cHAPTER 3  
the income statement

# Student Learning Objectives and Related Assignment Materials

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| **Student Learning Objectives** | **Mini-Exercises** | **Exercises** | **Coached Problems** | **Problems (Groups  A & B)** | **Compre-hensive Problem** | **Skills Develop-ment Cases** | **Continuing Case** |
| LO 3-1 Describe common operating transactions and select appropriate income statement account titles. | 8, 19, 20, 21 | 1, 2, 3, 4, 5, 6, 15 | 1, 3 | A1, A3, B1, B3 |  | 1, 2, 3, 4, 5, 6 |  |
| LO 3-2 Explain and apply the revenue and expense recognition principles. | 1, 2\*, 3\*, 6, 7, 9, 10, 17, 18 | 3, 4, 5, 6, 7, 8, 9, 10, 11, 12, 14^, 15, 16 | 1, 2, 3 | A1, A2, A3, B1, B2, B3 | 1 | 4, 5, 6, 7 | 1† |
| LO 3-3 Analyze, record, and summarize the effects of operating transactions, using the accounting equation, journal entries, and T-accounts. | 4\*, 5\*, 6, 7, 11, 12, 13\*, 14\*, 15, 16, 17, 18 | 7, 8, 9, 10, 11, 12, 14^, 15, 16, 17, 18, 20, 21 | 1, 2, 3, 4^ | A1, A2, A3, A4^, B1, B2, B3, B4^ | 1 | 4, 7 | 1† |
| LO 3-4 Prepare an unadjusted trial balance. | 20, 21 | 13, 19 | 3 | A3, B3 | 1 | 6, 7 |  |
| LO 3-5 Evaluate net profit margin, but beware of income statement limitations. | 8, 19, 21, 22, 23^ | 11, 20, 21 | 3, 4^ | A3,A4^, B3, B4^ | 1 | 3, 4, 5 | 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 3-1 builds on the story of Nicole’s Getaway Spa, introduced in earlier chapters. This case focuses on analyzing transactions and preparing journal entries, calculating the company’s preliminary net income and net profit margin for the month, and identifying the adjustment(s) that will have to be made before the income statement is finalized. This case will be extended in future chapters.

# Overview

The entrepreneur from Chapters 1 and 2 opens his doors to customers and completes daily operating transactions.

Students learn how to analyze and record operating transactions involving revenues and expenses and distinguish cash basis from accrual basis.

# Synopsis of Chapter Revisions

* New contemporary focus company: replaced pizza company with SonicGateway, thereby allowing revenue recognition to be illustrated when game app icon shows “installation completed”
* New illustrations to compare timing of revenue recognition and cash receipt (Exhibit 3.5)
* New Spotlight on Financial Reporting to illustrate revenue recognition policy of Take-Two Interactive (software maker of Grand Theft Auto)
* New illustrations to compare timing of expense recognition and cash payment (Exhibit 3.6)
* New transactions to illustrate contemporary technology, such as online Facebook advertising, automated monthly disbursements, and e-commerce sales with online receipts similar to PayPal
* New format for accounting equation effects to illustrate link between income statement and balance sheet
* New Spotlight on Financial Reporting to focus on technology companies, including Electronic Arts, Activision Blizzard, Facebook, and LinkedIn
* Updated demonstration case featuring Carnival Corporation
* Reviewed and updated all end-of-chapter material, including new problem formats that automatically post journal entries to T-accounts and prepare trial balances

# PowerPoint Slides

|  |  |
| --- | --- |
| **Student Learning Objective** | **PowerPoint® Slides** |
| LO 3-1 Describe common operating transactions and select appropriate income statement account titles. | 3-2 through 3-5 |
| LO 3-2 Explain and apply the revenue and expense recognition principles. | 3-6 through 3-9 |
| LO 3-3 Analyze, record, and summarize the effects of operating transactions, using the accounting equation, journal entries, and T-accounts. | 3-10 through 3-19 |
| LO 3-4 Prepare an unadjusted trial balance. | 3-20 through 3-23 |
| LO 3-5 Evaluate net profit margin, but beware of income statement limitations. | 3-24 through 3-26 |

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| **Animated Builds and Animated Solutions** | **PowerPoint® Slides** |
| Mini-Exercise 3-2 | 3-28 |
| Mini-Exercise 3-3 | 3-29 |
| Mini-Exercise 3-4 | 3-30 |
| Mini-Exercise 3-5 | 3-31 |
| Mini-Exercise 3-13 | 3-32 through 3-33 |
| Mini-Exercise 3-14 | 3-34 through 3-35 |

# Summary of Related Video Program

**Spotlight Video Series   
Chapter 3 – Time is Money (approximately 4:00)**

This video program covers time period assumption. In 2000 and 2001, Computer Associates violated the time period assumption to present a picture of smooth steady growth. This video illustrates the effect of shifting sales from one period to another and asks students to discuss its impact.

# Chapter Summary

**LO 3-1 Describe common operating transactions and select appropriate income statement account titles.**

* The income statement reports the effects of transactions that affect net income, which includes

Revenues—amounts charged to customers for sales of goods or services provided.

Expenses—costs of business activities undertaken to earn revenues.

* See Exhibit 3.2 for basic income statement format.

**LO 3-2 Explain and apply the revenue and expense recognition principles.**

* The two key concepts underlying accrual basis accounting and the income statement are

Revenue recognition principle—recognize revenues when they are earned, regardless of when cash is received.

Expense recognition (“matching”) principle—recognize expenses when they are incurred in generating revenue, regardless of when cash is paid.

**LO 3-3 Analyze, record, and summarize the effects of operating transactions, using the accounting equation, journal entries, and T-accounts.**

* The expanded transaction analysis model includes revenues and expenses as subcategories of Retained Earnings. Increases, decreases, and normal account balances (*dr* or *cr*) are shown below:

|  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **ASSETS** | | **=** | **LIABILITIES** | | **+** | | **STOCKHOLDERS’ EQUITY** | | | | | |
| + *dr* | – *cr* |  | – *dr* | + *cr* |
| **Common Stock** | | |  | **Retained Earnings** | |
| – *dr* | | + *cr* |  | *– dr* | +  *cr*  Net Income |
|  | |  |  |  |  |
|  | |  |  |  |  |
| **Revenues  (and Gains)** | | |  | **Expenses (and Losses)** | |
| – *dr* | | + *cr* |  | + *dr* | – *cr* |

# Chapter Summary, continued

**LO 3-4 Prepare an unadjusted trial balance.**

* The unadjusted trial balance is a list of all accounts and their unadjusted balances, and is used to check on the equality of recorded debits and credits.

**LO 3-5 Evaluate net profit margin, but beware of income statement limitations.**

* Net profit margin expresses net income as a percentage of total revenues.
* The income statement indicates whether the company is profitable, but this might not explain whether cash increased or decreased.
* Does not directly measure the change in value of a company during the period.
* Estimation plays a key role when measuring income.

***Accounting Decision Tools***

**Net Profit Margin = Net Income ÷ Total Revenues**

* It tells you how much profit is earned from each dollar of revenue.
* A higher ratio means better performance.

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| Chapter Outline | Teaching Notes |
| I. Understand the Business |  |
| ***LO 3-1 Describe common operating transactions and select appropriate income statement account titles.*** | |
| A. Operating Activities |  |
| 1. Operating activities—The day-to-day functions involved in running a business; include: | Illustrated in Exhibit 3.1 |
| a. Buying goods and services from suppliers and employees. |  |
| b. Selling goods and services to customers and collecting cash from them. |  |
| 2. Most businesses have the same steps in their operating cycles; however, the length of time for each step varies from company to company. |  |
| 3. Operating activities are the primary source of revenues and expenses and, thus, can determine whether a company earns a profit (or incurs a loss). |  |
| B. Income Statement Accounts | Examples provided in |
| 1. **Revenues**––amounts earned by selling goods or services to customers; reported first in the income statement. | Exhibit 3.2 |
| 2. **Expenses**––Costs of operating the business that are incurred to earn revenues; reported after revenues in the income statement. |  |
| 3. **Net income**––The excess of revenues over expenses; amount by which stockholders’ equity increases as a result of profitable operations. | *Stress that net income is a total and not an account* |
| C. The time period assumption assumes that the long life of a company can be divided into shorter time periods, such as months, quarters, and years. | The “Stoplight on Ethics” feature notes that some managers haven’t learned the |
| 1. Key distinction between the income statement and the balance sheet: | time period assumption |
| a. The revenues and expenses on an income statement report the financial impact of activities in just the current period. |  |
| b. Items on a balance sheet will continue to have a financial impact beyond the end of the current period. |  |
| 2. Balance sheet accounts are considered permanent whereas income statement accounts are considered temporary. |  |
| II. Study the Accounting Methods |  |
| A. Cash Basis Accounting |  |
| 1. **Cash basis accounting**––Reports revenues when cash is received and expenses when cash is paid. |  |
| 2. Doesn’t measure financial performance very well when transactions are conducted using credit rather than cash. |  |
| 3. Not likely to correspond to the business activities that actually occur during a given period; leads to a rather distorted view of the company’s financial performance. |  |
| Chapter Outline | Teaching Notes |
| B. Accrual Basis Accounting |  |
| 1. **Accrual basis accounting**––Reports revenues when they are earned and expenses when they are incurred, regardless of the timing of cash receipts or payments. |  |
| a. Produces a better measure of the profits arising from the company’s activities. |  |
| b. Only acceptable method for external reporting of income according to GAAP and IFRS. |  |
| c. The cash basis is sometimes used by some small companies. |  |
| ***LO 3-2 Explain and apply the revenue and expense recognition*** ***principles.*** | |
| 2. Revenue Recognition Principle |  |
| a. **Revenue principle—**The requirement under accrual basis accounting to record revenues when they are earned, not necessarily when cash is received for them. | * Spotlight Video Series - Chapter 3 |
| i. Recognized means revenues are measured and recorded in the accounting system. |  |
| ii. Earned means the company has fulfilled its performance obligation to the customer by doing what it promised to do. |  |
| b. All companies expect to receive cash in exchange for providing goods and services; timing of cash receipts does not dictate when revenues are recognized. | Timing of reporting revenue versus cash receipts illustrated in Exhibit 3.5 |
| c. Timing of related transactions: |  |
| i. Cash before sale/service—Cash received is reported but company hasn’t provided the promised goods or services, so no revenue is recorded yet. |  |
| * The obligation to provide the promised goods or service is a liability called Unearned Revenue. |  |
| * **Unearned Revenue**––A liability representing a company’s obligation to provide goods or services to customers in the future. |  |
| * Revenue will be reported later, when the goods or services are provided. |  |
| ii. Cash with sale/service—Cash and revenue are reported at the same time. | The “Spotlight on Financial Reporting” feature sets forth |
| iii. Sale/service before, and cash after—Revenue is reported since the company has provided the promised goods or services, but cash hasn’t been received. | The revenue recognition policy of Take-Two Interactive Software, Inc. |
| * Occurs when a company sells on account. |  |
| * The company provides goods or services to a customer for the right to collect cash in the future; right is the asset Accounts Receivable. |  |

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| Chapter Outline | Teaching Notes |
| 3. Expense Recognition Principle |  |
| a. **Expense recognition principle (“matching”)**—The practice under accrual basis accounting to record expenses in the same period as the revenues they generate, not necessarily the period in which cash is paid for them. | Timing of reporting expenses versus cash payments illustrated in Exhibit 3.6 |
| b. If an expense cannot be directly associated with revenues, it is recorded in the period that the underlying business activity occurs. |  |
| c. Timing of related transactions: |  |
| i. Cash before expense—It is common for businesses to pay for something that provides benefits only in future periods. |  |
| * The company might buy office supplies now but not use them until next month. |  |
| * The expense from using these supplies is reported next month, when the supplies are used; this month, the supplies represent an asset (Supplies). |  |
| * Similar situations arise when a company prepays rent or insurance this month and uses up these assets in a later month. |  |
| ii. Cash with expense—Expenses are sometimes paid for in the period that they arise. |  |
| * The company may arrange to make automatic payments to a utility company at the end of each month. |  |
| * Because the electricity is used up in the current month, it is an expense of the current month. |  |
| iii. Expense before, and cash after—Many costs are paid after receiving and using goods or services. |  |
| * Because the cost of the goods or services obtained relates to revenues earned this month, it represents an expense that will be reported on this month’s income statement. |  |
| * Because the cost has not yet been paid at the end of the month, the balance sheet reports a corresponding liability called Accounts Payable. |  |
| * Similar situations arise when employees work in the current period but are not paid until the following period; this period’s wages are reported as Wages Expense on the income statement and any unpaid wages are reported as Wages Payable on the balance sheet. |  |

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| Chapter Outline | Teaching Notes |
| ***LO 3-3 Analyze, record, and summarize the effects of operating transactions, using the accounting equation, journal entries, and T-accounts.*** | |
| C. The Expanded Accounting Equation |  |
| 1. Stockholders’ equity includes: |  |
| 1. Common Stock, given to stockholders when they contribute capital to the company. 2. Retained earnings, generated by the company itself through profitable operations. |  |
| 2. Because revenues and expenses as subcategories within retained earnings, they are affected by debits and credits in the same way as all stockholders’ equity accounts: |  |
| 1. Increases in stockholders’ equity are on the right. Revenues increase stockholders’ equity, so revenues are recorded on the right (credit). | Illustrated in Exhibit 3.7 |
| 1. Decreases in stockholders’ equity are recorded on the left. Expenses decrease net income and retained earnings, so expenses are recorded on the left (debit). |  |
| D. Transactions Analysis, Recording, and Summarizing |  |
| (a) Provide services for cash—In September, SonicGateway sold $3,000 of games at its online store; customers paid when the games were downloaded. | * Supplemental Enrichment Activity (Activity) #1 |
| 1. Analyze: Assets = Liabilities + Stockholders’ Equity Cash (A) +3,000 = Sales Revenue (R, SE) +3,000 |  |
| 2. Record: | *Refer to illustrations of* |
| |  |  |  | | --- | --- | --- | | Cash (+A) | 3,000 |  | | Sales Revenue (+R, +SE) |  | 3,000 | | *transactions in textbook for Step 3 – Summarize (which* |
| (b) Receive cash for future services – SonicGateway sold three $100 gift cards at the beginning of September. | *includes posting to T-accounts).* |
| 1. Analyze: Assets = Liabilities + Stockholders’ Equity Cash (A) + 300 = Unearned Revenue (L) + 300 |  |
| 2. Record: |  |
| |  |  |  | | --- | --- | --- | | Cash (+A) | 300 |  | | Unearned Revenue (+L) |  | 300 | |  |
| (c) Sells apps on credit—SonicGateway sold $9,000 of apps on the App Store and on Google Play; Apple and Google will release customer payments to SonicGateway later in the month. |  |
| 1. Analyze: Assets = Liabilities + Stockholders’ Equity Accounts Receivable (A) +9,000 = Sales Revenue (R, SE) +9,000 |  |
| 2. Record: |  |
| |  |  |  | | --- | --- | --- | | Accounts Receivable (+A) | 9,000 |  | | Sales Revenue (+R, +SE) |  | 9,000 | |  |

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| Chapter Outline | Teaching Notes |
| (d) Receive payment on account—SonicGateway received checks totaling $8,500 from Apple and Google, on account. |  |
| 1. Analyze: Assets = Liabilities + Stockholders’ Equity Cash (A) +8,500 + Accounts Receivable (A) –8,500  = 0 |  |
| 2. Record: |  |
| |  |  |  | | --- | --- | --- | | Cash (+A) | 8,500 |  | | Accounts Receivable (–A) |  | 8,500 | |  |
| (e) Pay cash to employees—SonicGateway wrote checks to employees, totaling $7,800 for wages related to hours worked in September. |  |
| 1. Analyze: Assets = Liabilities + Stockholders’ Equity Cash (A) –7,800 = Salaries and Wages Expense (E, SE) –7,800 |  |
| 2. Record: |  |
| |  |  |  | | --- | --- | --- | | Salaries and Wages Expense (+E, –SE) | 7,800 |  | | Cash (–A) |  | 7,800 | |  |
| (f) Pay cash in advance—On September 1, SonicGateway paid $7,200 in advance for September, October, and November rent. |  |
| 1. Analyze: Assets = Liabilities + Stockholders’ Equity Cash (A) –7,200 + Prepaid Rent (A) +7,200 = 0 |  |
| 2. Record: |  |
| |  |  |  | | --- | --- | --- | | Prepaid Rent (+A) | 7,200 |  | | Cash (–A) |  | 7,200 | |  |
| (g) Incur cost to be paid later—SonicGateway displayed Facebook sidebar ads in September, and received a bill for $500 to be paid in October. |  |
| 1. Analyze: Assets = Liabilities + Stockholders’ Equity 0 = Accounts Payable (L) +500 + Advertising Expense (E, SE) –500 |  |
| 2. Record: |  |
| |  |  |  | | --- | --- | --- | | dr Advertising Expense (+E, –SE) | 500 |  | | cr Accounts Payable (+L) |  | 500 | |  |
| (h) Pay cash for expenses—SonicGateway was notified by its bank that an automatic payment of $600 was transmitted to its utility company for electricity use in September. |  |
| 1. Analyze: Assets = Liabilities + Stockholders’ Equity Cash (A) –600 = Utility Expense (E, SE) –600 |  |
| 2. Record: |  |
| |  |  |  | | --- | --- | --- | | Utilities Expense. (+E, –SE) | 600 |  | | Accounts Payable (+L) |  | 600 | |  |

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| Chapter Outline | Teaching Notes |
| E. Calculating Account Balances |  |
| 1. After entering (“posting”) the effects of each journal entry into the T-accounts, the ending balances are calculated. |  |
| 2. Ending balance in each account is amount by which the total of the increase (+) side exceeds the total of the decrease (–) side. |  |
| ***LO 3-4 Prepare an unadjusted trial balance.*** | |
| F. Unadjusted Trial Balance | * Activity #2 |
| 1. After summarizing journal entries in the various accounts and then calculating ending balances for each account, an unadjusted trial balance is prepared. |  |
| 2. T**rial balance**––An internal report that lists all accounts and their balances to check on the equality of the total recorded debits and total recorded credits. | Illustrated in Exhibit 3.9 |
| 3. Income statement accounts follow balance sheet accounts. |  |
| 4. Ending balances obtained from ledger (T-accounts) are listed in the appropriate debit or credit column and columns are totaled. |  |
| a. If the trial balance does not balance, look at the difference between total debits and credits. |  |
| b. If the trial balance does balance, it’s still possible that you’ve made an error. An entry might include the wrong account or have been posted to the wrong account in the general ledger. |  |
| 5. If title says “unadjusted trial balance” then several adjustments will have to be made at the end of the accounting period to update the accounts. | The adjustments will be covered in chapter 4. |
| G. Review of Revenues and Expenses |  |
| 1. Remember that revenues are recorded when the business fulfills its promise to provide goods or services to customers, which is not necessarily the same time that cash is received. |  |
| 2. Under accrual accounting, expenses are recorded when incurred (by using up the economic benefits of acquired items). Expenses are not necessarily incurred at the same time that cash is paid. |  |

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| Chapter Outline | Teaching Notes |
| III. Evaluate the Results |  |
| ***LO 3-5 Evaluate net profit margin, but beware of income statement limitations.*** | |
| A. Net Profit Margin | The “Spotlight on Financial |
| 1. Net Profit Margin = Net Income ÷ Total Revenues | Reporting” feature addresses |
| 2. Indicates how much profit is earned from each dollar of revenue. | The net profit margin for video game and social media |
| B. Income Statement Limitations | companies |
| 1. The income statement indicates whether the company is profitable, but this might not explain whether cash increased or decreased. |  |
| 2. The income statement does not directly measure the change in value of a company during the period. |  |
| 3. Estimation plays a key role when measuring income. |  |

# Supplemental Enrichment Activities

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

1. Handout 3**–**1

Use this handout for an in-class activity designed to review transaction analysis (preparation of journal entries and impact on the accounting equation) and the posting to T-accounts. The solution follows the handout master.

1. Handout 3**–**1

If you used Handout 3**–**1, then use Handout 3**–**2 for an in-class activity designed to review the preparation of an unadjusted trial balance. The solution follows the handout master.

# HANDOUT 3–1

# TRANSACTION ANALYSIS AND POSTING TO T-ACCOUNTS

## The following activities occurred during January 2016. Prepare a journal entry for ensure that the basic accounting equation balances for each transaction. Then, summarize the effects of each transaction in the appropriate T-account. (*See the last page for T-accounts.)*

(a) Provide website design services for $40,000.

|  |
| --- |
| Debit and credit the accounts affected |
| |  |  |  |  | | --- | --- | --- | --- | |  |  |  |  | |  |  |  |  | |
| Ensure the equation still balances and debits = credits |
| |  |  |  |  |  |  |  |  | | --- | --- | --- | --- | --- | --- | --- | --- | | **Assets** | | **=** | **Liabilities** | | **+** | **Stockholders’ Equity** | | |  |  |  |  |  |  |  |  | |

(b) Provide website design services to Acme Company, for $20,000 on account.

|  |
| --- |
| Debit and credit the accounts affected |
| |  |  |  |  | | --- | --- | --- | --- | |  |  |  |  | |  |  |  |  | |
| Ensure the equation still balances and debits = credits |
| |  |  |  |  |  |  |  |  | | --- | --- | --- | --- | --- | --- | --- | --- | | **Assets** | | **=** | **Liabilities** | | **+** | **Stockholders’ Equity** | | |  |  |  |  |  |  |  |  | |

(c) Collect $18,000 from Acme Company on account.

|  |
| --- |
| Debit and credit the accounts affected |
| |  |  |  |  | | --- | --- | --- | --- | |  |  |  |  | |  |  |  |  | |
| Ensure the equation still balances and debits = credits |
| |  |  |  |  |  |  |  |  | | --- | --- | --- | --- | --- | --- | --- | --- | | **Assets** | | **=** | **Liabilities** | | **+** | **Stockholders’ Equity** | | |  |  |  |  |  |  |  |  | |

# HANDOUT 3–1, continued

(d) Sell a $1,000 gift certificate.

|  |
| --- |
| Debit and credit the accounts affected |
| |  |  |  |  | | --- | --- | --- | --- | |  |  |  |  | |  |  |  |  | |
| Ensure the equation still balances and debits = credits |
| |  |  |  |  |  |  |  |  | | --- | --- | --- | --- | --- | --- | --- | --- | | **Assets** | | **=** | **Liabilities** | | **+** | **Stockholders’ Equity** | | |  |  |  |  |  |  |  |  | |

(e) Customer redeems $1,000 gift certificate for website design services.

|  |
| --- |
| Debit and credit the accounts affected |
| |  |  |  |  | | --- | --- | --- | --- | |  |  |  |  | |  |  |  |  | |
| Ensure the equation still balances and debits = credits |
| |  |  |  |  |  |  |  |  | | --- | --- | --- | --- | --- | --- | --- | --- | | **Assets** | | **=** | **Liabilities** | | **+** | **Stockholders’ Equity** | | |  |  |  |  |  |  |  |  | |

(f) Paid employees $16,000 earned.

|  |
| --- |
| Debit and credit the accounts affected |
| |  |  |  |  | | --- | --- | --- | --- | |  |  |  |  | |  |  |  |  | |
| Ensure the equation still balances and debits = credits |
| |  |  |  |  |  |  |  |  | | --- | --- | --- | --- | --- | --- | --- | --- | | **Assets** | | **=** | **Liabilities** | | **+** | **Stockholders’ Equity** | | |  |  |  |  |  |  |  |  | |

# HANDOUT 3–1, continued

(g) Paid $3,000 insurance for next year in advance.

|  |
| --- |
| Debit and credit the accounts affected |
| |  |  |  |  | | --- | --- | --- | --- | |  |  |  |  | |  |  |  |  | |
| Ensure the equation still balances and debits = credits |
| |  |  |  |  |  |  |  |  | | --- | --- | --- | --- | --- | --- | --- | --- | | **Assets** | | **=** | **Liabilities** | | **+** | **Stockholders’ Equity** | | |  |  |  |  |  |  |  |  | |

(h) Paid $9,000 rent for next six months in advance.

|  |
| --- |
| Debit and credit the accounts affected |
| |  |  |  |  | | --- | --- | --- | --- | |  |  |  |  | |  |  |  |  | |
| Ensure the equation still balances and debits = credits |
| |  |  |  |  |  |  |  |  | | --- | --- | --- | --- | --- | --- | --- | --- | | **Assets** | | **=** | **Liabilities** | | **+** | **Stockholders’ Equity** | | |  |  |  |  |  |  |  |  | |

(i) Received $250 telephone bill for previous month, to be paid next month.

|  |
| --- |
| Debit and credit the accounts affected |
| |  |  |  |  | | --- | --- | --- | --- | |  |  |  |  | |  |  |  |  | |
| Ensure the equation still balances and debits = credits |
| |  |  |  |  |  |  |  |  | | --- | --- | --- | --- | --- | --- | --- | --- | | **Assets** | | **=** | **Liabilities** | | **+** | **Stockholders’ Equity** | | |  |  |  |  |  |  |  |  | |

# HANDOUT 3–1, continued

(j) Received $500 utility bill for this month, to be paid immediately.

|  |
| --- |
| Debit and credit the accounts affected |
| |  |  |  |  | | --- | --- | --- | --- | |  |  |  |  | |  |  |  |  | |
| Ensure the equation still balances and debits = credits |
| |  |  |  |  |  |  |  |  | | --- | --- | --- | --- | --- | --- | --- | --- | | **Assets** | | **=** | **Liabilities** | | **+** | **Stockholders’ Equity** | | |  |  |  |  |  |  |  |  | |

# HANDOUT 3–1, continued

|  |  |  |
| --- | --- | --- |
| **Assets** | **Liabilities** | **Stockholders’ Equity** |
| + Cash –   |  |  |  |  | | --- | --- | --- | --- | | BegBal | 3,100 |  |  | |  |  |  |  | |  |  |  |  | |  |  |  |  | |  |  |  |  | |  |  |  |  |   + Supplies –   |  |  |  |  | | --- | --- | --- | --- | | BegBal | 900 |  |  | |  |  |  |  | |  |  |  |  | |  |  |  |  |   + Accounts Receivable –   |  |  |  |  | | --- | --- | --- | --- | | BegBal | 0 |  |  | |  |  |  |  | |  |  |  |  | |  |  |  |  |   + Prepaid Rent –   |  |  |  |  | | --- | --- | --- | --- | | BegBal | 0 |  |  | |  |  |  |  | |  |  |  |  | |  |  |  |  |   + Prepaid Insurance –   |  |  |  |  | | --- | --- | --- | --- | | BegBal | 0 |  |  | |  |  |  |  | |  |  |  |  | |  |  |  |  |   + Property, Plant & Equipment –   |  |  |  |  | | --- | --- | --- | --- | | BegBal | 21,000 |  |  | |  |  |  |  | |  |  |  |  | | − Accounts Payable +   |  |  |  |  | | --- | --- | --- | --- | |  |  | 0 | BegBal | |  |  |  |  | |  |  |  |  |   − Notes Payable +   |  |  |  |  | | --- | --- | --- | --- | |  |  | 15,000 | BegBal | |  |  |  |  |   + Unearned Revenue –   |  |  |  |  | | --- | --- | --- | --- | |  |  | 0 | BegBal | |  |  |  |  | |  |  |  |  | |  |  |  |  | | + Common Stock –   |  |  |  |  | | --- | --- | --- | --- | |  |  | 10,000 | BegBal | |  |  |  |  | |  |  |  |  |   − Retained Earnings +   |  |  |  |  | | --- | --- | --- | --- | |  |  | 0 | BegBal | |  |  |  |  | |  |  |  |  |   − Revenue +   |  |  |  |  | | --- | --- | --- | --- | |  |  | 0 | BegBal | |  |  |  |  | |  |  |  |  | |  |  |  |  | |  |  |  |  |   + Wage Expense –   |  |  |  |  | | --- | --- | --- | --- | | BegBal | 0 |  |  | |  |  |  |  | |  |  |  |  | |  |  |  |  |   + Utilities Expense –   |  |  |  |  | | --- | --- | --- | --- | | BegBal | 0 |  |  | |  |  |  |  | |  |  |  |  | |  |  |  |  |   + Telephone Expense –   |  |  |  |  | | --- | --- | --- | --- | | BegBal | 0 |  |  | |  |  |  |  | |  |  |  |  | |  |  |  |  | |

# HANDOUT 3–1 SOLUTION

# TRANSACTION ANALYSIS AND POSTING TO T-ACCOUNTS

## The following activities occurred during January 2016. Prepare a journal entry for ensure that the basic accounting equation balances for each transaction. Then, summarize the effects of each transaction in the appropriate T-account. (*See the last page for T-accounts.)*

(a) Provide website design services for $40,000.

|  |
| --- |
| Debit and credit the accounts affected |
| |  |  |  |  | | --- | --- | --- | --- | |  | Cash (+A) | 40,000 |  | |  | Revenue (+R, +SE) |  | 40,000 | |
| Ensure the equation still balances and debits = credits |
| |  |  |  |  |  |  |  |  | | --- | --- | --- | --- | --- | --- | --- | --- | | **Assets** | | **=** | **Liabilities** | | **+** | **Stockholders’ Equity** | | | Cash | +40,000 |  |  |  |  | Revenue | +40,000 | |

(b) Provide website design services to Acme Company, for $20,000 on account.

|  |
| --- |
| Debit and credit the accounts affected |
| |  |  |  |  | | --- | --- | --- | --- | |  | Accounts Receivable (+A) | 20,000 |  | |  | Revenue (+R, +SE) |  | 20,000 | |
| Ensure the equation still balances and debits = credits |
| |  |  |  |  |  |  |  |  | | --- | --- | --- | --- | --- | --- | --- | --- | | **Assets** | | **=** | **Liabilities** | | **+** | **Stockholders’ Equity** | | | Accounts Receivable | +20,000 |  |  |  |  | Revenue | +20,000 | |

(c) Collect $18,000 from Acme Company on account.

|  |
| --- |
| Debit and credit the accounts affected |
| |  |  |  |  | | --- | --- | --- | --- | |  | Cash (+A) | 18,000 |  | |  | Accounts Receivable (–A) |  | 18,000 | |
| Ensure the equation still balances and debits = credits |
| |  |  |  |  |  |  |  |  | | --- | --- | --- | --- | --- | --- | --- | --- | | **Assets** | | **=** | **Liabilities** | | **+** | **Stockholders’ Equity** | | | Cash | +18,000 |  |  |  |  |  |  | | Accounts Receivable | –18,000 |  |  |  |  |  |  | |

# HANDOUT 3–1 SOLUTION, continued

(d) Sell a $1,000 gift certificate.

|  |
| --- |
| Debit and credit the accounts affected |
| |  |  |  |  | | --- | --- | --- | --- | |  | Cash (+A) | 1,000 |  | |  | Unearned Revenue (+L) |  | 1,000 | |
| Ensure the equation still balances and debits = credits |
| |  |  |  |  |  |  |  |  | | --- | --- | --- | --- | --- | --- | --- | --- | | **Assets** | | **=** | **Liabilities** | | **+** | **Stockholders’ Equity** | | | Cash | +1,000 |  | Unearned  Revenue. | +1,000 |  |  |  | |

(e) Customer redeems $1,000 gift certificate for website design services.

|  |
| --- |
| Debit and credit the accounts affected |
| |  |  |  |  | | --- | --- | --- | --- | |  | Unearned Revenue (−L) | 1,000 |  | |  | Revenue (+R, +SE) |  | 1,000 | |
| Ensure the equation still balances and debits = credits |
| |  |  |  |  |  |  |  |  | | --- | --- | --- | --- | --- | --- | --- | --- | | **Assets** | | **=** | **Liabilities** | | **+** | **Stockholders’ Equity** | | |  |  |  | Unearned Revenue | -1,000 |  | Revenue | +1,000 | |

(f) Paid employees $16,000 earned.

|  |
| --- |
| Debit and credit the accounts affected |
| |  |  |  |  | | --- | --- | --- | --- | |  | Wage expense (+E, –SE) | 16,000 |  | |  | Cash (–A) |  | 16,000 | |
| Ensure the equation still balances and debits = credits |
| |  |  |  |  |  |  |  | | --- | --- | --- | --- | --- | --- | --- | | **Assets** | | **=** | **Liabilities** | **+** | **Stockholders’ Equity** | | | Cash | –16,000 |  |  |  | Wage Exp. | –16,000 | |

# HANDOUT 3–1 SOLUTION, continued

(g) Paid $3,000 insurance for next year in advance.

|  |
| --- |
| Debit and credit the accounts affected |
| |  |  |  |  | | --- | --- | --- | --- | |  | Prepaid insurance (+A) | 3,000 |  | |  | Cash (–A) |  | 3,000 | |
| Ensure the equation still balances and debits = credits |
| |  |  |  |  |  |  |  | | --- | --- | --- | --- | --- | --- | --- | | **Assets** | | **=** | **Liabilities** | **+** | **Stockholders’ Equity** | | | Prepaid Insurance | +3,000 |  |  |  |  |  | | Cash | –3,000 |  |  |  |  |  | |

(h) Paid $9,000 rent for next six months in advance.

|  |
| --- |
| Debit and credit the accounts affected |
| |  |  |  |  | | --- | --- | --- | --- | |  | Prepaid rent(+A) | 9,000 |  | |  | Cash (–A) |  | 9,000 | |
| Ensure the equation still balances and debits = credits |
| |  |  |  |  |  |  |  | | --- | --- | --- | --- | --- | --- | --- | | **Assets** | | **=** | **Liabilities** | **+** | **Stockholders’ Equity** | | | Prepaid. Rent | +9,000 |  |  |  |  |  | | Cash | –9,000 |  |  |  |  |  | |

(i) Received $250 telephone bill for previous month, to be paid next month.

|  |
| --- |
| Debit and credit the accounts affected |
| |  |  |  |  | | --- | --- | --- | --- | |  | Telephone expense (+E, –SE) | 250 |  | |  | Accounts payable (+L) |  | 250 | |
| Ensure the equation still balances and debits = credits |
| |  |  |  |  |  |  |  |  | | --- | --- | --- | --- | --- | --- | --- | --- | | **Assets** | | **=** | **Liabilities** | | **+** | **Stockholders’ Equity** | | |  |  |  | Accts. Pay. | +250 |  | Tel. Exp. | –250 | |

(j) Received $500 utility bill for this month, to be paid immediately.

|  |
| --- |
| Debit and credit the accounts affected |
| |  |  |  |  | | --- | --- | --- | --- | |  | Utilities expense (+E, –SE) | 500 |  | |  | Cash (–A) |  | 500 | |
| Ensure the equation still balances and debits = credits |
| |  |  |  |  |  |  |  | | --- | --- | --- | --- | --- | --- | --- | | **Assets** | | **=** | **Liabilities** | **+** | **Stockholders’ Equity** | | | Cash | –500 |  |  |  | Utilities Expense | –500 | |

# HANDOUT 3–1 SOLUTION, continued

|  |  |  |
| --- | --- | --- |
| **Assets** | **Liabilities** | **Stockholders’ Equity** |
| + Cash –   |  |  |  |  | | --- | --- | --- | --- | | BegBal | 3,100 |  |  | | (a) | 40,000 | 16,000 | (f) | | (c) | 18,000 | 3,000 | (g) | | (d) | 1,000 | 9,000 | (h) | |  |  | 500 | (j) | | EndBal | 33,600 |  |  |   + Supplies –   |  |  |  |  | | --- | --- | --- | --- | | BegBal | 900 |  |  | |  |  |  |  | |  |  |  |  | | EndBal | 900 |  |  |   + Accounts Receivable –   |  |  |  |  | | --- | --- | --- | --- | | BegBal | 0 |  |  | | (b) | 20,000 | 18,000 | (c) | |  |  |  |  | | EndBal | 2,000 |  |  |   + Prepaid Rent –   |  |  |  |  | | --- | --- | --- | --- | | BegBal | 0 |  |  | | (h) | 9,000 |  |  | |  |  |  |  | | EndBal | 9,000 |  |  |   + Prepaid Insurance –   |  |  |  |  | | --- | --- | --- | --- | | BegBal | 0 |  |  | | (g) | 3,000 |  |  | |  |  |  |  | | EndBal | 3,000 |  |  |   + Property, Plant & Equipment –   |  |  |  |  | | --- | --- | --- | --- | | BegBal | 21,000 |  |  | |  |  |  |  | | EndBal | 21,000 |  |  | | – Accounts Payable +   |  |  |  |  | | --- | --- | --- | --- | |  |  | 0 | BegBal | |  |  | 250 | (i) | |  |  | 250 | EndBal |   – Notes Payable +   |  |  |  |  | | --- | --- | --- | --- | |  |  | 15,000 | BegBal | |  |  | 15,000 | EndBal |   – Unearned Revenue +   |  |  |  |  | | --- | --- | --- | --- | |  |  | 0 | BegBal | | (e) | 1,000 | 1,000 | (d) | |  |  |  |  | |  |  | 0 | EndBal | | – Common Stock +   |  |  |  |  | | --- | --- | --- | --- | |  |  | 10,000 | BegBal | |  |  |  |  | |  |  | 10,000 | EndBal |   – Retained Earnings +   |  |  |  |  | | --- | --- | --- | --- | |  |  | 0 | BegBal | |  |  |  |  | |  |  | 0 | EndBal |   – Revenue +   |  |  |  |  | | --- | --- | --- | --- | |  |  | 0 | BegBal | |  |  | 40,000 | (a) | |  |  | 20,000 | (b) | |  |  | 1,000 | (e) | |  |  | 61,000 | EndBal |   + Wage Expense –   |  |  |  |  | | --- | --- | --- | --- | | BegBal | 0 |  |  | | (f) | 16,000 |  |  | |  |  |  |  | | EndBal | 16,000 |  |  |   + Utilities Expense –   |  |  |  |  | | --- | --- | --- | --- | | BegBal | 0 |  |  | | (j) | 500 |  |  | |  |  |  |  | | EndBal | 500 |  |  |   + Telephone Expense –   |  |  |  |  | | --- | --- | --- | --- | | BegBal | 0 |  |  | | (i) | 250 |  |  | |  |  |  |  | | EndBal | 250 |  |  | |

# HANDOUT 3–2

# PREPARATION OF UNADJUSTED TRIAL BALANCE

Use the balances in the T-accounts in Handout 3**–**1 to prepare an unadjusted trial balance.

World Wide Webster

Unadjusted Trial Balance

January 31, 2016

|  |  |  |
| --- | --- | --- |
| Account | Debit | Credit |
| Cash |  |  |
| Supplies |  |  |
| Accounts Receivable |  |  |
| Prepaid Rent |  |  |
| Prepaid Insurance |  |  |
| Property, Plant & Equipment |  |  |
| Accounts Payable |  |  |
| Notes Payable |  |  |
| Unearned Revenue |  |  |
| Common Stock |  |  |
| Retained Earnings |  |  |
| Revenue |  |  |
| Wage Expense |  |  |
| Utilities Expense |  |  |
| Telephone Expense |  |  |
| Totals |  |  |

# HANDOUT 3–2 SOLUTION

# PREPARATION OF UNADJUSTED TRIAL BALANCE

Use the balances in the T-accounts in Handout 3**–**1 to prepare an unadjusted trial balance.

World Wide Webster

Unadjusted Trial Balance

January 31, 2016

|  |  |  |
| --- | --- | --- |
| Account | Debit | Credit |
| Cash | $33,600 |  |
| Supplies | 900 |  |
| Accounts Receivable | 2,000 |  |
| Prepaid Rent | 9,000 |  |
| Prepaid Insurance | 3,000 |  |
| Property, Plant & Equipment | 21,000 |  |
| Accounts Payable |  | $ 250 |
| Notes Payable |  | 15,000 |
| Unearned Revenue |  | 0 |
| Common Stock |  | 10,000 |
| Retained Earnings |  | 0 |
| Revenue |  | 61,000 |
| Wage Expense | 16,000 |  |
| Utilities Expense | 500 |  |
| Telephone Expense | 250 |  |
| Totals | $86,250 | $86,250 |