires that debits = credits. a. Step 1: Analyzing Transactions – The debit/credit framework does not change this step. b. Step 2: Recording Journal Entries - The financial effects of transactions are entered into a journal using a debits-equal-credits format.	

Chapter Outline	Teaching Notes
8. **Journal entries** – Indicate the effects of each day's transactions in a debits-equal-credits format. a. A date is included for each transaction. b. Debits appear first (on top). Credits are written below the debits and are indented to the right (both the words and the amounts). c. Total debits must equal total credits. d. Dollar signs are not used. e. The reference column (Ref.) will be used later (in step 3) to indicate when the journal entry has been summarized in the ledger accounts. f. A brief explanation of the transaction is written below the debits and credits. g. The line after the description is left blank.	Illustrated in Exhibit 2.8
D. Step 3: Summarizing in Ledger Accounts:	
1. After journal entries have been recorded (in step 2), their dollar amounts are copied ("**posted**") to each ledger account affected by the transaction so that account balances can be computed.	Illustrated in Exhibit 2.9
2. The posting of journal entries to general ledger accounts is kept track of by writing the account number in the Ref. column of the journal and the journal page number in the Ref. column of the ledger.	✓ Activity #5
3. **T-account** – Simplified version of a ledger account used for summarizing the effects of journal entries. a. Every account starts with a beginning balance usually on the side where increases are summarized. b. Dollar signs are not needed. c. Each amount is accompanied by a reference to the related journal entry, which makes it easy to trace back to the original transaction should errors occur. d. To find ending account balances, express the T-accounts as equations: Start with beginning balance Add "+" side Subtract " –" side Equals ending balance i. Assets normally end with a debit balance (because debits to assets normally exceed credits). ii. Liabilities and stockholders' equity accounts normally end with credit balances (credits normally exceed debits).	Illustrated in Exhibit 2.10

Chapter Outline	**Teaching Notes**
E. Pizza Aroma's Accounting Records	
(a) Issue Stock to Owners - The company issues stock as evidence of their contribution of $50,000 cash.	
1. Analyze: Assets = Liabilities + Stockholders' Equity Cash (A) + 50,000 = Contributed Capital (SE) + 50,000	*Refer to illustrations of transactions (a) through (g) in textbook for Step 3 - Summarize (which includes posting to T-accounts).*
2. Record: dr Cash (+A) 50,000 cr Contributed Capital (+SE) 50,000	
(b) Invest in Equipment – Pizza Aroma pays $42,000 cash to buy restaurant booths and other equipment.	
1. Analyze: Assets = Liabilities + Stockholders' Equity Cash (A) – 42,000; Equipment (A) + 42,000 = 0	
2. Record: dr Equipment (+A) 42,000 cr Cash (–A) 42,000	
(c) Obtain Loan from Bank – Pizza Aroma borrows $20,000 from a bank and signs a formal agreement to repay the loan in two years (on September 1, 2015).	
1. Analyze: Assets = Liabilities + Stockholders' Equity Cash (A) + 20,000 = Note Payable (L) + 20,000	
2. Record: dr Cash (+A) 20,000 cr Note Payable (+L) 20,000	
(d) Invest in Equipment – Pizza Aroma purchases $18,000 in pizza ovens and other restaurant equipment, paying $16,000 in cash and giving an informal promise to pay $2,000 at the end of the month.	
1. Analyze: Assets = Liabilities + Stockholders' Equity Cash (A) – 16,000; Equipment (A) + 18,000 = Accounts Payable +2,000	
2. Record: dr Equipment (+A) 18,000 cr Cash (–A) 16,000 cr Accounts Payable (+L) 2,000	
(e) Order Cookware – Pizza Aroma orders $630 of pans, dishes, and other cookware. None have been received yet.	
1. Analyze: Assets = Liabilities + Stockholders' Equity No change = No change	
2. Record – No journal entry is needed.	
(f) Pay Supplier – Pizza Aroma pays $2,000 to the equipment supplier in (d).	
1. Analyze: Assets = Liabilities + Stockholders' Equity Cash – 2,000 = Accounts Payable – 2,000	
2. Record: dr Accounts Payable (–L) 2,000 cr Cash (–A) 2,000	

Chapter Outline	Teaching Notes
(g) Receive Cookware – Pizza Aroma receives $630 of the cookware ordered in (e) and promises to pay for it next month. 1. Analyze: Assets = Liabilities + Stockholders' Equity Cookware (A) + 630 = Accounts Payable (L) + 630 2. Record: dr Cookware (+A) 630 cr Accounts Payable (+L) 630	

LO 2-4 – Prepare a classified balance sheet.

F. Preparing a Balance Sheet 1. **Classified balance sheet** – One that shows a subtotal for current assets and current liabilities. 2. **Current assets** – Will be used up or converted into cash within 12 months of the balance sheet date. 3. **Current liabilities** – Debts and obligations that will be paid, settled, or fulfilled within 12 months of the balance sheet date. III. Evaluate the Results	✓ Activity #6

LO 2-5 – Interpret the balance sheet using the current ratio and an understanding of the related concepts.

A. Assessing the Ability to Pay 1. The classified balance sheet format makes it easy to see whether current assets are sufficient to pay current liabilities. 2. The only problem with this approach is that looking at total dollar amounts can be awkward, especially if we want to compare across several companies.	
3. **Current Ratio** a. Current assets divided by current liabilities. b. Used to evaluate the ability to pay liabilities as they come due in the short run. c. Generally speaking, a high ratio suggests good liquidity. B. Balance Sheet Concepts and Values 1. Some mistakenly believe that the balance sheet reports what a business is actually worth. 2. In fact, net worth is a term that many accountants and analysts use when referring to stockholders' equity. 3. The answer comes from knowing that accounting is based on recording and reporting transactions: a. What is (and is not) recorded? i. Only measurable exchanges are recorded. ii. Because Pizza Aroma 's gourmet pizza recipes were not acquired in an exchange, they are not on the balance sheet.	✓ Activity #7

Chapter Outline	**Teaching Notes**
b. What amounts are assigned to recorded items?	
i. Following the cost principle, assets and liabilities are first recorded at the amounts that were measurable and accurate at the time the transaction occurred.	
ii. Does that mean that if an asset's value falls over time, it will continue to be reported at its original cost? The answer is no.	
c. Conservatism – Requirement to use the least optimistic measures when uncertainty exists about the value of an asset or liability. Businesses should not:	
i. Overstate assets and revenues.	
ii. Understate liabilities and expenses.	
C. A Review of the Accounting Cycle	Summarized in Exhibit 2.14
1. During the accounting period, transactions take place.	
a. Picture the documented activity.	
b. Name what's exchanged.	
c. Analyze the financial effects.	
d. Record a journal entry.	
e. Summarize in T-accounts.	
2. At the end of accounting period:	
a. Prepare a trial balance.	
b. Adjust the accounts.	*Covered in Chapter 4*
c. Prepare financial statements from the trial balance and distribute to users. *(Because the company does not report any operations here, it prepares only the balance sheet.)*	
d. Close the books	*Covered in Chapter 4*

Supplemental Enrichment Activities

Note: These activities would be suitable for individual or group activities.

1. Handout 2-1

   Use this handout for an in-class activity designed to review the analysis of various business transactions that affect the balance sheet. The solution follows the handout master.

2. Handout 2-2

   This activity is a continuation of Activity #1. Use this handout for an in-class activity designed to continue the review of the analysis of various business transactions that affect the balance sheet. The solution follows the handout master.

3. Handout 2-3

   Use Handout 2-3 for an in-class activity designed to review the debit/credit framework. Note that these transactions are the same as those analyzed on Handout 2-1. However, it can be assigned even if Activity #1 was not assigned. The solution follows the handout master.

4. Handout 2-4

   This activity is a continuation of Activity #3. Use this handout for an in-class activity designed to review the debit/credit framework. Note that these transactions are the same as those analyzed on Handout 2-2. However, it can be assigned even if Activity #2 was not assigned. The solution follows the handout master.

5. Handout 2-5

   Use this handout for an in-class activity designed to review the posting of various balance sheet transactions to T-accounts. This activity is a continuation of Activity #3 and Activity #4; it should be assigned only if both of those activities were assigned. The solution follows the handout master.

6. Handout 2-6

   Use this handout for an in-class activity designed to review the preparation of a classified balance sheet. This activity is a continuation of Activity #5; it should be assigned only if that activity was assigned. The solution follows the handout master.

7. Use Handout 2-7

   Use this handout for an in-class activity designed to review the calculation and interpretation of the current ratio. This activity is a continuation of Activity #6; it should be assigned only if that activity was assigned. The solution follows the handout master.

HANDOUT 2-1

ANALYZING TRANSACTIONS

Analyze each of the following transactions by answering each of the questions. Use the spreadsheet on the following page to keep track of the amount in each account:

(a) Stockholder invests $10,000 into the business.

1.	Does a transaction exist?	
2.	Examine it for accounts affected.	
3.	Classify each account affected.	
4.	Identify direction and amount.	
5.	Ensure the equation still balances.	

(b) Borrow $15,000, using a note payable to the bank.

1.	Does a transaction exist?	
2.	Examine it for accounts affected.	
3.	Classify each account affected.	
4.	Identify direction and amount.	
5.	Ensure the equation still balances.	

(c) Acquire a $15,000 truck and $5,000 worth of equipment.

1.	Does a transaction exist?	
2.	Examine it for accounts affected.	
3.	Classify each account affected.	
4.	Identify direction and amount.	
5.	Ensure the equation still balances.	

HANDOUT 2-1, continued

(d) Purchase $300 worth of supplies on credit. "On credit" means that you receive the supplies now, and pay for them later.

1.	Does a transaction exist?	
2.	Examine it for accounts affected.	
3.	Classify each account affected.	
4.	Identify direction and amount.	
5.	Ensure the equation still balances.	

(e) Sign contract for first website design for $10,000.

1.	Does a transaction exist?	
2.	Examine it for accounts affected.	
3.	Classify each account affected.	
4.	Identify direction and amount.	
5.	Ensure the equation still balances.	

Spreadsheet

	Assets					=	Liabilities			+	SE
Ref.	Cash	+	Supplies	+	Property, Plant & Equipment	=	Accounts Payable	+	Notes Payable	+	Contributed Capital
(a)											
(b)											
(c)											
(d)											
(e)											

<u>HANDOUT 2-1 SOLUTION</u>, continued

ANALYZING TRANSACTIONS

Analyze each of the following transactions by answering each of the questions. Use the spreadsheet on the following page to keep track of the amount in each account:

(a) Stockholder invests $10,000 into the business.

1.	Does a transaction exist?	Yes – received cash and gave stock.
2.	Examine it for accounts affected.	Cash and Contributed Capital
3.	Classify each account affected.	Cash is an Asset (A) and Contributed Capital is Stockholders' Equity (SE)
4.	Identify direction and amount.	Cash (A) + $10,000 = Stockholders' Equity (SE) + $10,000.
5.	Ensure the equation still balances.	Yes – see below.

(b) Borrow $15,000 signing a note payable to the bank that is due in three months.

1.	Does a transaction exist?	Yes – received cash and gave a note payable.
2.	Examine it for accounts affected.	Cash and Notes Payable
3.	Classify each account affected.	Cash is an Asset (A) and Notes Payable is a Liability (L)
4.	Identify direction and amount.	Cash (A) + $15,000 = Notes payable + $15,000.
5.	Ensure the equation still balances.	Yes – see below.

(c) Acquire a $15,000 truck and $5,000 worth of equipment.

1.	Does a transaction exist?	Yes – paid cash and received truck and equipment.
2.	Examine it for accounts affected.	Cash and Equipment
3.	Classify each account affected.	Cash is an Asset (A) and Equipment is an Asset (A)
4.	Identify direction and amount.	Cash (A) **-** $20,000 and Equipment (A) + 20,000
5.	Ensure the equation still balances.	Yes – see below.

HANDOUT 2-1 SOLUTION, continued

(d) Purchase $300 worth of supplies on credit. "On credit" means that you receive the supplies now, and pay for them later.

1.	Does a transaction exist?	Yes – received supplies and obligated to pay for them.
2.	Examine it for accounts affected.	Supplies and Accounts Payable
3.	Classify each account affected.	Supplies is an Asset (A) and Accounts Payable is a Liability (L)
4.	Identify direction and amount.	Supplies (A) + $300 and Accounts Payable (L) + $300.
5.	Ensure the equation still balances.	Yes – see below.

(e) Sign contract for first website design for $10,000.

1.	Does a transaction exist?	No – no exchange took place.
2.	Examine it for accounts affected.	
3.	Classify each account affected.	
4.	Identify direction and amount.	
5.	Ensure the equation still balances.	

Spreadsheet

	Assets					=	Liabilities			+	Stockholders' Equity
Ref.	Cash	+	Supplies	+	Equipment	=	Accounts Payable	+	Notes Payable	+	Contributed Capital
(a)	+10,000					=					+10,000
(b)	+15,000					=			+15,000		
(c)	–20,000				+20,000	=					
(d)			+300			=	+300				
Total	5,000		300		20,000		300		15,000		10,000
	$25,300						$15,300				$10,000

HANDOUT 2-2

ANALYZING TRANSACTIONS

Analyze the following transactions as set forth below. Use the spreadsheet on the next page to keep track of the amount in each account:

(f) Company pays off $300 Accounts Payable.

1.	Does a transaction exist?	
2.	Examine it for accounts affected.	
3.	Classify each account affected.	
4.	Identify direction and amount.	
5.	Ensure the equation still balances.	

(g) Company pays for and receives $600 worth of supplies.

1.	Does a transaction exist?	
2.	Examine it for accounts affected.	
3.	Classify each account affected.	
4.	Identify direction and amount.	
5.	Ensure the equation still balances.	

(h) Company acquires and receives $1,000 worth of equipment.

1.	Does a transaction exist?	
2.	Examine it for accounts affected.	
3.	Classify each account affected.	
4.	Identify direction and amount.	
5.	Ensure the equation still balances.	

(i) Order a $900 lawn mower, to be delivered next month.

1.	Does a transaction exist?	
2.	Examine it for accounts affected.	
3.	Classify each account affected.	
4.	Identify direction and amount.	
5.	Ensure the equation still balances.	

<u>HANDOUT 2-2</u>, continued

Spreadsheet

	Assets				=	Liabilities			+	Stockholders' Equity
Ref.	Cash	+	Supplies	+	Equipment	=	Accounts Payable	+	Notes Payable	+	Contributed Capital
(a)	+10,000					=					+10,000
(b)	+15,000					=			+15,000		
(c)	–20,000				+20,000	=					
(d)			+300			=	+300				
(f)											
(g)											
(h)											
(i)											

HANDOUT 2-2 SOLUTION

ANALYZING TRANSACTIONS

Analyze the following transactions as set forth below. Use the spreadsheet on the next page to keep track of the amount in each account:

(f) Company pays off $300 Accounts Payable.

1.	Does a transaction exist?	Yes – paid cash to reduce accounts payable.
2.	Examine it for accounts affected.	Cash and Accounts Payable
3.	Classify each account affected.	Cash is an Asset (A) and Accounts Payable is a Liability (L)
4.	Identify direction and amount.	Cash (A) – $300 = Liabilities (L) – $300
5.	Ensure the equation still balances.	Yes – see below.

(g) Company pays for and receives $600 worth of supplies.

1.	Does a transaction exist?	Yes – paid cash to purchase supplies.
2.	Examine it for accounts affected.	Cash and Supplies
3.	Classify each account affected.	Cash is an Asset (A) and Supplies is an Asset
4.	Identify direction and amount.	Cash (A) – $600 and Supplies (A) – $600.
5.	Ensure the equation still balances.	Yes - see below.

(h) Company acquires and receives $1,000 worth of equipment.

1.	Does a transaction exist?	Yes – paid cash to purchase equipment
2.	Examine it for accounts affected.	Cash and Equipment
3.	Classify each account affected.	Cash is an Asset (A) and Equipment is an Asset (A)
4.	Identify direction and amount.	Cash (A) – $1,000 and Equipment (A) - $1,000
5.	Ensure the equation still balances.	Yes - see below.

(i) Order a $900 computer, to be delivered next month.

1.	Does a transaction exist?	No.
2.	Examine it for accounts affected.	
3.	Classify each account affected.	
4.	Identify direction and amount.	
5.	Ensure the equation still balances.	

<u>HANDOUT 2-2 SOLUTION</u>, continued

Spreadsheet

	Assets					=	Liabilities			+	Stockholders' Equity
Ref.	Cash	+	Supplies	+	Equipment	=	Accounts Payable	+	Notes Payable	+	Contributed Capital
(a)	+10,000					=					+10,000
(b)	+15,000					=			+15,000		
(c)	–20,000				+20,000	=					
(d)			+300			=	+300				
(f)	–300						–300				
(g)	–600		+600								
(h)	–1,000				–1,000						
(i)											

HANDOUT 2-3

THE DEBIT/CREDIT FRAMEWORK

The following activities occurred during January 2013. Prepare a journal entry for ensure that the basic accounting equation balances for each transaction.

(a) Stockholder invests $10,000 into the business.

Debit and credit the accounts affected

Ensure the equation still balances and debits = credits

Assets		=	Liabilities	+	Stockholders' Equity	

(b) Borrow $15,000 signing a note payable to the bank that is due in three months.

Debit and credit the accounts affected

Ensure the equation still balances and debits = credits

Assets		=	Liabilities	+	Stockholders' Equity	

(c) Acquire a $15,000 truck and $5,000 worth of equipment.

Debit and credit the accounts affected

Ensure the equation still balances and debits = credits

Assets		=	Liabilities	+	Stockholders' Equity	

HANDOUT 2-3, continued

(d) Purchase $300 worth of supplies on credit.

Debit and credit the accounts affected

Ensure the equation still balances and debits = credits

Assets		=	Liabilities	+	Stockholders' Equity	

(e) Sign contract for first website design for $10,000.

Debit and credit the accounts affected

Ensure the equation still balances and debits = credits

Assets		=	Liabilities	+	Stockholders' Equity	

HANDOUT 2-3 SOLUTION

THE DEBIT/CREDIT FRAMEWORK

The following activities occurred during January 2013. Prepare a journal entry for ensure that the basic accounting equation balances for each transaction.

(a) Stockholder invests $10,000 into the business.

Debit and credit the accounts affected

(a)	Cash (+A)	10,000	
	Contributed Capital (+SE)		10,000

Ensure the equation still balances and debits = credits

Assets		=	Liabilities		+	Stockholders' Equity	
Cash	+10,000					Contributed Capital	+10,000

(b) Borrow $15,000 signing a note payable to the bank that is due in three months.

Debit and credit the accounts affected

(b)	Cash (+A)	15,000	
	Note Payable (+L)		15,000

Ensure the equation still balances and debits = credits

Assets		=	Liabilities		+	Stockholders' Equity	
Cash	+15,000		Note Payable	+15,000			

(c) Acquire a $15,000 truck and $5,000 worth of equipment.

Debit and credit the accounts affected

(c)	Equipment (+A)	20,000	
	Cash (–A)		20,000

Ensure the equation still balances and debits = credits

Assets		=	Liabilities		+	Stockholders' Equity	
Cash Equipment	–20,000 +20,000						

HANDOUT 2-3 SOLUTION, continued

(d) Purchase $300 worth of supplies on credit.

Debit and credit the accounts affected

(d)	Supplies (+A)	300	
	Accounts Payable (+A)		300

Ensure the equation still balances and debits = credits

Assets		=	Liabilities		+	Stockholders' Equity	
Supplies	+300		Accounts Payable	+300			

(e) Sign contract for first website design for $10,000.

No entry – this is not a transaction

HANDOUT 2-4

THE DEBIT/CREDIT FRAMEWORK

(f) Company pays off $300 Accounts Payable.

Debit and credit the accounts affected

Ensure the equation still balances and debits = credits

Assets		=	Liabilities		+	Stockholders' Equity	

(g) Company pays for and receives $600 worth of supplies.

Debit and credit the accounts affected

Ensure the equation still balances and debits = credits

Assets		=	Liabilities	+	Stockholders' Equity	

(h) Company acquires and receives $1,000 worth of equipment.

Debit and credit the accounts affected

Ensure the equation still balances and debits = credits

Assets		=	Liabilities	+	Stockholders' Equity	

HANDOUT 2-4, continued

(i) Order a $900 computer, to be delivered in 90 days.

Debit and credit the accounts affected

Ensure the equation still balances and debits = credits

Assets		=	Liabilities	+	Stockholders' Equity	

HANDOUT 2-4 SOLUTION

THE DEBIT/CREDIT FRAMEWORK

(f) Company pays off $300 Accounts Payable.

Debit and credit the accounts affected

(f)	Accounts Payable (–L)	300	
	Cash (–A)		300

Ensure the equation still balances and debits = credits

Assets		=	Liabilities		+	Stockholders' Equity	
Cash	–300		Acct. Pay.	–300			

(g) Company pays for and receives $600 worth of supplies.

Debit and credit the accounts affected

(g)	Supplies (+A)	600	
	Cash (–A)		600

Ensure the equation still balances and debits = credits

Assets		=	Liabilities	+	Stockholders' Equity	
Supplies	+600					
Cash	–600					

(h) Company acquires and receives $1,000 worth of equipment.

Debit and credit the accounts affected

(h)	Equipment (+A)	1,000	
	Cash (–A)		1,000

Ensure the equation still balances and debits = credits

Assets		=	Liabilities	+	Stockholders' Equity	
Equipment	+1,000					
Cash	–1,000					

(i) Order a $900 computer, to be delivered in 90 days.
No entry – this is not a transaction.

HANDOUT 2-5

POSTING TO T-ACCOUNTS

Post the transactions from handouts 2-3 and 2-4 to and then determine the ending balances of each of the following T-accounts.

Assets	Liabilities	Stockholders’ Equity
+ Cash –	- Accounts Payable +	- Contributed Capital +
+ Supplies –	- Notes Payable +	- Retained Earnings +
+ Equipment –		

HANDOUT 2-5 SOLUTION

POSTING TO T-ACCOUNTS

Post the transactions from handouts 2-3 and 2-4 to and then determine the ending balances of each of the following T-accounts.

Assets

+ Cash –

BegBal	0		
(a)	10,000		
(b)	15,000	20,000	(c)
		300	(f)
		600	(g)
		1,000	(h)
EndBal	3,100		

+ Supplies –

BegBal	0		
(d)	300		
(g)	600		
EndBal	900		

+ Equipment –

BegBal	0		
(c)	20,000		
(h)	1,000		
EndBal	21,000		

Liabilities

- Accounts Payable +

		0	BegBal
(f)	300	300	(d)
		0	EndBal

- Notes Payable +

		0	BegBal
		15,000	(b)
		15,000	EndBal

Stockholders' Equity

- Contributed Capital +

		0	BegBal
		10,000	(a)
		10,000	EndBal

- Retained Earnings +

		0	BegBal
		0	EndBal

<u>**HANDOUT 2-6**</u>

PREPARING A BALANCE SHEET

Use the ending balances from the T-accounts on Handout 2-5 to prepare a classified balance sheet. Assume a year-end of December 31, 2013.

HANDOUT 2-6 SOLUTION

PREPARING A BALANCE SHEET

Use the ending balances from the T-accounts on Handout 2-5 to prepare a classified balance sheet. Assume a year-end of December 31, 2013.

World Wide Webster
Balance Sheet
At December 31, 2013

Assets

Current Assets:	
Cash	$ 3,100
Supplies	900
Total Current Assets	4,000
Equipment	21,000
Total Assets	$25,000

Liabilities

Current Liabilities:	
Notes Payable	$15,000
Total Current Liabilities	15,000

Stockholders' Equity

Contributed Capital	10,000
Retained Earnings	0
Total Stockholders' Equity	10,000
Total Liabilities and Stockholders' Equity	$25,000

HANDOUT 2-7

CURRENT RATIO

Refer to the classified balance sheet from Handout 2-6 and calculate the current ratio of World Wide Webster as of December 31, 2013. Then, interpret the current ratio.

Calculation:

Interpretation:

HANDOUT 2-7 SOLUTION

CURRENT RATIO

Refer to the classified balance sheet from Handout 2-6 and calculate the current ratio of World Wide Webster as of December 31, 2013. Then, interpret the current ratio.

Calculation:

Current ratio = Current assets ÷ Current liabilities

Current ratio = $4,000 ÷ $15,000 = 0.27

Interpretation:

A current ratio of 0.27 indicates that the company has $0.27 of current assets for $1.00 of current liabilities as of December 31, 2013. It does not appear that the company's current assets are sufficient to pay its current liabilities.