

# CHAPTER 2

## ACCOUNTING FOR TRANSACTIONS

### Key Terms and Concepts to Know

**Double–entry accounting:**

- Debits and Credits
- Total debits must always equal total credits

**Accounting Books:**

- Accounts
- General Journal
- General Ledger (T account)
- Chart of Accounts

**Business Transactions:**

- Impact on the accounting equation
- Impact on accounts and financial statements
- Journalizing (Recording) transactions in the General Journal
- Posting (Recording) Transactions from the General Journal to the General Ledger

**Trial Balance:**

- Prepare a Trial Balance
- Use the trial balance to prepare financial statements
- Find and correct errors using the trial balance

**Debt Ratio**

## Key Topics to Know

### Debits and Credits

DEBIT SIDE	CREDIT SIDE
<u>A</u> fter – <u>A</u> ssets <u>E</u> ating – <u>E</u> xpenses  <u>D</u> inner – <u>D</u> ividends	<u>L</u> et's – <u>L</u> iabilitys <u>R</u> ead – <u>R</u> evenues and <u>R</u> etained Earnings <u>C</u> omics – <u>C</u> apital Stock
<u>Assets, Expenses and Dividends</u> Normal balance on the DEBIT side Increase on the DEBIT side Decrease on the CREDIT side	<u>Liabilities, Revenues and Capital Stock</u> Normal balance on the CREDIT side Increase on the CREDIT side Decrease on the DEBIT side

### Journals and Ledgers

**Example #1:**

1) Journalize the transactions below using the following account titles:

Cash Accounts Receivable Supplies Accounts Payable	Capital Stock Dividends Sales Commissions Office Salaries Expense	Rent expense Automobile expense Supplies expense Misc. expense
---	--	---

2) Prepare T-accounts and post the entries to the appropriate accounts. Determine balances after all entries are posted.

- a) Issued capital stock for \$16,000.
- b) Paid rent on office building for the month, \$3,000.
- c) Purchased supplies on account, \$1,200.
- d) Paid creditor on account, \$800.
- e) Earned sales commissions and sent invoices to customers, \$22,500.
- f) Paid automobile expenses for month, \$2,900, and miscellaneous expenses, \$1,450.
- g) Paid office salaries, \$4,200.
- h) Determined the cost of supplies used was \$960.
- i) Paid cash dividends, \$1,400.

**Solution #1**

a) Cash	16,000	
Capital Stock		16,000
b) Rent Expense	3,000	
Cash		3,000
c) Supplies	1,200	
Accounts Payable		1,200
d) Accounts Payable	800	
Cash		800
e) Accounts Receivable	22,500	
Sales Commissions		22,500
f) Automobile Expenses	2,900	
Misc. Expenses	1,450	
Cash		4,350
g) Salaries Expense	4,200	
Cash		4,200
h) Supplies Expense	960	
Supplies		960
i) Dividends	1,400	
Cash		1,400

<table border="1" style="width: 100%; border-collapse: collapse;"> <tr><th colspan="2" style="text-align: center;">Cash</th></tr> <tr><td style="width: 50%;">a) 16,000</td><td style="width: 50%;">b) 3,000</td></tr> <tr><td></td><td style="text-align: right;">800</td></tr> <tr><td></td><td style="text-align: right;">4,350</td></tr> <tr><td></td><td style="text-align: right;">4,200</td></tr> <tr><td></td><td style="text-align: right;">1,400</td></tr> <tr><td style="border-top: 1px solid black;">2,250</td><td></td></tr> </table>	Cash		a) 16,000	b) 3,000		800		4,350		4,200		1,400	2,250		<table border="1" style="width: 100%; border-collapse: collapse;"> <tr><th colspan="2" style="text-align: center;">A/R</th></tr> <tr><td style="width: 50%;">e) 22,500</td><td style="width: 50%;"></td></tr> <tr><td colspan="2" style="border-top: 1px solid black;">22,500</td></tr> </table>	A/R		e) 22,500		22,500		<table border="1" style="width: 100%; border-collapse: collapse;"> <tr><th colspan="2" style="text-align: center;">Supplies</th></tr> <tr><td style="width: 50%;">c) 1,200</td><td style="width: 50%;">h) 960</td></tr> <tr><td colspan="2" style="border-top: 1px solid black;">240</td></tr> </table>	Supplies		c) 1,200	h) 960	240	
Cash																												
a) 16,000	b) 3,000																											
	800																											
	4,350																											
	4,200																											
	1,400																											
2,250																												
A/R																												
e) 22,500																												
22,500																												
Supplies																												
c) 1,200	h) 960																											
240																												
<table border="1" style="width: 100%; border-collapse: collapse;"> <tr><th colspan="2" style="text-align: center;">A/P</th></tr> <tr><td style="width: 50%;">d) 800</td><td style="width: 50%;">e) 1,200</td></tr> <tr><td colspan="2" style="border-top: 1px solid black;">400</td></tr> </table>	A/P		d) 800	e) 1,200	400		<table border="1" style="width: 100%; border-collapse: collapse;"> <tr><th colspan="2" style="text-align: center;">Capital Stock</th></tr> <tr><td style="width: 50%;"></td><td style="width: 50%;">c) 16,000</td></tr> <tr><td colspan="2" style="border-top: 1px solid black;">16,000</td></tr> </table>	Capital Stock			c) 16,000	16,000		<table border="1" style="width: 100%; border-collapse: collapse;"> <tr><th colspan="2" style="text-align: center;">Dividends</th></tr> <tr><td style="width: 50%;">i) 1,400</td><td style="width: 50%;"></td></tr> <tr><td colspan="2" style="border-top: 1px solid black;">1,400</td></tr> </table>	Dividends		i) 1,400		1,400									
A/P																												
d) 800	e) 1,200																											
400																												
Capital Stock																												
	c) 16,000																											
16,000																												
Dividends																												
i) 1,400																												
1,400																												
<table border="1" style="width: 100%; border-collapse: collapse;"> <tr><th colspan="2" style="text-align: center;">Sales Commission</th></tr> <tr><td style="width: 50%;"></td><td style="width: 50%;">e) 22,500</td></tr> <tr><td colspan="2" style="border-top: 1px solid black;">22,500</td></tr> </table>	Sales Commission			e) 22,500	22,500		<table border="1" style="width: 100%; border-collapse: collapse;"> <tr><th colspan="2" style="text-align: center;">Salaries Expense</th></tr> <tr><td style="width: 50%;">g) 4,200</td><td style="width: 50%;"></td></tr> <tr><td colspan="2" style="border-top: 1px solid black;">4,200</td></tr> </table>	Salaries Expense		g) 4,200		4,200		<table border="1" style="width: 100%; border-collapse: collapse;"> <tr><th colspan="2" style="text-align: center;">Rent Expense</th></tr> <tr><td style="width: 50%;">b) 3,000</td><td style="width: 50%;"></td></tr> <tr><td colspan="2" style="border-top: 1px solid black;">3,000</td></tr> </table>	Rent Expense		b) 3,000		3,000									
Sales Commission																												
	e) 22,500																											
22,500																												
Salaries Expense																												
g) 4,200																												
4,200																												
Rent Expense																												
b) 3,000																												
3,000																												
<table border="1" style="width: 100%; border-collapse: collapse;"> <tr><th colspan="2" style="text-align: center;">Auto Expense</th></tr> <tr><td style="width: 50%;">f) 2,900</td><td style="width: 50%;"></td></tr> <tr><td colspan="2" style="border-top: 1px solid black;">2,900</td></tr> </table>	Auto Expense		f) 2,900		2,900		<table border="1" style="width: 100%; border-collapse: collapse;"> <tr><th colspan="2" style="text-align: center;">Supply Expense</th></tr> <tr><td style="width: 50%;">h) 960</td><td style="width: 50%;"></td></tr> <tr><td colspan="2" style="border-top: 1px solid black;">960</td></tr> </table>	Supply Expense		h) 960		960		<table border="1" style="width: 100%; border-collapse: collapse;"> <tr><th colspan="2" style="text-align: center;">Misc. Expense</th></tr> <tr><td style="width: 50%;">f) 1,450</td><td style="width: 50%;"></td></tr> <tr><td colspan="2" style="border-top: 1px solid black;">1,450</td></tr> </table>	Misc. Expense		f) 1,450		1,450									
Auto Expense																												
f) 2,900																												
2,900																												
Supply Expense																												
h) 960																												
960																												
Misc. Expense																												
f) 1,450																												
1,450																												

**Practice Problem #1:** Journalize each of the following transactions in a two-column journal and post the entries to T-accounts. Use the chart of accounts below.

Cash Accounts Receivable Supplies Prepaid Insurance	Accounts Payable Capital Stock Dividends Fees Earned	Rent Expense Utilities Expense Equipment
--	---	--

- a) Issued capital stock for cash, \$27,500
- b) Paid rent on office for month, \$2,500
- c) Purchased office supplies for cash, \$2,225
- d) Paid insurance premiums, \$1,500
- e) Purchased office equipment on account, \$10,000
- f) Received cash for services completed, \$3,800
- g) Received an invoice for utilities, \$475
- h) Billed customers for services completed, \$1,800
- i) Received cash from customers on account, \$900
- j) Paid \$4,200 on account
- k) Paid cash dividends, \$2,800

<b>Trial Balance</b>
----------------------

**Example #2:**

The debit and credit totals of the following trial balance are unequal as a result of the following errors. Prepare a corrected trial balance as of June 30 of the current year.

Cash	\$26,500	
Accounts Receivable	37,775	
Prepaid Insurance	800	
Office Supplies	960	
Accounts Payable		\$11,410
Notes Payable		6,000
Capital Stock		7,500
Retained Earnings		25,340
Dividends		2000
Fees Earned		126,500
Wages Expense	84,100	
Rent Expense	5,500	
Advertising Expense	3,900	
Automobile Expense	275	
Miscellaneous Expense	1,550	
Totals	\$161,360	\$178,750

Errors noted:

- a) The balance of cash was understated by \$750. (Cash +750)
- b) A cash receipt of \$2,100 was posted as a debit to Cash of \$1,200. (Cash +900)
- c) A debit of \$3,000 for a cash dividend was posted as a credit to Retained Earnings. (Dividends +3,000; RE -3,000)
- d) The balance of \$2,750 in Automobile Expense was entered in the trial balance as \$275. (Auto Exp. = 2,750)
- e) A debit of \$975 to Accounts Receivable was not posted. (A/R +975)
- f) A return of \$125 of defective supplies was erroneously posted as a \$215 credit to Supplies. (Supplies +90)
- g) An insurance policy acquired at a cost of \$150 was posted as a credit to Prepaid Insurance. (Prepaid Ins. +300)
- h) A debit of \$900 in Accounts Payable was overlooked when determining the balance of the account. (A/P -900)
- i) The balance of Notes Payable was overstated by \$5,000. (Notes Payable -5,000)
- j) The balance of cash was understated by \$750. (Cash +750)
- k) A cash receipt of \$2,100 was posted as a debit to Cash of \$1,200. (Cash +900)

**Solution #2:**

Corrected Trial Balance		
Cash	\$28,150	
Accounts Receivable	38,750	
Prepaid Insurance	1,100	
Office Supplies	1,050	
Land	0	
Accounts Payable		\$10,510
Notes Payable		1,000
Capital Stock		7,500
Retained Earnings		22,340
Dividends	1,000	
Fees Earned		126,500
Wages Expense	84,100	
Rent Expense	5,500	
Advertising Expense	3,900	
Automobile Expense	2,750	
Miscellaneous Expense	1,550	
Total	\$167,850	\$167,850

**Practice Problem #2:** The debit and credit totals of the following Trial Balance are unequal as a result of the following errors. Prepare a corrected trial balance as of September 30 of the current year.

Errors noted:

- a) The balance of cash was overstated by \$850.
- b) A cash payment of \$3,600 was posted as a credit to Cash of \$6,300.
- c) A debit of \$3,000 for a cash dividend was posted as a credit to Delivery Expense.
- d) The balance of \$8,900 in Advertising Expense was entered as \$890 in the Trial Balance.
- e) A credit of \$250 to Accounts Receivable was not posted.
- f) A purchase of \$250 in supplies was posted as a credit to Supplies.
- g) The balance of Retained Earnings was overstated by \$1,500.
- h) An insurance policy acquired at a cost of \$315 was erroneously posted as a \$135 debit to Prepaid Insurance.
- i) Rent Expense, with a balance of \$19,000 was omitted from the trial balance.
- j) A credit of \$700 in Accounts Payable was overlooked when determining the balance of the account.

Trial Balance	
Cash	27,650
Accounts Receivable	38,850
Prepaid Insurance	570
Supplies	125
Land	0
Accounts Payable	12,550
Capital Stock	15,000
Retained Earnings	49,525
Dividends	7,000
Fees Earned	158,725
Salary Expense	123,075
Advertising Expense	890
Delivery Expense	950
Miscellaneous Expense	600
Total	<span style="border-bottom: 1px solid black;">\$199,710</span> <span style="border-bottom: 1px solid black;">\$235,800</span>

## Sample True / False Questions

1. A list of all account names used to record transactions of a company is referred to as a T-account.  
True    False
2. After recording each transaction, total assets must equal total liabilities plus stockholders' equity.  
True    False
3. Borrowing cash from the bank causes assets to increase and liabilities to increase.  
True    False
4. Providing services to customers for cash causes stockholders' equity to increase.  
True    False
5. Receiving cash in advance from a customer for services to be provided in the future causes assets to increase and stockholders' equity to increase.  
True    False
6. Expenses have the effect of decreasing retained earnings.  
True    False
7. The Dividends account increases with a credit and decreases with a debit.  
True    False
8. A journal provides a chronological record of all transactions affecting a firm.  
True    False
9. A credit to an account balance always results in the balance decreasing.  
True    False
10. For each transaction, there must be at least one debit amount and one credit amount.  
True    False



11. Paying employees' salaries for the current period is recorded with a debit to Salaries Expense.  
True False
12. The general ledger includes all accounts used to record the company's transactions.  
True False
13. The process of transferring the debit and credit information from the journal to individual accounts in the general ledger is called journalizing.  
True False
14. A trial balance is a list of all accounts and their balances at a particular date, showing that assets equal liabilities.  
True False
15. If total debits equal total credits in the trial balance, then all balances are correct.  
True False
16. Financial statements are prepared from the general ledger.  
True False
17. A trial balance is prepared only once in the accounting cycle.  
True False
18. The debt ratio is total assets divided by total assets.  
True False
19. The higher the debt ratio, the more risk of the company not being able to repay its liabilities.  
True False
20. Financial leverage measures the degree to which the company has borrowed funds to acquire assets.  
True False

## Sample Multiple Choice Questions

1. Accounts:
  - a) Are records of increases and decreases in individual financial statement items.
  - b) Are only used by large entities with many transactions.
  - c) Do not reflect money amounts.
  - d) Are used only by entities that manufacture products.
  
2. Which of the following accounts is an asset account?
  - a) Dividends
  - b) Accounts Payable
  - c) Equipment
  - d) Salaries Expense
  
3. Which of the following accounts is a liability account?
  - a) Dividends
  - b) Cash
  - c) Accounts Payable
  - d) Capital Stock
  
4. The gross increase in stockholder's equity attributable to business activities are called:
  - a) Dividends
  - b) Revenues
  - c) Expenses
  - d) Assets
  
5. The debit side of an account:
  - a) Is the right-hand side of the account.
  - b) Is the left-hand side of the account.
  - c) Depends on whether the account is an asset, liability, or stockholder's equity.
  - d) Can be either side of the account depending on how the accountant set up the system.
  
6. A debit may signify a(n):
  1. Increase in asset accounts
  2. Increase in liability accounts
  3. Increase in the capital account
  4. Decrease in expense accounts

7. A credit may signify a(n):
  - a) Increase in assets
  - b) Increase in liabilities
  - c) Decrease in capital
  - d) Decrease in revenue
  
8. Which of the following applications of the rules of debit and credit is true?
  - a) Increase rent expense with debits and the normal balance is a debit.
  - b) Decrease accounts receivable with credits and the normal balance is a credit.
  - c) Increase accounts payable with credits and the normal balance is a debit.
  - d) Decrease cash with debits and the normal balance is a credit.
  
9. In which of the following types of accounts are increases recorded by credits?
  - a) Liability, Revenue
  - b) Dividends, Asset
  - c) Expense, Liability
  - d) Revenue, Dividends
  
10. A credit balance in which of the following accounts would indicate a likely error?
  - a) Dividends
  - b) Accounts Payable
  - c) Fees Earned
  - d) Capital Stock
  
11. Which of the following entries records the payment of an account payable?
  - a) Debit Accounts Payable, credit Cash
  - b) Debit Cash, credit Accounts Payable
  - c) Debit Expense, credit Cash
  - d) Debit Cash, credit Expense
  
12. Which of the following entries records the receipt of a utility bill from the power company?
  - a) Debit Utilities Payable, credit Accounts Payable
  - b) Debit Accounts Payable, credit Utilities Payable
  - c) Debit Utilities Expense, credit Accounts Payable
  - d) Debit Accounts Payable, credit Utilities Expense

13. The process of initially recording a business transaction is called:
  - a) Sliding
  - b) Posting
  - c) Journalizing
  - d) Transposing
  
14. Which of the following entries records the payment of rent for the current month?
  - a) Cash, debit; Rent Expense, credit
  - b) Rent Expense, debit; Cash, credit
  - c) Rent Expense, debit; Accounts Payable, credit
  - d) Accounts Payable, debit; Rent Expense, credit
  
15. Which of the following entries records the collection of cash from cash customers?
  - a) Accounts Receivable, debit; Fees Earned, credit
  - b) Fees Earned, debit; Accounts Receivable, credit
  - c) Fees Earned, debit; Cash credit
  - d) Cash, debit; Fees Earned, credit
  
16. The verification that the sum of the debits and the sum of the credits in the ledger are equal is called:
  - a) A journal
  - b) A ledger
  - c) Posting
  - d) A trial balance
  
17. An error was discovered in computing and paying the wages of an employee of Allen Appliance Repair. Allen received cash from the employee for the amount of the overpayment. Which of the following entries for Allen records this transaction?
  - a) Wages Payable, debit; Wages Expense, credit
  - b) Wages Expense, debit; Wages Payable, credit
  - c) Wages Expense, debit; Cash, credit
  - d) Cash, debit; Wages Expense, credit
  
18. If an expense is incurred but not paid, then
  - a) Liabilities will increase
  - b) Stockholder's equity will increase
  - c) Assets will decrease
  - d) Expenses will decrease

19. Which of the following errors, each considered individually, would cause the trial balance totals to be unequal?
  - a) A payment of \$248 to a creditor was posted as a debit of \$248 to Accounts Payable and a debit of \$248 to Accounts Receivable.
  - b) Cash received from customers on account was posted as a debit of \$450 to Cash and a credit of \$450 to Accounts Payable.
  - c) A payment of \$79 for supplies was posted as a debit of \$97 to Supplies and a credit of \$97 to Cash.
  - d) A transaction was not posted.
  
20. Accounts with normal debit balances include:
  - a) Assets and liabilities
  - b) Liabilities and expenses
  - c) Stockholder's equity and revenues
  - d) Expenses and assets
  
21. Accounts with normal credit balances include:
  - a) Assets and liabilities
  - b) Revenues and expenses
  - c) Liabilities and revenues
  - d) Revenues and assets
  
22. The process of transferring entries from the journal to the ledger is called:
  - a) Journalizing
  - b) Transferring
  - c) Posting
  - d) Balancing
  
23. The entire group of accounts maintained by a company is collectively referred to as the:
  - a) Ledger
  - b) Journal
  - c) Financial statements
  - d) Basic equation
  
24. The chart of accounts lists a company's accounts in what order?
  - a) Assets, liabilities, revenues, expenses, stockholders' equity
  - b) Assets, revenues, expenses, liabilities, stockholders' equity
  - c) Assets, liabilities, stockholders' equity, expenses, revenue
  - d) Assets, liabilities, stockholders' equity, revenues, expenses

25. When a trial balance balances, it is an indication that:
- a) All journal entries have been posted.
  - b) The account balances are correct.
  - c) Debits equal credits.
  - d) All transactions have been journalized.
26. Accounts are listed on the trial balance in:
- a) Chronological order
  - b) The order that they appear in the ledger
  - c) Alphabetical order
  - d) The order in which they are posted

## SOLUTIONS TO PRACTICE PROBLEMS

### Practice Problem #1

a) Cash	27,500	
Capital Stock		27,500
b) Rent Expense	2,500	
Cash		2,500
c) Supplies	2,225	
Cash		2,225
d) Prepaid Insurance	1,500	
Cash		1,500
e) Equipment	10,000	
Accounts Payable		10,000
f) Cash	3,800	
Fees Earned		3,800
g) Utilities Expense	475	
Accounts Payable		475
h) Accounts Receivable	1,800	
Fees earned		1,800
i) Cash	900	
Accounts Receivable		900
j) Accounts Payable	4,200	
Cash		4,200
k) Dividends	2,800	
Cash		2,800

Cash	
a) 27,500	2,500 b)
f) 3,800	2,225 c)
i) 900	1,500 d)
	4,200 j)
	2,800 k)
18,975	

A/R	
h) 1,800	900 i)
900	

Supplies	
c) 2,225	
2,225	

A/P	
j) 4,200	10,000 e)
	475 g)
	400

Capital Stock	
	27,500 a)
	27,500

Dividends	
k) 2,800	
2,800	

Fees Earned	
	3,800 f)
	1,800 h)
	5,600

Utilities Expense	
g) 475	
475	

Rent Expense	
b) 2,500	
2,500	

Prepaid Insurance	
d) 1,500	
1,500	

Equipment	
e) 10,000	
10,000	



**Practice Problem #2**

Corrections required:

- a) Cash -850
- b) Cash +2,700
- c) Dividend +3,000; Delivery Expense +3,000
- d) Advertising Expense change to 8,900
- e) A/R -250
- f) Supplies +500
- g) Retained Earnings -1,500
- h) Prepaid Expenses +180
- i) Rent Expense should be included at \$19,000
- j) A/P +700

Corrected Trial Balance

Cash	\$29,500	
Accounts Receivable	38,600	
Prepaid Insurance	750	
Supplies	625	
Land	0	
Accounts Payable		\$13,250
Capital Stock		15,000
Retained Earnings		48,025
Dividends	10,000	
Fees Earned		158,725
Salary Expense	123,075	
Rent Expense	19,000	
Advertising Expense	8,900	
Delivery Expense	3,950	
Miscellaneous Expense	600	
Total	<u>\$235,000</u>	<u>\$235,000</u>

## SOLUTIONS TO TRUE / FALSE QUESTIONS

1. False - this is referred to as a chart of accounts.
2. True
3. True
4. True
5. False - assets increase and liabilities increase.
  
6. True
7. False - the Dividends account increases with a debit and decreases with a credit.
8. True
9. False - a credit decreases assets, dividends, and expense, but increases liabilities, stockholders' equity, and revenues.
10. True
11. True
12. True
13. False - the process is called posting.
14. False - the trial balance shows that total debits equal total credits.
15. False - a trial balance could contain offsetting errors where the balance of one account is misstated in one direction but the balance of another account (with the same type of debit or credit balance) is misstated in the other direction.
16. False – financial statements are prepared from a trial balance.
17. False – trial balances may be prepared before and after adjusting entries are prepared and after the closing process has been completed.
18. False – the debt ratio is total liabilities divided by total assets.
19. True
20. True

## SOLUTIONS TO MULTIPLE CHOICE QUESTIONS

1. A
2. C
3. C
4. B
5. B
6. A
7. B
8. A
9. A
10. A
11. A
12. C
13. C
14. B
15. D
16. D
17. D
18. A
19. A
20. D
21. C
22. C
23. A
24. D
25. C
26. B