

CHAPTER 2

ANALYZING BUSINESS TRANSACTIONS

Chapter Opener: Thinking Critically

Answers will vary but students should recognize that happy employees are more productive and present a positive image to the company. Happy employees are also loyal which leads to lower employee turnover, and lower training and recruiting expenses. Happy employees are much less likely to steal from the company, and of course, happy employees mean happy customers who become repeat customers.

Fast Facts

- Southwest Airlines opened in 1971 with three planes flying between Houston, Dallas, and San Antonio. Southwest Airlines currently flies almost 100 million passengers a year to 63 cities all across the country.
- For the fiscal year 2009, the company's net income was \$99 million while its total operating revenue was \$10.4 billion.
- In 2009 Southwest served 63.2 million cans of soda, juices, and water; 14.3 million alcoholic beverages; 14 million bags of pretzels; 90 million bags of peanuts; 17.7 million Select-A-Snacks; and 33.5 million other snacks.

Managerial Implications: Thinking Critically

Answers will vary. Students should mention total assets and the type of assets, the liabilities the business would be responsible for, and whether the business is making a profit.

Discussion Questions

Note to instructor: These questions are designed to check students' understanding of new terms, concepts, and procedures presented in the chapter.

1. Assets = Liabilities + Owner's Equity
2. Outflow of money/assets for costs used to produce revenue
3. Inflow of money/assets resulting from sales or use of property
4.
 - a. assets increase, owner's equity increase
 - b. one asset increase and another decrease; no change in total assets
 - c. assets decrease, liabilities decrease
 - d. assets increase, owner's equity increase
 - e. assets decrease, owner's equity decrease
 - f. assets increase, liabilities increase
5. Revenue and expenses; net income or loss
6. Subtract total expenses from revenue
7. Firm name, title of statement, date of statement or the period of time covered
8. Balance sheet shows position at particular date; increase of operations for a period of time
9. Beginning-of-period capital balance, additional investments, net income/loss for period, less withdrawal ending capital balance

Discussion Questions (continued)

10. Increases owner's equity
11. Assets: property owned. Liabilities: debts. Owners' equity: owner's financial interest.
12. Assets, liabilities, and owner's equity.

EXERCISE 2.1

Assets:	\$122,900
Liabilities:	\$24,975
Owners' Equity	\$97,925

EXERCISE 2.2

1. \$21,740
2. \$18,520
3. \$5,425
4. \$35,975
5. \$8,625

EXERCISE 2.3

Transaction	Assets	=	Liabilities	+	Owners' Equity	
1.	<u>I</u>				<u>I</u>	I = Increase D = Decrease
2.	<u>I</u>		<u>I</u>			
3.	<u>I/D</u>					
4.	<u>I/D</u>					
5.	<u>I</u>				<u>I</u>	
6.	<u>D</u>				<u>D</u>	
7.	<u>I</u>				<u>I</u>	
8.	<u>I/D</u>					
9.	<u>D</u>				<u>D</u>	
10.	<u>D</u>		<u>D</u>			

EXERCISE 2.4

	Assets	=	Liabilities	+	Owner's Equity
1.	Cash \$12,500				
2.	Dental Supplies 3,150	=	Accounts Payable \$21,680	+	Donna Wells, Capital \$26,520
3.	Dental Equipment 25,550	=		+	
4.	Office Furniture 7,000	=		+	
5.	Total \$48,200	=	\$21,680	+	\$26,520

EXERCISE 2.5

	Assets		=	Liabilities	+	Owner's Equity							
	Cash	+	Accounts Receivable	+	Equipment	=	Accounts Payable	+	Amos Roberts Capital	+	Revenue	-	Expenses
1.	+\$50,000								+\$50,000				
2.					+\$17,000		+\$17,000						
3.	+\$2,100										+\$2,100		
4.	-\$3,600				+\$3,600								
5.			+\$4,550								+\$4,550		
6.	-\$3,950												+\$3,950
7.	+\$2,200		-\$2,200										
8.	-\$9,000						-\$9,000						
Totals	<u>\$37,750</u>	+	<u>\$2,350</u>	+	<u>\$20,600</u>	=	<u>\$8,000</u>	+	<u>\$50,000</u>	+	<u>\$6,650</u>	-	<u>\$3,950</u>

EXERCISE 2.6

Net income of \$20,000	
<u>Revenue</u>	
Repair Fees	\$45,150
<u>Expenses</u>	
Advertising Expense	\$5,300
Salaries Expense	18,100
Telephone Expense	650
Utilities Expense	1,100
Total Expenses	\$25,150
Net Income	<u>\$20,000</u>

EXERCISE 2.7

1. Services were performed for cash.
2. Equipment was purchased for cash.
3. A payment was made on the amount owed to a creditor.
4. An expense was paid in cash.
5. Cash was received from charge customer.
6. Services were performed on credit.
7. An expense was paid in cash.

EXERCISE 2.8

Parker Investment Services

Income Statement

Month Ended September 30, 2013

Revenue										
Fees Income						72	8	0	0	00
Expenses										
Advertising Expense	5	5	0	0	00					
Salaries Expense	15	0	0	0	00					
Telephone Expense		7	0	0	00					
Total Expenses						21	2	0	0	00
Net Income						51	6	0	0	00

EXERCISE 2.9

Net loss of \$950

Revenue	
Service Revenue	\$4,800
Expenses	
Advertising Expense.....	\$2,600
Telephone Expense.....	700
Salaries Expense	2,100
Cleaning Expense	350
Total Expense	\$5,750
Net Loss	(\$950)

EXERCISE 2.10

Parker Investment Services

Statement of Owner's Equity

Month Ended September 30, 2013

Alexander Parker, Capital, September 1, 2013										
						25	7	0	0	00
Net Income for September	51	6	0	0	00					
Less Withdrawals for September	8	0	0	0	00					
Increase in Capital						43	6	0	0	00
Alexander Parker, Capital, September 30, 2013						69	3	0	0	00

EXERCISE 2.10 (continued)

Parker Investment Services

Balance Sheet

Month Ended September 30, 2013

Assets					Liabilities				
Cash	32	1	0	00	Accounts Payable	4	7	0	00
Accounts Receivable	3	0	0	00					
Office Supplies	2	4	0	00	Owner's Equity				
Office Equipment	36	5	0	00	Alexander Parker, Capital	69	3	0	00
Total Assets	74	0	0	00	Total Liabilities and Owner's Equity	74	0	0	00

PROBLEM 2.1A

	Assets			=	Liabilities + Owner's Equity	
	Cash	+ Receivable	+ Supplies + Equipment		Accounts Payable	+ Owner's Capital
1.	+\$92,000					+\$92,000
2.	-\$18,750		+\$18,750			
3.			+\$12,400	+\$12,400		
4.	-\$10,800			-\$10,800		
5.	+\$25,000					+\$25,000
6.	+\$7,200					+\$7,200
7.		+\$4,300				+\$4,300
8.	-\$3,000					-\$3,000
9.	+\$2,500	-\$2,500				
10.	-\$5,460		+\$5,460			
11.	-\$8,000					-\$8,000
Totals	\$80,690	+\$1,800	+\$5,460 + \$31,150	=	\$1,600	+ \$117,500

Analyze: The ending balance in the Cash account is \$80,690.

PROBLEM 2.2A

	Assets			=	Liabilities + Owner's Equity		
	Cash	+ Receivable	+ Furniture + Auto		Payable	+ Capital	+ Revenue - Expenses
Beginning Balances	\$60,000	+ \$15,600	+ \$34,800 + \$22,500	=	\$10,200	+ \$90,500	+ \$55,600 - \$23,400
1.		+6,580					+6,580
New Balances	60,000	+ 22,180	+ 34,800 + \$22,500	=	10,200	+ 90,500	+ 62,180 - 23,400
2.	-1,600		+1,600				
New Balances	58,400	+ 22,180	+ 36,400 + \$22,500	=	10,200	+ 90,500	+ 62,180 - 23,400
3.	+10,200						

PROBLEM 2.2A (continued)

	Assets				= Liabilities +		Owner's Equity	
	Cash	Accounts	Office	Auto	Payable	Capital	Revenue	Expenses
New Balances	68,600	+ 11,980	+ 36,400	+ \$22,500	= 10,200	+ 90,500	+ 62,180	- 23,400
4.	-780							+780
New Balances	67,820	+ 11,980	+ 36,400	+ \$22,500	= 10,200	+ 90,500	+ 62,180	- 24,180
5.	-2,500				-2,500			
New Balances	65,320	+ 11,980	+ 36,400	+ \$22,500	= 7,700	+ 90,500	+ 62,180	- 24,180
6.	-8,700							+8,700
New Balances	56,620	+ 11,980	+ 36,400	+ \$22,500	= 7,700	+ 90,500	+ 62,180	- 32,880
7.	-1020							+1020
New Balances	55,600	+ 11,980	+ 36,400	+ \$22,500	= 7,700	+ 90,500	+ 62,180	- 33,900
8.	+9,500						+9,500	
New Balances	65,100	+ 11,980	+ 36,400	+ \$22,500	= 7,700	+ 90,500	+ 71,680	- 33,900
9.	-2,250							+2,250
New Balances	62,850	+ 11,980	+ 36,400	+ \$22,500	= 7,700	+ 90,500	+ 71,680	- 36,150
10.		+ +11,500					+11,500	
New Balances	\$62,850	+ \$23,480	+ \$36,400	+ \$22,500	= \$7,700	+ \$90,500	+ \$83,180	- \$36,150

Analyze: Total assets equal \$145,230.

PROBLEM 2.3A

Valdez Equipment Repair

Balance Sheet

February 28, 2013

Assets					Liabilities					
Cash	33	3	0	0	00	Accounts Payable	23	0	0	00
Supplies	5	3	8	0	00					
Accounts Receivable	12	2	0	0	00	Owner's Equity				
Equipment	77	0	0	0	00	Francisco Valdez, Capital	104	8	8	00
Total Assets	127	8	8	0	00	Total Liabilities and Owner's Equity	127	8	8	00

Analyze: Owner's Equity is \$104,880 at February 28, 2013.

PROBLEM 2.4A

West Cleaning Service

Income Statement

Month Ended May 31, 2013

Revenue										
Fees Income						7	2	8	0	00
Expenses										
Utilities Expense			8	8	00					
Salaries Expense		8	4	0	00					
Telephone Expense			3	0	40					
Total Expenses						9	5	8	4	00
Net Loss						(2)	3	0	4	00

West Cleaning Service

Statement of Owner's Equity

Month Ended May 31, 2013

Carol West, Capital, May 1, 2013						47	6	0	0	00
Net Loss for May	(2)	3	0	4	00					
Less Withdrawal for May	2	0	0	0	00					
Decrease in Capital						(4)	3	0	4	00
Carol West, Capital, May 31, 2013						43	2	9	6	00

PROBLEM 2.4A (continued)

West Cleaning Service

Balance Sheet

May 31, 2013

Assets					Liabilities				
Cash	5	6	9	6 00	Accounts Payable	4	4	0	0 00
Accounts Receivable	4	4	0	0 00					
Supplies	4	8	0	0 00	Owner's Equity				
Equipment	32	8	0	0 00	Carol West, Capital	43	2	9	6 00
Total Assets	47	6	9	6 00	Total Liabilities and Owner's Equity	47	6	9	6 00

Analyze: The amount of \$43,296 (Carol West, Capital) was transferred to the balance sheet.

PROBLEM 2.1B

	Assets			=	Liabilities + Owner's Equity		
	Cash	+ Receivable	+ Supplies	=	Accounts Payable	+ Equipment	+ Owner's Capital
1.	+\$36,000			=			+\$36,000
2.	-\$16,000			=		+\$16,000	
3.				=	+\$6,000		
4.	-\$3,000			=	-\$3,000		
5.	+\$6,000			=			+\$6,000
6.	+\$4,200			=			+\$4,200
7.			+\$3,650	=			+\$3,650
8.	-\$2,600			=			-\$2,600
9.	+\$2,500			=			
10.	-\$3,150			=			
11.	-\$5,000			=			-\$5,000
Totals	\$18,950	+ \$1,150	+ \$3,150	=	\$3,000	+ \$22,000	+ \$42,250

Analyze: Transaction 3 increased the Company's debt by \$6,000.

PROBLEM 2.2B

	Assets			=	Liabilities + Owner's Equity		
	Cash	+ Receivable	+ Supplies	=	Accounts Payable	+ Office Furniture	+ R. Johnson Capital
Beginning Balances	\$19,000	+ \$6,000	+ \$6,400	=	\$5,000	+ \$12,000	+ \$24,900
1.				=			+\$26,000
New Balances	19,000	+ 10,000	+ 6,400	=	5,000	+ 12,000	+ 30,000
2.				=			+\$4,000
New Balances	17,560	+ 10,000	+ 6,400	=	5,000	+ 12,000	+ 24,900
3.				=			+\$5,000
New Balances	17,560	+ 10,000	+ 6,400	=	5,000	+ 12,000	+ 30,000
				=			+\$1,440
				=			-\$12,500
				=			-\$13,940

PROBLEM 2.2B (continued)

		Assets				=	Liabilities +		Owner's Equity		
		Cash	+ Accounts Receivable	+ Supplies	+ Office Furniture	=	Accounts Payable	+ R. Johnson Capital	+ Revenue	- Expenses	
New	Balances	22,560	+ 10,000	+ 6,400	+ 12,000	=	5,000	+ 24,900	+ 35,000	- 13,940	
	4.	-800								+800	
New	Balances	21,760	+ 10,000	+ 6,400	+ 12,000	=	5,000	+ 24,900	+ 35,000	- 14,740	
	5.	-2,400					-2,400				
New	Balances	19,360	+ 10,000	+ 6,400	+ 12,000	=	2,600	+ 24,900	+ 35,000	- 14,740	
	6.	-960								+960	
New	Balances	18,400	+ 10,000	+ 6,400	+ 12,000	=	2,600	+ 24,900	+ 35,000	- 15,700	
	7.	-7,000								+7,000	
New	Balances	11,400	+ 10,000	+ 6,400	+ 12,000	=	2,600	+ 24,900	+ 35,000	- 22,700	
	8.	+5,600							+5,600		
New	Balances	17,000	+ 10,000	+ 6,400	+ 12,000	=	2,600	+ 24,900	+ 40,600	- 22,700	
	9.		+1,000				+1,000				
New	Balances	17,000	+ 10,000	+ 7,400	+ 12,000	=	3,600	+ 24,900	+ 40,600	- 22,700	
	10.	+3,000	+ -3,000								
New	Balances	\$20,000	+ \$7,000	+ \$7,400	+ \$12,000	=	\$3,600	+ \$24,900	+ \$40,600	- \$22,700	

Analyze: Owner's Equity balance is \$42,800; \$24,900 + (\$40,600 - \$22,700).

PROBLEM 2.3B

Taylor's Tax Service

Balance Sheet

December 1, 2013

Assets				Liabilities					
Cash	24	0	0	0	00				
Furniture	8	0	0	0	00				
Equipment	9	6	0	0	00	Owner's Equity			
						David Taylor, Capital			
						41	6	0	00
Total Assets	41	6	0	0	00	Total Liabilities and Owner's Equity			
						41	6	0	00

Analyze: The amount reported on the balance sheet for owner's equity would be \$33,600.

PROBLEM 2.4B

Linda Carter, Attorney and Counselor of Law

Income Statement

Month Ended August 31, 2013

Revenue									
Fees Income						10	8	0	00
Expenses									
Utilities Expense		6	0	0	00				
Salaries Expense	5	4	0	0	00				
Telephone Expense		6	0	0	00				
Total Expenses						6	6	0	00
Net Income						4	2	0	00

Linda Carter, Attorney and Counselor of Law

Statement of Owner's Equity

Month Ended August 31, 2013

Linda Carter, Capital, Aug. 1, 2013						23	2	0	00
Net Income for August	4	2	0	0	00				
Less Withdrawals for August	1	2	0	0	00				
Increase in Capital						3	0	0	00
Linda Carter, Capital, Aug. 31, 2013						26	2	0	00

PROBLEM 2.4B (continued)

Linda Carter, Attorney and Counselor at Law

Balance Sheet

August 31, 2013

Assets					Liabilities				
Cash	4	8	0	00	Accounts Payable		6	0	00
Accounts Receivable	6	6	0	00					
Supplies	5	4	0	00	Owner's Equity				
Equipment	10	0	0	00	Linda Carter, Capital	26	2	0	00
Total Assets	26	8	0	00	Total Liabilities and Owner's Equity	26	8	0	00

Analyze: Net income of \$4,200 was transferred from the income statement.

CRITICAL THINKING PROBLEM 2.1

Body Builders Fitness Center

Income Statement

Month Ended November 30, 2013

Revenue										
Fees Earned						9	7	6	0	00
Expenses										
Rent Expense	8	0	0	0	00					
Cleaning Expense	2	1	0	0	00					
Advertising Expense		8	0	0	00					
Total Expenses						10	9	0	0	00
Net Loss						(1	1	4	0	00)

Some students may include the warm-up suits as a business expense. If the suits are a type of uniform, their inclusion is appropriate; if they are to be worn at home and at work, their cost is not a business expense.

The parking ticket is a personal expense. The cleaning of the studio and the printing of the flyers are business expenses. Payment of expenses with the owner’s personal credit card would be considered an additional investment by the owner.

It is not unusual for new businesses to operate at a loss. James should project his income and expenses for the next several months to determine how much new business he will need to earn an income. Students’ suggestions for improving the accounting system might include opening a business checking account, not using a personal credit card for business expenses, setting up a filing system for business records, and purchasing a computer to maintain financial records.

CRITICAL THINKING PROBLEM 2.2

Determine the balance for Dolly Garcia, April 30, 2013.

Assets		= Liabilities		+ Owner's Equity			
Accounts		D. Garcia		D. Garcia			
Cash	+ Receivable	+ Machinery	= Payable	+ Capital	- Drawing	+ Revenue	- Expenses
\$26,000	+ \$10,800	+ \$19,000	= \$12,800	+ ?	-	+ \$23,800	- \$17,150

Let Dolly Garcia, Capital = X.

Solving for X:

$$\$55,800 \text{ (Total Assets)} = \$12,800 \text{ (Accounts Payable)} - \$5,200 \text{ (Drawing)} + \$23,800 \text{ (Revenue)} - \$17,150 \text{ (Expenses)} + X$$

$$\begin{array}{r}
 \$55,800 - \\
 \$14,250 = \\
 \$41,550 = \\
 \hline
 \$41,550
 \end{array}
 =
 \begin{array}{r}
 \$14,250 + \\
 \$14,250 - \\
 X \\
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 +
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 X \\
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 X
 \end{array}$$

Dolly Garcia, Capital,	=	<u><u>\$41,550</u></u>
April 1, 2013		
Advertising Expense		\$3,750
Maintenance Expense		4,400
Salaries Expense		9,000
Total Expenses		<u><u>\$17,150</u></u>

CRITICAL THINKING PROBLEM 2.2 (continued)

Dolly Garcia, Certified Public Accountant

Income Statement

Month Ended April 30, 2013

Revenue									
Fees Earned					23	8	0	0	00
Expenses									
Advertising Expense	3	7	5	0	00				
Maintenance Expense	4	4	0	0	00				
Salaries Expense	9	0	0	0	00				
Total Expenses					17	1	5	0	00
Net Income					6	6	5	0	00

Dolly Garcia, Certified Public Accountant

Statement of Owner's Equity

Month Ended April 30, 2013

Dolly Garcia, Capital, April 1, 2013					41	5	5	0	00
Net Income for April	6	6	5	0	00				
Less Withdrawals for April	5	2	0	0	00				
Increase in Capital					1	4	5	0	00
Dolly Garcia, Capital, April 30, 2013					43	0	0	0	00

Dolly Garcia, Certified Public Accountant

Balance Sheet

April 30, 2013

Assets					Liabilities						
Cash	26	0	0	0	00	Accounts Payable	12	8	0	0	00
Accounts Receivable	10	8	0	0	00	Owner's Equity					
Equipment	19	0	0	0	00	Dolly Garcia, Capital	43	0	0	0	00
Total Assets	55	8	0	0	00	Total Liabilities and Owner's Equity	55	8	0	0	00

Analyze: The increase in owner's equity was \$1,450.

SOLUTIONS TO BUSINESS CONNECTIONS

Managerial Focus:

1. Organized financial information can be used to evaluate operating efficiency and to make decisions about current and future activities.
2. The firm's obligations must be met as they become due.
3. No. Early development is expensive, risky, and time consuming. Profits may not be achieved for a year or more.
4. Not necessarily. Reinvestments in assets or use of cash to pay debts affect cash. In addition, sales or revenue may have been "on account."

Ethical Dilemma:

Sarineh should not record the sale until she receives the purchase order from the customer. If she enters the sale and for some reason the customer doesn't make the order, Joseph would need to pay the bonus back. Sarineh's job would be in jeopardy.

Financial Statement Analysis:

1. Southwest Airlines Co., Consolidated Statement of Income, Years Ended December 31,
2. Passenger, Freight, Other.
3. Statement of Owner's Equity (Consolidated Statement of Stockholders' Equity).
4. Total operating revenue was \$3,712,000,000 for the quarter ended September 30, 2010.
5. See current topic on website.

Internet Connection:

Macy's, Bloomingdales, and now May is included in the Federated Corporation. Shopping online is on every home page. To record an online sale it must debit a credit card receivable and credit sales. A general job announcement and requirements are given at the site.

Team Work:

Accounts Payable Clerk would use Purchases (Increase), A/P (increase and decrease) and Cash (decrease). Accounts Receivable Clerk would use Sales (increase), A/R (increase and decrease) and Cash (increase). Full charge bookkeeper would use accounts Cash (increase and decrease), Bank Charges (increase) and Miscellaneous account (increase), Interest Income (increase), Interest Expense (increase). Accurate numbers are developed when it is determined that all transactions have been entered and that total assets equal total liabilities plus owner's equity.

SOLUTIONS TO PRACTICE TEST

Part A True-False

1. TRUE
2. FALSE
3. TRUE
4. TRUE
5. TRUE
6. FALSE
7. TRUE
8. FALSE
9. TRUE
10. FALSE

Part B Matching

1. a
2. g
3. c
4. e
5. b
6. f
7. h
8. d

Part C Completion

1. analyze
2. accounts payable or liability
3. equal
4. profit
5. credit on account
6. reduced or decreased
7. assets
8. asset or property