

ACCOUNTING FOR TRANSACTIONS, THE ACCOUNTING EQUATION AND THE TRIAL BALANCE

Key Terms and Concepts to Know

The Accounting Cycle (first four steps):

- **Analyze transactions** to understand them and determine their effect on the accounting equation
- **Journalize transactions** for the various types of transactions.
- **Post transactions** from the journal to the general ledger
- **Prepare a trial balance**
 - Identify the types of errors a trial balance can and cannot help to locate
 - How to correct the errors.

Accounting Equation and Components:

- Three basic elements: Assets, Liabilities, Stockholders Equity
- $\text{Stockholders' Equity} = \text{Retained Earnings} + \text{Common Stock}$
- $\text{Retained earnings} = \text{Revenues} - \text{Expenses} - \text{Dividends}$
- The accounting equation must always balance

Business Transactions:

- Analyze each transaction to determine its impact on the accounting equation
- Analyze each transaction to determine its impact on accounts and financial statements

Journal and Ledger

- Journal is used to record complete transactions
- Ledger is used to record all activity in each account and to maintain the balance in each account
- Both a journal and a ledger are necessary because they provide different information to management
- A chart of accounts is a listing of all possible accounts to be used in the journal and ledger. Each account is assigned a number in the following order: assets, liabilities, owners' equity, revenues and expenses

The Rules of Debit and Credit:

- Debit is the left side of an account and Credit is the right side of an account
- Normal balances of accounts and how debits and credits increase or decrease account balances

	<u>Normal Balance</u>	<u>Increase</u>	<u>Decrease</u>
Balance Sheet Accounts			
Assets	Debit	Debit	Credit
Liabilities	Credit	Credit	Debit
Owners' Equity	Credit	Credit	Debit
Capital Stock	Credit	Credit	Debit
Retained Earnings	Credit	Credit	Debit
Dividends	Debit	Debit	Credit
Income Statement Accounts			
Revenue	Credit	Credit	Debit
Expenses	Debit	Debit	Credit

Analyzing a general ledger account (T-account)

- Use the general equation:
Beginning Balance + Inflows – Outflows = Ending Balance.
- Remember that the inflows and outflows are renamed for the types of activity in each specific account
 - Cash has receipts and supplies has purchases but both are inflows into (additions to) these accounts
 - Accounts receivable as collections and accounts payable has payments but both are outflows from (deductions from) these accounts
- The equation can be manipulated to solve for an unknown as any one of the four terms.

Components of Stockholders equity:

- The two main components of Stockholders' equity are Common Stock and Retained Earnings
- Retained Earnings includes the balance in Retained earnings at the beginning of the year plus Net Income and less Dividends for the year
- Net income equals Revenues less expenses

Trial Balance:

- A listing of all accounts in the general ledger at the balance sheet date with the account balance; one column for debit balances and one column for credit balances
- The totals of the two columns must be equal
- A trial balance is an intermediate step between the general ledger and the financial statement, as the size and complexity of a general ledger for a large company makes preparing financial statements from the general ledger impractical.
- The trial balance also allows the company to find and correct certain types of errors

Key Topics to Know

Transactions

- Transactions are the result of economic events that affect the accounting equation.
- Transactions require a minimum of two items or parts.
- Since the rules of algebra apply to the accounting equation, transactions must have one of three effects:
 - Increase both sides of the equation
 - Decrease both sides of the equation
 - Have offsetting increases or decreases on one side of the equation
- These increases and decreases in the various account balances form the basis for the use of debits and credits.

Example #1

X Company engaged in three transactions during May:

- Purchased a truck for \$20,000 cash
- Paid a bill from VISA for \$500 which was received and recorded in April
- Purchased office supplies for \$1,000 which will be paid for in June

Required: Identify the accounts, amounts and increases/decreases for each transaction.

Solution #1

- Two assets accounts are used: Cash is decreased \$20,000 and Truck is increased \$20,000
- One asset account and one liability account are used: the asset account Cash is decreased \$500 and the liability account Accounts Payable is decreased \$500
- One asset account and one liability account are used: the asset account Office Supplies is increased \$1,000 and the liability account Accounts Payable is increased \$1,000

Debits and Credits

- Debit means left
- Credit means right
- They DO NOT mean increase or decrease or plus or minus or anything else by themselves.
- Each of the 6 types of accounts is assigned a normal or typical balance according to the following table.
- Each of the 6 types of accounts is assigned debits and credits as increases or decreases based on the following table:

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 Normal balance on the DEBIT side Increase on the DEBIT side Decrease on the CREDIT side	<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 Normal balance on the CREDIT side Increase on the CREDIT side Decrease on the DEBIT side

- Another approach to understanding is based on the accounting equation:

Assets		=	Liabilities		+	Owners’ Equity	
debits	credits		debits	credits		debits	credits
+	-		-	+		-	+

- Owners’ equity is not an account in the general ledger. Rather it is a collection of four accounts:

Capital Stock	Revenue
debits	debits
-	-
credits	credits
+	+
Expenses	Dividends
debits	debits
+	+
credits	credits
-	-

- Capital Stock and Revenue mirror owners’ equity; that is, increases in these two accounts increase owners’ equity.

- Expenses and Dividends have the opposite effect on owners' equity; that is, increases in these two accounts decrease owners' equity.
- Retained Earnings is the accumulation of all revenues, expenses and dividends since the inception of the company. Since a company is in business to make a profit (revenues > expenses) and it would not distribute all of its net income to shareholders through dividends, Retained Earnings also mirrors Owners' equity:

Retained Earnings

debits	credits
-	+

- However, if the company is not profitable, then revenues have been less than expenses and Retained earnings would have a negative or debit balance.

Example #2

X Company engaged in three transactions during May:

- Purchased a truck for \$30,000 cash
- Paid a bill from VISA for \$500 which was received and recorded in April
- Purchased office supplies for \$1,000 which will be paid for in June

Required: Identify the accounts, amounts and debits and credits for each transaction.

Solution #2

- Two assets accounts are used: Cash is credited (decreased) \$20,000 and Truck is debited (increased) \$20,000
- One asset account and one liability account are used: the asset account Cash is credited (decreased) \$500 and the liability account Accounts Payable is debited (decreased) \$500
- One asset account and one liability account are used: the asset account Office Supplies is debited (increased) \$1,000 and the liability account Accounts Payable is credited (increased) \$1,000

Journals and Ledgers

- Accounting uses two books to record transactions.
- The Journal is the book of original entry; transactions are first recorded in the journal using journal entries.
- Each journal entry records an entire transaction at the time it is completed.
- Total debits must equal total credits for each journal entry.
- Journal entries are posted to the General Ledger, one entry at a time.
- Posting separates each transaction into its parts, account by account, and records each part on the Page(s) dedicated to that account.
- The General Ledger accumulates all the transactions for an account and maintains a running balance of all postings for each account.
- The shorthand for a Ledger account is called a T-account.

Example #3

W Company uses a chart of accounts which includes the following accounts.

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

During the first month of operation, W Company had the following transactions;

- 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.

- Required:
- a) Journalize the transactions
 - b) Prepare T-accounts and post the entries to the appropriate accounts. Determine balances after all entries are posted.

Solution #3

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

Cash	
a) 16,000	b) 3,000
	d) 800
	f) 4,350
	g) 4,200
	i) 1,400
<hr/>	
2,250	

A/R	
e) 22,500	
<hr/>	
22,500	

Supplies	
c) 1,200	h) 960
<hr/>	
240	

A/P	
d) 800	e) 1,200
<hr/>	
	400

Capital Stock	
	c) 16,000
<hr/>	
	16,000

Dividends	
i) 1,400	
<hr/>	
1,400	

Sales Commission	
	e) 22,500
<hr/>	
	22,500

Salaries Expense	
g) 4,200	
<hr/>	
4,200	

Rent Expense	
b) 3,000	
<hr/>	
3,000	

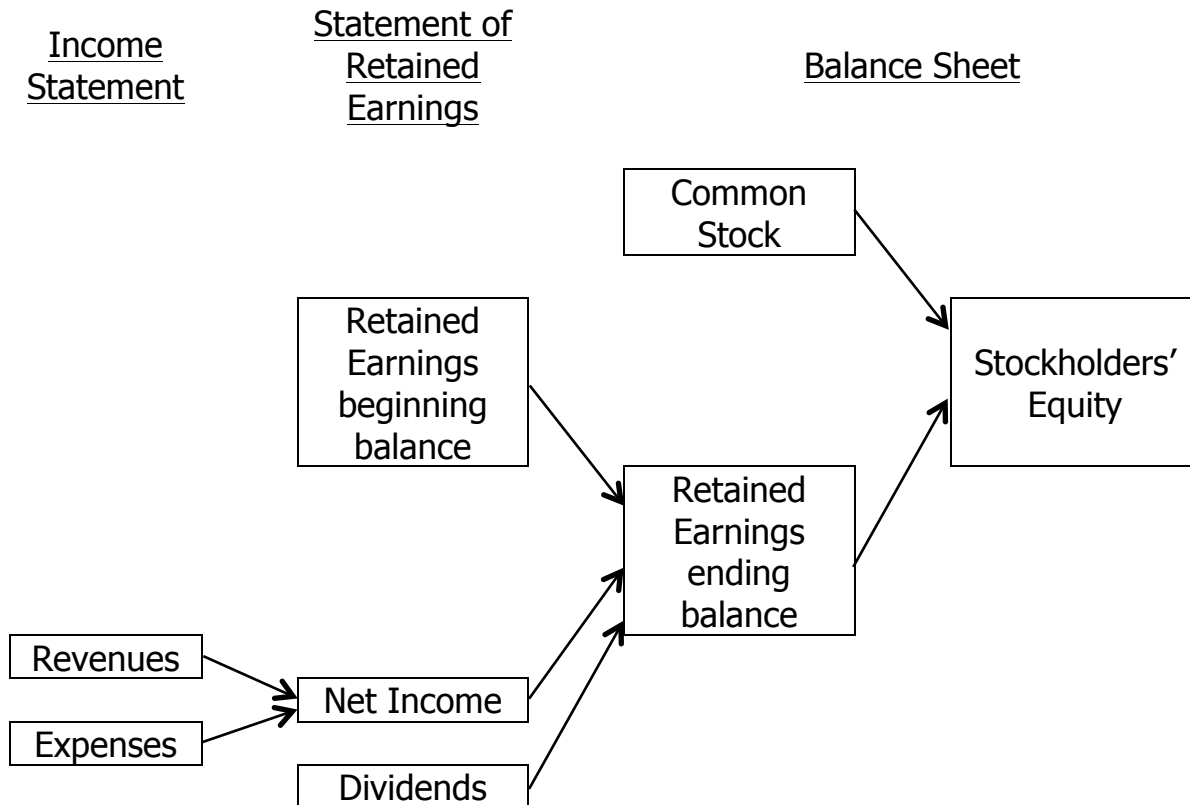
Auto Expense	
f) 2,900	
<hr/>	
2,900	

Supply Expense	
h) 960	
<hr/>	
960	

Misc. Expense	
f) 1,450	
<hr/>	
1,450	

Stockholders' Equity

- The components of Stockholders' equity are reported in various places in the financial statements:



Trial Balance

- A trial balance is a listing of the balances in all general ledger accounts.
- It is used to prepare financial statements.
- It may be used to find errors in the ledger caused by debits not equal to credits.
- It may also highlight illogical account balances such as a debit balance in sales or account balances that illogically high or low.

Example #4

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.

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		2,000
Fees Earned		126,500
Wages Expense	84,100	
Rent Expense	5,500	
Advertising Expense	3,900	
Automobile Expense	275	
Miscellaneous Expense	1,550	
Totals	<u>\$161,360</u>	<u>\$178,750</u>

Errors noted:

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

Required: Prepare a corrected trial balance.

Solution #4

Corrected Trial Balance	
Cash	\$28,150
Accounts Receivable	38,750
Prepaid Insurance	1,100
Office Supplies	1,050
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	<u>\$167,850</u> <u>\$167,850</u>

Practice Problems

Practice Problem #1

K Company had the following transactions during August:

- 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

The company uses this chart of accounts:

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

Required: Journalize the transactions and post the entries to T-accounts

Practice Problem #2

The debit and credit totals of the following Trial Balance are unequal as a result of the following errors:

- 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	\$199,710 \$235,800

Required: Prepare a corrected trial balance as of September 30 of the current year.

Practice Problem #3

T Company owned a tugboat and provides day tugboat tours to tourists along the Mississippi River near St. Louis. T Company had the following transactions during the first month of business.

- May 1 Butler invested \$20,000 cash and his tugboat valued at \$90,000 in the business.
- May 2 T Company paid \$3,000 cash for office equipment to keep track of business activities.
- May 3 T Company bought boating supplies costing \$2,500 on credit.
- May 4 B T Company paid the river master \$500 cash for the first month's dock rental.
- May 5 T Company paid \$1,800 cash for a six-month insurance policy.
- May 10 T Company received \$2,000 cash from clients for his first tour.
- May 12 T Company provided a \$3,500 tour on credit; the customer has agreed to pay within 10 days.
- May 19 T Company paid for the supplies originally purchased on May 3.
- May 22 T Company receives payment on the account from the client entry on May 12.
- May 25 T Company received \$2,750 cash for additional tours provided.
- May 31 T Company paid his crewmember a salary of \$1,000.
- May 31 T Company paid \$2,000 cash in dividends to the owner.

Required: Prepare journal entries to record the following transactions.

Practice Problem #4

The following information is from M Company's financial records for the last 3 years:

	<u>Assets</u>	<u>Liabilities</u>	<u>Owners' Equity</u>
End of Year 1	\$200,000	?	?
Change during Year 2	_____?	_____?	-30,000
End of Year 2	_____?	_____?	100,000
Change during Year 3	_____ -40,000	_____?	_____?
End of Year 3	_____?	_____?	130,000

Required: Fill in the missing dollar amounts.

Practice Problem #5

After preparing an unadjusted trial balance at year-end, R Company discovered the following errors:

1. Cash payment of the \$225 telephone bill for December was recorded twice.
2. Cash payment of a note payable was recorded as a debit to Cash and a debit to Notes Payable for \$1,000.
3. The balance in the Retained Earnings account was a debit of \$413. It was listed on the trial balance as a credit of the same amount.
4. An additional investment of \$5,000 cash by the owner was recorded as a debit to Common Stock and a credit to Cash.
5. A credit purchase of office equipment for \$1,800 was recorded as a debit to the Office Equipment account with no offsetting credit entry.
6. Payment of \$3,000 for the purchase of furniture was not recorded.
7. Sale of \$700 of merchandise on account to a customer was recorded as credit Revenue \$700 and debit Accounts Receivable \$70.
8. Sale of \$700 of merchandise to a customer was recorded as credit Revenue \$700 and debit Accounts Receivable \$700.
9. The revenue account balance of \$79,817 was listed on the trial balance as \$97,817.
10. A \$900 cash payment for dividends was recorded to the correct accounts as \$90.

Required: Complete the following chart for the errors noted.

<u>Error</u>	<u>Would the error cause the trial balance to be out of balance?</u>		<u>Amount of Imbalance</u>	<u>Debits or Credits higher?</u>	<u>Correcting journal entry required?</u>	
	<u>Yes</u>	<u>No</u>			<u>Yes</u>	<u>No</u>
1						
2						
3						
4						
5						
6						
7						
8						
9						
10						

True / False Questions

1. A list of a general ledger accounts and their account numbers is a chart of accounts.
True False
2. After recording each transaction, total assets must equal total liabilities plus stockholders' equity.
True False
3. A company's general ledger provides a chronological record of its business transactions.
True False
4. Paying cash to a supplier for services causes assets to increase and stockholders' equity to increase.
True False
5. Increases in expenses have the effect of decreasing retained earnings.
True False
6. A liability account normally has a debit balance.
True False
7. A credit to an account balance always results in the balance decreasing.
True False
8. For each transaction, there must be at least one debit amount and one credit amount.
True False
9. Any error in the accounting system will cause the trial balance to be out of balance.
True False
10. Double entry accounting requires that every entry must include at least one debit and at least one credit.
True False
11. The process of transferring the debit and credit information from the journal to individual accounts in the general ledger is called journalizing.

True False

12. A trial balance is a list of all accounts and their balances at a particular date, showing that assets equal liabilities.

True False

13. If total debits equal total credits in the trial balance, then all balances are correct.

True False

14. Financial statements are prepared from the general ledger.

True False

15. The left side of a T-account is the credit side.

True False

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 a liability account?
 - a) Dividends
 - b) Cash
 - c) Accounts Payable
 - d) Capital Stock

3. 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.

4. A debit may signify a(n):
 - a) Increase in asset accounts
 - b) Increase in liability accounts
 - c) Increase in the capital account
 - d) Decrease in expense accounts

5. A credit may signify a(n):
 - a) Increase in assets
 - b) Increase in liabilities
 - c) Decrease in capital
 - d) Decrease in revenue

6. 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.

7. 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

8. 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

9. 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

10. The process of initially recording a business transaction is called:
 - a) Sliding
 - b) Posting
 - c) Journalizing
 - d) Transposing

11. 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

12. 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
13. The verification that the sum of the debits and the sum of the credits in the ledger are equal is called:
- e) A journal
 - f) A ledger
 - g) Posting
 - h) A trial balance
14. 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.
15. Accounts with normal debit balances include:
- a) Assets and liabilities
 - b) Liabilities and expenses
 - c) Stockholder's equity and revenues
 - d) Expenses and assets

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)
<hr/>	
18,975	

A/R	
h) 1,800	900 i)
<hr/>	
900	

Supplies	
c) 2,225	
<hr/>	
2,225	

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

Capital Stock	
	27,500 a)
<hr/>	
	27,500

Dividends	
k) 2,800	
<hr/>	
2,800	

Fees Earned	
	3,800 f)
	1,800 h)
<hr/>	
	5,600

Utilities Expense	
g) 475	
<hr/>	
475	

Rent Expense	
b) 2,500	
<hr/>	
2,500	

Prepaid Insurance	
d) 1,500	
<hr/>	
1,500	

Equipment	
e) 10,000	
<hr/>	
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>

Practice Problem #3

May 1	Cash	20,000	
	Tugboat	90,000	
	Common Stock		110,000
2	Office Equipment	3,000	
	Cash		3,000
3	Boating Supplies	2,500	
	Accounts Payable		2,500
4	Rent expense	500	
	Cash		500
5	Prepaid Insurance	1,800	
	Cash		1,800
10	Cash	2,000	
	Tugboat Tour Revenue		2,000
12	Accounts Receivable	3,500	
	Tugboat Tour Revenue		3,500
19	Accounts Payable	2,500	
	Cash		2,500
22	Cash	3,500	
	Accounts Receivable		3,500
25	Cash	2,750	
	Tugboat Tour Revenue		2,750
31	Salary expense	1,000	
	Cash		1,000
31	Dividends	2,000	
	Cash		2,000

Practice Problem #4

Step (1)	Year 1 Owners' Equity	$100,000 + 30,000 = 130,000$
Step (2)	Year 1 Liabilities	$200,000 - 130,000 = 70,000$
Step (3)	Change in Year 2 Assets	$92,000 - 30,000 = 62,000$
Step (4)	Year 2 Liabilities	$70,000 + 92,000 = 162,000$
Step (5)	Year 2 Assets	$200,000 + 62,000 = 262,000$
Step (6)	Year 3 Assets	$262,000 - 40,000 = 222,000$
Step (7)	Change in Year 3 Owners' Equity	$130,000 - 100,000 = 30,000$
Step (8)	Year 3 Liabilities	$222,000 - 130,000 = 92,000$
Step (9)	Change in Year 3 Liabilities	$92,000 - 162,000 = -70,000$
Proof:	Change in Year 3 Liabilities	$-40,000 - 30,000 = -70,000$

Practice Problem #5

<u>Error</u>	<u>Would the error cause the trial balance to be out of balance?</u>		<u>Amount of Imbalance</u>	<u>Debits or Credits higher?</u>	<u>Correcting journal entry required?</u>	
	<u>Yes</u>	<u>No</u>			<u>Yes</u>	<u>No</u>
1		X			X	
2	X		\$2,000	Debits	(1)	
3	X		\$826	Credits		X
4		X			X	
5	X		\$1,800	Debits	(1)	
6		X			X	
7	X		\$630	Credits	(1)	
8		X			X	
9	X		\$18,000	Credits		X
10		X			X	

Solutions to True / False Problems

1. True
2. True
3. False - the general journal provides a chronological record of business transactions.
4. False – paying cash for services causes assets to decrease and stockholders' equity to decrease.
5. True
6. False – a liability account normally has a credit balance because increases to liabilities are recorded as credits.
7. False - a credit decreases assets, dividends, and expense, but increases liabilities, stockholders' equity, and revenues.
8. True
9. False - errors that involve posting an entry to the wrong account, posting an entry twice or failing to post an entry will not cause the trial balance to be out of balance.
10. True
11. False - the process is called posting.
12. False - the trial balance shows that total debits equal total credits.
13. False - a trial balance could contain offsetting errors where the balance of one account is overstated or understated but the balance of another account (with the same type of debit or credit balance) is understated or overstated by the same amount
14. False – financial statements are prepared from a trial balance.
15. False – the left side of a T-account is the debit side

Solutions to Multiple Choice Questions

- | | |
|-----|---|
| 1. | A |
| 2. | C |
| 3. | B |
| 4. | A |
| 5. | B |
| 6. | A |
| 7. | A |
| 8. | A |
| 9. | C |
| 10. | C |
| 11. | B |
| 12. | D |
| 13. | D |
| 14. | A |
| 15. | D |