

College Accounting

A Contemporary Approach

Fourth Edition

Haddock | Price | Farina

Mc
Graw
Hill
Education

Chapter 2

Analyzing Business Transactions

by
Haddock, Price, and Farina

Chapter 2 Learning Objectives

SECTION 1: Property and Financial Interests

- 2-1 Record in equation form the financial effects of a business transaction.**
- 2-2 Define, identify, and understand the relationship between asset, liability, and owner's equity accounts.**

SECTION 2: The Accounting Equation and Financial Statements

- 2-3 Analyze the effects of business transactions on a firm's assets, liabilities, and owner's equity and record these effects in accounting equation form.**
- 2-4 Prepare an income statement.**
- 2-5 Prepare a statement of owner's equity and a balance sheet.**
- 2-6 Define the accounting terms new to this chapter.**

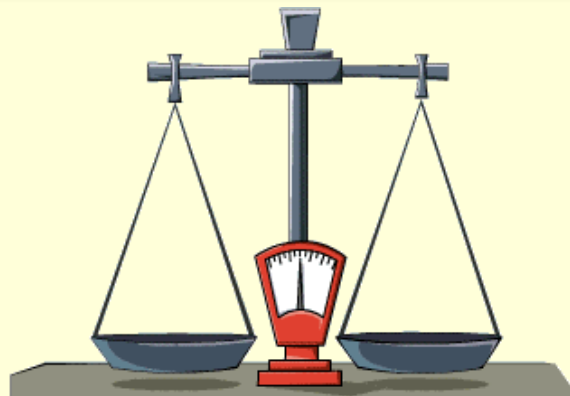
Meet Eli's Consulting Services

- **Eli's Consulting Services is a firm that provides a wide range of accounting and consulting services.**
- **Trayton Eli, CPA is the sole proprietor of the firm.**
- **Carlos Valdez is the office manager of the firm.**
- **Every month the firm bills clients for the services provided that month.**
- **Customers can also pay in cash when the services are provided.**

Steps to analyze the effect of a business transaction

1. Describe the financial event.

- Identify the property.
- Identify who owns the property.
- Determine the amount of increase or decrease.



2. Make sure the equation is in balance.

**Property (asset) = Financial Interest
(creditors and owners)**

Section 1: Property and Financial Interests

Learning Objective

2-1: Record in equation form the financial effects of a business transaction.

Business Transaction

Trayton Eli withdrew \$100,000 from personal savings and deposited it in a new checking account in the name of Eli's Consulting Services.

Analysis:

- (a) The business received \$100,000 of **property** in the form of cash.
- (a) Eli has a \$100,000 **financial interest** in the business.

The owner invested cash into the business

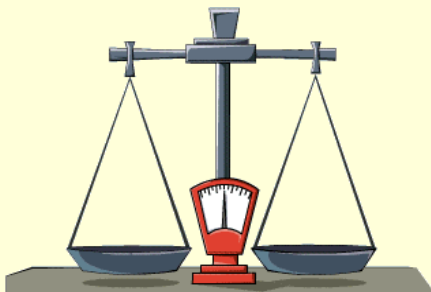
Property	=	Financial Interest
Cash	=	Trayton Eli, Capital
(a) Invested cash		
	+\$100,000	
(a) Increased equity		+\$100,000
New balances	=	\$100,000



Trayton Eli now has \$100,000 equity in Eli's Consulting Services.

The company buys equipment for \$5,000 cash

Property				=	Financial Interest
	Cash	+	Equipment	=	Trayton Ell, Capital
Previous balances	\$100,000			=	\$100,000
(b) Purchased equipment		+	\$5,000		
(b) Paid cash	-5,000				
New balances	\$95,000	+	\$5,000	=	\$100,000



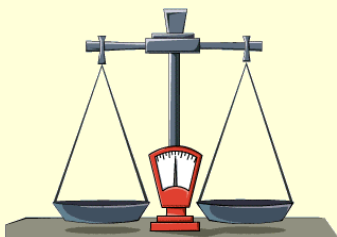
$$\mathbf{\$100,000 = \$100,000}$$

The company buys \$6,000 of equipment on account (on credit)

	Property			=	Financial Interest		
	Cash	+	Equipment	=	Accounts Payable	+	Trayton Ell, Capital
Previous balances	\$95,000	+	\$ 5,000	=			\$100,000
(c) Purchased equip.		+	6,000	=			
(c) Incurred debt						+\$6,000	
New balances	\$95,000	+	\$11,000	=	\$6,000	+	\$100,000

\$106,000 = \$106,000

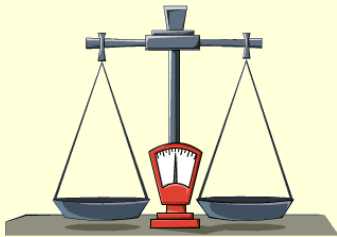
Notice the new claim against the firm's property – the creditor's claim of \$6,000.



The firm purchases supplies for \$1,500 cash

	Property				=	Financial Interest			
	Cash	+	Supplies	+	Equipment	=	Accounts Payable	+	Trayton Ell, Capital
Previous balances	\$95,000			+	\$11,000	=	\$6,000	+	\$100,000
(d) Purchased supplies		+	\$1,500						
(d) Paid cash	-\$1,500								
New balances	\$93,500	+	\$1,500	+	\$11,000	=	\$6,000	+	\$100,000

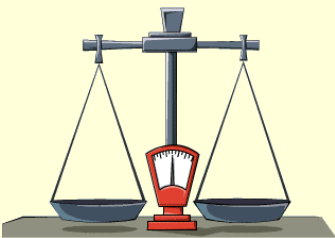
\$106,000 = \$106,000



The firm makes a payment of \$2,500 on account

Property				=	Financial Interest			
Cash	+	Supplies	+	Equipment	=	Accounts Payable	+	Trayton Ell, Capital
\$93,500	+	\$1,500	+	\$11,000	=	\$6,000	+	\$100,000
-\$ 2,500						-\$2,500		
<hr/>						<hr/>		
\$91,000	+	\$1,500	+	\$11,000	=	\$3,500	+	\$100,000

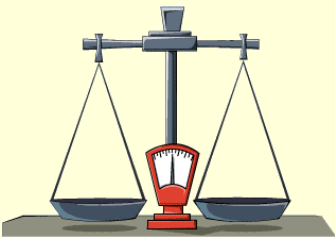
$$\mathbf{\$103,500 = \$103,500}$$



The firm makes a payment of \$8,000 rent in advance

Property						=	Financial Interest			
Cash	+	Supplies	+	Prepaid Rent	+	Equipment	=	Accounts Payable	+	Trayton Ell, Capital
\$91,000	+	\$1,500			+	\$11,000	=	\$3,500	+	\$100,000
-\$8,000				+\$8,000						
\$83,000	+	\$1,500	+	\$8,000	+	\$11,000	=	\$3,500	+	\$100,000

\$103,500 = \$103,500



Section 1: Property and Financial Interests

Learning Objective

2-2: Define, identify, and understand the relationship between asset, liability, and owner's equity accounts.

Assets, Liabilities, and Owner's Equity

QUESTION:

What are assets?

ANSWER:

Assets are property owned by a business.

Liabilities and Equity

QUESTION:

What are liabilities?

ANSWER:

Liabilities are debts or obligations of a business

QUESTION:

What is owner's equity?

ANSWER:

Owner's equity is the term used by sole proprietorships. It is the financial interest of an owner of a business. It is also called proprietorship or net worth.

The Balance Sheet

QUESTION:

What is a Balance Sheet?

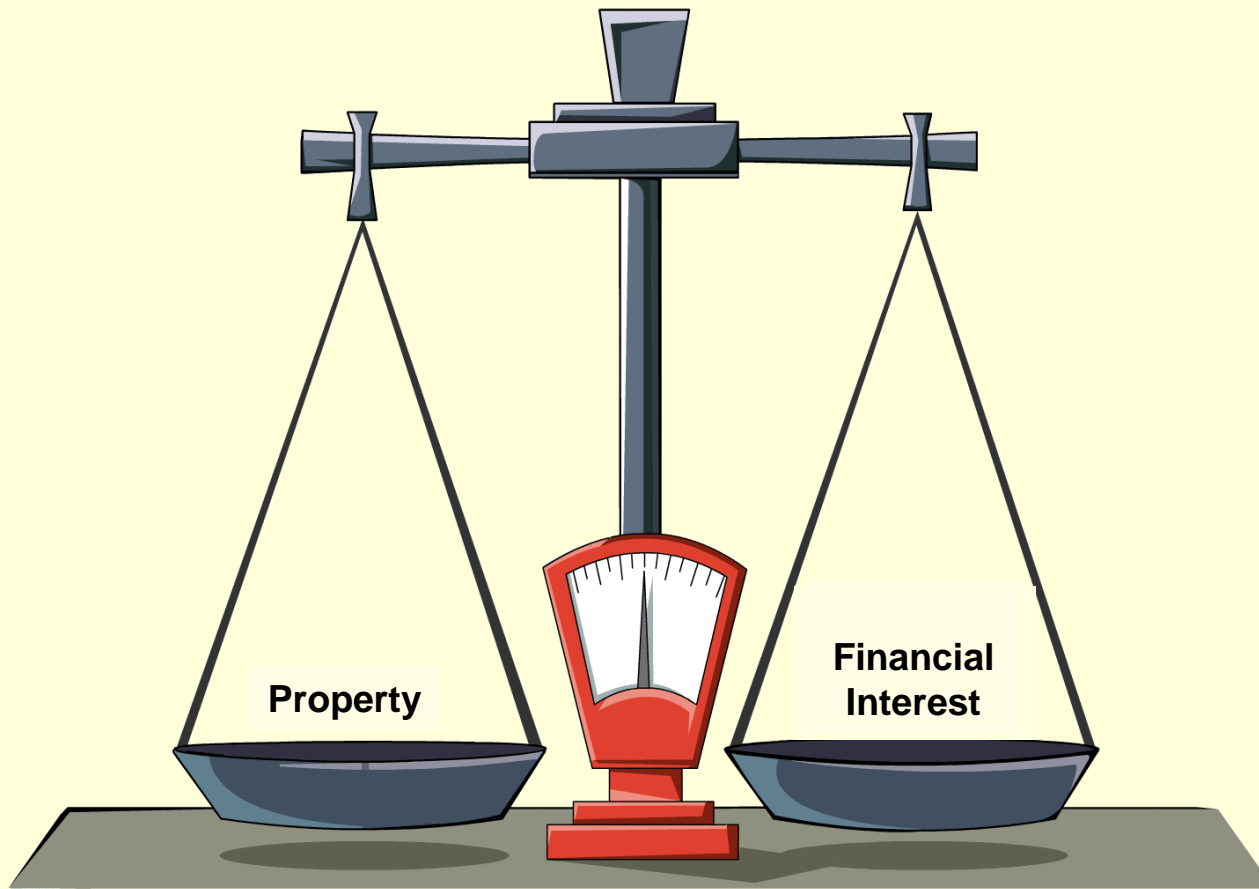
ANSWER:

A balance sheet is a formal report of the financial position of a business on a certain date. It reports the assets, liabilities, and owner's equity of the business

The Balance Sheet

Assets				Liabilities						
Cash	83	0	0	00	Accounts Payable	3	5	0	0	00
Supplies	1	5	0	0						
Prepaid Rent	8	0	0	0	Owner's Equity					
Equipment	11	0	0	0	Trayton Eli, Capital	100	0	0	0	00
Total Assets	103	5	0	00	Total Liabilities and Owner's Equity	103	5	0	00	00

- **Assets** – the amount and types of property owned by the business
- **Liabilities** – the amount owed to the creditors
- **Equity** – the owner's interest



Property equals Financial Interest

Section 2: The Accounting Equation and Financial Statements

Learning Objective

2- 3: Analyze the effects of business transactions on a firm's assets, liabilities, and owner's equity and record these effects in accounting equation form.

The Fundamental Accounting Equation

QUESTION:

What is the fundamental accounting equation?

ANSWER:

The fundamental accounting equation is the relationship between assets and liabilities plus owner's equity.



The Fundamental Accounting Equation

- In accounting terms the firm's assets must equal the total of its liabilities and owner's equity.
- This equality can be expressed in equation form as:

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

- The entire accounting process of analyzing, recording and reporting business transactions is based on the fundamental accounting equation.
- If any two parts of the equation are known, the third part can be determined.

Revenues

QUESTION:

What is revenue?

ANSWER:

A revenue is an inflow of money or other assets that results from the sales of goods or services or from the use of money or property. It is also called income.

Expenses

QUESTION:

What is an expense?

ANSWER:

An expense is an outflow of cash, use of other assets, or incurring of a liability.

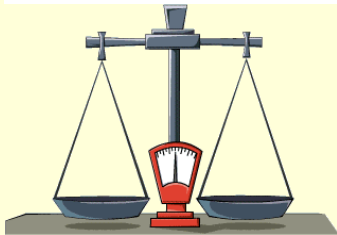
The firm receives \$36,000 in cash for services provided to clients

Assets					=	Liabilities	+	Owner's Equity				
Cash	+	Supplies	+	Prepaid Rent	+	Equipment	=	Accounts Payable	+	Trayton Eli, Capital	+	Revenue
\$ 83,000	+	\$ 1,500	+	\$ 8,000	+	\$ 11,000	=	\$ 3,500	+	\$ 100,000		
+\$36,000												
												+ \$36,000
\$119,000	+	\$ 1,500	+	\$ 8,000	+	\$ 11,000	=	\$ 3,500	+	\$ 100,000	+	\$ 36,000
}								}				
\$139,500								\$139,500				



The company performs services on account for \$11,000

Assets						=	Liab.	+	Owner's Equity					
Cash	+	Accts. Rec.	+	Supp.	+	Prepaid Rent	+	Equip.	=	Accts. Pay.	+	Trayton Eli, Capital	+	Rev.
\$119,000			+	\$1,500	+	\$8,000	+	\$11,000	=	\$3,500	+	\$100,000	+	\$36,000
		+\$11,000												
													+	\$11,000
\$119,000	+	\$11,000	+	\$1,500	+	\$8,000	+	\$11,000	=	\$3,500	+	\$100,000	+	\$47,000
} \$150,500										} \$150,500				



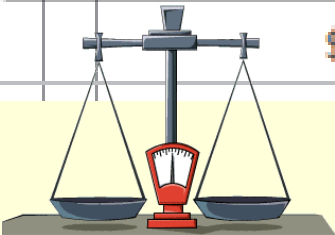
Collection of \$6,000 from customers on account

Assets					=	Liab.	+	Owner's Equity						
Cash	+	Accts. Rec.	+	Supp.	+	Prepaid Rent	+	Equip.	=	Accts. Pay.	+	Trayton Eli, Capital	+	Rev.
\$119,000	+	\$11,000	+	\$1,500	+	\$8,000	+	\$11,000	=	\$3,500	+	\$100,000	+	\$47,000
+\$6,000														
		-\$6,000												
\$125,000	+	\$5,000	+	\$1,500	+	\$8,000	+	\$11,000	=	\$3,500	+	\$100,000	+	\$47,000
\$150,500										\$150,500				



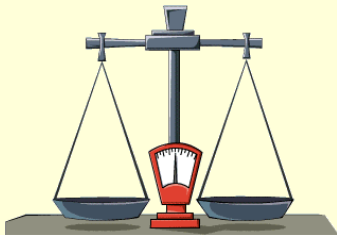
The firm pays \$8,000 in salaries expense for the month

Assets					=	Liab.	+	Owner's Equity								
Cash	+	Accts Rec.	+	Supp.	+	Prepaid Rent	+	Equip.	=	Accts. Pay.	+	Trayton Eli, Capital	+	Rev.	-	Exp.
\$125,000	+	\$5,000	+	\$1,500	+	\$8,000	+	\$11,000	=	\$3,500	+	\$100,000	+	\$47,000		
- \$8,000																
															+ \$8,000	
\$117,000	+	\$5,000	+	\$1,500	+	\$8,000	+	\$11,000	=	\$3,500	+	\$100,000	+	\$47,000	-	\$8,000
<div style="border-top: 1px solid black; width: 100%;"></div> }									<div style="border-top: 1px solid black; width: 100%;"></div> }							
\$142,500									\$142,500							



The firm pays \$650 for utilities expenses

Assets					=	Liab.	+	Owner's Equity								
Cash	+	Accts. Rec.	+	Supp.	+	Prepaid Rent	+	Equip.	=	Accts. Pay.	+	T. Eli, Capital	+	Rev.	-	Exp.
\$117,000	+	\$5,000	+	\$1,500	+	\$8,000	+	\$11,000	=	\$3,500	+	\$100,000	+	\$47,000	-	\$8,000
- \$650																
																+ \$650
\$116,350	+	\$5,000	+	\$1,500	+	\$8,000	+	\$11,000	=	\$3,500	+	\$100,000	+	\$47,000	-	\$8,650
\$141,850										\$141,850						



The firm records a withdrawal by the owner of \$5,000

Assets					=	Liab.	+	Owner's Equity								
Cash	+	Accts. Rec.	+	Supp.	+	Prepaid Rent	+	Equip.	=	Accts. Pay.	+	Trayton Eli, Capital	+	Rev.	-	Exp.
\$116,350	+	\$5,000	+	\$1,500	+	\$8,000	+	\$11,000	=	\$3,500	+	\$100,000	+	\$47,000	-	\$8,650
-\$5,000																
												\$ 5,000				
\$111,350	+	\$5,000	+	\$1,500	+	\$8,000	+	\$11,000	=	\$3,500	+	\$95,000	+	\$47,000	-	\$8,650
}										}						
\$136,850										\$136,850						



Section 2: The Accounting Equation and Financial Statements

Learning Objective

2-4: Prepare an Income Statement

QUESTION:

What is an income statement?

ANSWER:

An income statement is a formal report of business operations covering a specific period of time. It is also called a profit and loss statement or a statement of income and expenses.

The income statement has a three-line heading

The third line shows that the report covers operations over a period of time

**Eli's Consulting Services
Income Statement
Month Ended December 31, 2019**

Revenue		
Fees Income		\$47,000.00
Expenses		
Salaries Expense	\$8,000.00	
Utilities Expense	<u>650.00</u>	
Total Expenses		<u>8,650.00</u>
Net Income		<u><u>\$ 38,350.00</u></u>

The income statement reports revenue



**Eli's Consulting Services
Income Statement
Month Ended December 31, 2019**

Revenue		
Fees Income		\$47,000.00
Expenses		
Salaries Expense	8,000.00	
Utilities Expense	<u>650.00</u>	
Total Expenses		<u>8,650.00</u>
Net Income		\$ <u><u>38,350.00</u></u>

The income statement also reports expenses

**Eli's Consulting Services
Income Statement
Month Ended December 31, 2019**

Revenue		
Fees Income		\$47,000.00
Expenses		
Salaries Expense	8,000.00	
Utilities Expense	<u>650.00</u>	
Total Expenses		<u>8,650.00</u>
Net Income		\$ 38,350.00

The result is net income or net loss for the period

**Eli's Consulting Services
Income Statement
Month Ended December 31, 2019**

Revenue		
Fees Income		\$47,000.00
Expenses		
Salaries Expense	8,000.00	
Utilities Expense	<u>650.00</u>	
Total Expenses		<u>8,650.00</u>
Net Income		<u>\$ 38,350.00</u>

Section 2: The Accounting Equation and Financial Statements

Learning Objective

**2-5: Prepare a Statement of Owner's
Equity and Balance Sheet**

A Statement of Owner's Equity

Eli's Consulting Services Statement of Owner's Equity Month Ended December 31, 2019

Trayton Eli, Capital, December 1, 2019		\$100,000.00
Net Income for December	\$38,350.00	
Less Withdrawals for December	<u>5,000.00</u>	
Increase in Capital		<u>33,350.00</u>
Trayton Eli, Capital, December 31, 2019		<u>\$133,350.00</u>

The Balance Sheet

Eli's Consulting Services Balance Sheet December 31, 2019			
<u>Assets</u>		<u>Liabilities</u>	
Cash	111,350.00	Accounts Payable	3,500.00
Accounts Receivable	5,000.00		
Supplies	1,500.00		
Prepaid Rent	8,000.00		
Equipment	<u>11,000.00</u>		
Total Assets	<u><u>136,850.00</u></u>		
		<u>Owner's Equity</u>	
		Trayton Eli, Capital	<u>133,350.00</u>
		Total Liabilities and Owner's Equity	<u><u>136,850.00</u></u>

- A single line shows that the amounts above it are being added or subtracted.
- A double line indicates final amounts for the column or section of a report.

The Importance of Financial Statements

- Business managers and owners use the balance sheet and the income statement to control current operations and plan for the future.
- Creditors, prospective investors, governmental agencies, and others are interested in the profits of the business and in the asset and equity structure.

Financial statements are always prepared in a specific order:

1st Income Statement

2nd Statement of Owner's equity

3rd Balance Sheet

Financial statements :

Eli's Consulting Services					
Income Statement					
Month Ended December 31, 2019					
<i>Revenue</i>					
<i>Fees Income</i>					4 7 0 0 0 00
<i>Expenses</i>					
<i>Salaries Expense</i>	8 0 0 0 00				
<i>Utilities Expense</i>	6 5 0 0 00				
<i>Total Expenses</i>				8 6 5 0 00	
<i>Net Income</i>				3 8 3 5 0 00	

Net income (or loss) is transferred to the statement of owner's equity.

The ending capital balance is transferred to the balance sheet.

Eli's Consulting Services			
Statement of Owner's Equity			
Month Ended December 31, 2019			
<i>Trayton Eli, Capital, December 1, 2019</i>			1 0 0 0 0 00
<i>Net Income for December</i>	3 8 3 5 0 00		
<i>Less Withdrawals for December</i>	5 0 0 0 00		
<i>Increase in Capital</i>			3 3 3 5 0 00
<i>Trayton Eli, Capital, December 31, 2019</i>			1 3 3 3 5 0 00

Eli's Consulting Services					
Balance Sheet					
December 31, 2019					
<i>Assets</i>			<i>Liabilities</i>		
<i>Cash</i>	1 1 1 3 5 0 00		<i>Accounts Payable</i>	3 5 0 0 00	
<i>Accounts Receivable</i>	5 0 0 0 00				
<i>Supplies</i>	1 5 0 0 00				
<i>Prepaid Rent</i>	8 0 0 0 00		<i>Owner's Equity</i>		
<i>Equipment</i>	1 1 0 0 0 00		<i>Trayton Eli, Capital</i>	1 3 3 3 5 0 00	
<i>Total Assets</i>	1 3 6 8 5 0 00		<i>Total Liabilities and Owner's Equity</i>	1 3 6 8 5 0 00	

Thank You

for using

***College Accounting:
A Contemporary Approach
4th Edition***

Haddock • Price • Farina