cHAPTER 2

the balance sheet

# Student Learning Objectives and Related Assignment Materials

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| **Student Learning Objectives** | **Mini-Exercises** | **Exercises** | **Coached Problems** | **Problems (Groups  A & B)** | **Skills Development Cases** | **Continuing Case** |
| LO 2-1 Identify financial effects of common business activities that affect the balance sheet. | 4, 5, 6 | 1, 2, 3, 4\*, 6, 9, 11, 13, 14 |  |  | 1, 2, 3, 4, 5, 6 | 1† |
| LO 2-2 Apply transaction analysis to accounting transactions. | 3, 7, 8, 9 | 1, 2, 4\*, 6, 8, 9, 10, 11, 12, 13, 15^ | 1, 2, 3 | A1, A2, A3, B1, B2, B3 | 7 | 1† |
| LO 2-3 Use journal entries and T-accounts to show how transactions affect the balance sheet. | 1, 2, 3, 5, 6, 10, 11, 14, 15\*, 16, 17\*, 18, 19\*^, 20 | 1, 3, 5\*, 7, 8, 10, 12, 13, 15^ | 2, 3 | A2, A3, B2, B3 |  | 1† |
| LO 2-4 Prepare a trial balance and a classified balance sheet. | 4, 5, 6, 12, 13\*, 21, 22 | 3, 9, 10, 12, 15^ | 2, 3 | A2, A3, B2, B3 | 1, 2, 3, 4, 6 | 1† |
| LO 2-5 Interpret the balance sheet using the current ratio and an understanding of related concepts. | 3, 22, 23, 24^, 25^ | 1, 2, 6, 7, 8, 11, 14, 15^ | 1, 2, 3 | A1, A2, A3, B1, B2, B3 | 1, 2, 3, 4, 5, 6 | 1† |
| LO 2-S1 Describe examples of common career paths in accounting. |  |  |  |  |  |  |

\* 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 2-1 builds on the story of Nicole’s Getaway Spa, introduced in Chapter 1. This case focuses on analyzing transactions, preparing and recording journal entries, posting to T-accounts, preparing a classified balance sheet, and interpreting the current ratio. This case will be extended in future chapters.

# Overview

The entrepreneur from Chapter 1 organizes his business as a corporation and completes business transactions to establish the business.

Students learn how to analyze and record business transactions that affect the balance sheet and then prepare and interpret a classified balance sheet.

# Synopsis of Chapter Revisions

Focus Company: **Noodlecake Studios**

* New contemporary focus company: continuation of business case from Chapter 1
* New Spotlight on Business Decisions to highlight the value of accounting automation
* Updated analysis of current ratios in [Exhibit 2.14](file:///C:\Users\Jeannie's%20Laptop\Desktop\2017%20Phillips%206e\Instructor's%20Resource%20Manual\03812f9bc9fd47549ebb9e4b1e4995a7) and Spotlight on Financial Reporting to focus on technology companies, including Apple, Expedia, Electronic Arts, Facebook, and TripAdvisor
* Reviewed and updated all end-of-chapter material, including financial data for Columbia Sportswear, Ethan Allen Interiors, Starbucks, and others

# PowerPoint Slides

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| **Student Learning Objective** | **PowerPoint® Slides** |
| LO 2-1 Identify financial effects of common business activities that affect the balance sheet. | 2-2 through 2-6 |
| LO 2-2 Apply transaction analysis to accounting transactions. | 2-7 through 2-19 |
| LO 2-3 Use journal entries and T-accounts to show how transactions affect the balance sheet. | 2-20 through 2-34 |
| LO 2-4 Prepare a trial balance and a classified balance sheet. | 2-35 through 2-37 |
| LO 2-5 Interpret the balance sheet using the current ratio and an understanding of related concepts. | 2-38 through 2-40 |
| LO 2-S1 Describe examples of common career paths in accounting. | 2-42 through 2-43 |

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| **Animated Builds and Animated Solutions** | **PowerPoint® Slides** |
| Mini-Exercise 2-13 | 2-45 through 2-46 |
| Mini-Exercise 2-15 | 2-47 through 2-48 |
| Mini-Exercise 2-17 | 2-49 through 2-50 |
| Mini-Exercise 2-19 | 2-51 through 2-52 |
| Exercise 2-4 | 2-53 |
| Exercise 2-5 | 2-54 through 2-55 |

# Chapter Summary

**LO 2-1 Identify financial effects of common business activities that affect the balance sheet.**

* Financing activities involve debt transactions with lenders (e.g., Notes Payable) or equity transactions with investors (e.g., Common Stock).
* Investing activities involve buying and selling long-term assets (e.g., Buildings, Equipment).
* Operating activities involve day-to-day transactions with suppliers, employees, and customers, and typically affect current assets and current liabilities.

# Chapter Summary, continued

**LO 2-2 Apply transaction analysis to accounting transactions.**

* Transactions include external exchanges and internal events.
* Transaction analysis is based on the duality of effects and the basic accounting equation. *Duality of effects* means that every transaction affects at least two accounts.
* Transaction analysis follows a systematic approach of picturing the documented business activity; naming the exchanged asset, liability, and stockholders’ equity accounts; and analyzing the financial effects on the basic accounting equation.

**LO 2-3 Use journal entries and T-accounts to show how transactions affect the balance sheet.**

* Debit means left and credit means right.
* Debits increase assets and decrease liabilities and stockholders’ equity.
* Credits decrease assets and increase liabilities and stockholders’ equity.
* Journal entries express, in debits-equal-credits form, the effects of a transaction on various asset, liability, and stockholders’ equity accounts. Journal entries are used to record financial information in the accounting system, which is later summarized by accounts in the ledger (T-accounts).
* T-accounts are a simplified version of the ledger, which summarizes transaction effects for each account. T-accounts show increases on the left (debit) side for assets, which are on the left side of the accounting equation. T-accounts show increases on the right (credit) side for liabilities and stockholders’ equity, which are on the right side of the accounting equation.

**LO 2-4 Prepare a trial balance and a classified balance sheet.**

* A trial balance checks on the equality of debit and credit balances.
* A *classified balance sheet* separately classifies assets as current if they will be used up or turned into cash within one year. Liabilities are classified as current if they will be paid, settled, or fulfilled within one year.

**LO 2-5 Interpret the balance sheet using the current ratio and an understanding of related concepts.**

* The current ratio divides current assets by current liabilities to determine the extent to which current assets are likely to be sufficient for paying current liabilities.
* Because accounting is transaction-based, the balance sheet does not necessarily represent the current value of a business. Some assets are not recorded because they do not arise from transactions.
* The amounts recorded for assets and liabilities may not represent current values because under the cost principle they generally are recorded at cost, using the exchange amounts established at the time of the initial transaction.

***Accounting Decision Tools***

**Current Ratio = Current Assets ÷ Current Liabilities**

* It tells you whether current assets are sufficient to pay current liabilities.
* A higher ratio means better ability to pay.

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| Chapter Outline | Teaching Notes |
| ***LO 2-1 Identify financial effects of common business activities that affect the balance sheet.*** | |
| I. Understand the Business |  |
| A. Building a Balance Sheet from Business Activities |  |
| 1. **Asset**––Probable future economic benefits owned by the business as a result of past transactions. |  |
| 2. **Liabilities**––Probable debts or obligations of the entity that result from past transactions, which will be fulfilled by providing assets or services. |  |
| 3. **Stockholders’ equity**––The financing provided by the owners and the operations of the business. |  |
| 4. Key activity for any start-up company is to obtain financing. | Illustrated in Exhibit 2.1 |
| a. Equity financing––Financing a business through owners’ contributions and reinvestments of profit. |  |
| b. Debt financing––Financing a business through loans and other amounts that must be repaid. |  |
| c. A business is obligated to repay debt financing, but it is not obligated to repay its equity financing. |  |
| 5. After obtaining initial financing, company will start investing in assets that will be used when business opens. | Illustrated in Exhibit 2.2 |
| 6. Features important for understanding how accounting works; a company always: |  |
| a. Documents its activities. |  |
| b. Receives something and gives something (basic feature of all business activities). |  |
| c. Determines a dollar amount for each exchange based on value of items given and exchanged. |  |
| i. Exchange is either to earn a profit immediately or obtain resources that will allow it to earn a profit later. | *Fundamental idea of business is to create value through exchange.* |
| ii. Any exchange that affects company’s assets, liabilities, or stockholders’ equity must be captured in and reported by the accounting system. |  |
| iii. A dollar amount is determined for each exchange based on the value (cost) of items given and received. |  |
| iv. Because the accounting system captures both what is received and what is given, it is often referred to as a “double-entry” system. |  |
| v. **Cost principle**––Requires assets to be initially recorded at the historical cash-equivalent cost, which is the amount paid or payable on the date of the transaction. |  |

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| Chapter Outline | Teaching Notes |
| 7. Accounting for business activities: | Illustrated in Exhibit 2.3 |
| a. Picture the documented activity. |  |
| b. Name what’s exchanged––Building on the last step, assign names to what your business has received and given. | *Ultimate goal*––*capture financial effects so that they* |
| c. Analyze the financial affects––Building on the last step, show how the costs cause elements of the accounting equation to increase and/or decrease. | *can be reported in financial statements for use by decision makers.* |
| B. Transactions and Other Activities |  |
| 1. **Transaction**––An event or activity that has a direct economic effect on the assets, liabilities, or stockholders’ equity of a business. |  |
| 2. Transactions include two types of events: |  |
| a. External exchanges––Exchanges involving assets, liabilities, and/or stockholders’ equity between the company and someone else. |  |
| b. Internal events––Events that do not involve exchanges with others outside the business, but rather occur within the company itself. |  |
| 3. Exchange of only promises is not an accounting transaction. |  |
| a. Documents are created to indicate these activities occurred. |  |
| b. Later, when promises result in actually receiving or giving an asset or service, they become transactions captured by the accounting system. |  |
| ***LO 2-2 Apply transaction analysis to accounting transactions.*** | |
| II. The Accounting Cycle |  |
| A. Step 1––Analyze Transactions |  |
| 1. A systematic accounting process is used to capture and report the financial effects of a company’s activities. |  |
| a. Process is called the accounting cycle; repeats itself over and over. | Illustrated by circular graphic in text |
| b. Steps include: analyze, record, summarize, prepare trial balance, and report financial statements. |  |
| 2. Transaction analysis involves determining whether a transaction exists and, if it does, analyzing its impact on the accounting equation. | *Analyze transactions from the standpoint of the business, not its owners.* |
| a. Duality of effects––Every transaction has at least two effects on the basic accounting equation. |  |
| b. A = L + SE––The dollar amount for assets must always equal the total of liabilities plus stockholders’ equity for every accounting transaction. |  |
| c. As part of transaction analysis, a name (or account title) is given to each item exchanged. |  |

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| Chapter Outline | Teaching Notes |
| d. **Chart of accounts**––A summary of all account names (and corresponding account numbers) used to record financial results in the accounting system. | Illustrated in Exhibit 2.4 *Chart of accounts shown in Chapter 2 includes only* |
| i. Ensures account titles are used consistently. | *balance sheet accounts.* |
| ii. Tailored to each company’s business. |  |
| iii. Many account titles are common across all companies; others may be used only by a particular company. |  |
| 3. Illustrative Business Activities | *Stress that students should* |
| (a) Issue Stock to Owners––Jordan incorporates Noodlecake Studios, Inc., and the company issues common stock to Jordan and Ty as evidence of their total contribution of $10,000 cash, which is deposited in the company’s bank account. | *not skip this section with the*  *plan of coming back to it later; the next part of the chapter builds on this part.* |
| * Name: Noodlecake has received $10,000 cash. Noodlecake issues $10,000 of common stock. |  |
| * Analyze:  Assets = Liabilities + Stockholders’ Equity Cash (A) +10,000 = Common Stock (SE) +10,000 |  |
| (b) Invest in Logo/Trademarks––Noodlecake pays $300 cash to create the company’s logo. |  |
| * Name: Noodlecake has received a logo costing $300. Noodlecake gave $300 cash. | *This transaction did not affect liabilities or stockholders’ equity; the* |
| * Analyze:  Assets = Liabilities + Stockholders’ Equity Cash (A) −300 + Logo/Trademarks (A) +300 = 0 | *decrease in one asset was offset by an increase in another asset.* |
| (c) Obtain Loan from Bank––Noodlecake borrows $20,000 from a bank, depositing those funds in its bank account and signing a formal agreement to repay the loan in two years. | *Notes payable are like accounts payable except  they:* |
| * Name: Noodlecake has received $20,000 cash. Noodlecake gave a note, payable to the bank for $20,000. | *(a) charge interest,*  *(b) can be outstanding for periods either shorter or longer than one year, and* |
| * Analyze:  Assets = Liabilities + Stockholders’ Equity Cash (A) +20,000 = Note Payable (L) +20,000 | *(c) are documented using formal documents called notes.* |
| (d) Invest in Equipment––Noodlecake purchases and receives $9,600 in computers, printers, and desks, signing a purchase order to indicate its promise to pay $9,600 at the end of the month. |  |
| * Name: Noodlecake has received $9,600 of equipment. Noodlecake gave a promise to pay $9,600 on account. |  |

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| Chapter Outline | Teaching Notes |
| * Analyze:  Assets = Liabilities + Stockholders’ Equity Equipment (A) +9,600 = Accounts Payable +9,600 |  |
| (e) Pay Supplier––Noodlecake pays $5,000 of its promise to the equipment supplier in (d). | *Stress that the company would typically wait until the* |
| * Name: Noodlecake has received back its $5,000 promise to pay on account. Noodlecake gave $5,000 cash. | *end of the month to pay the amount owed to the supplier.* |
| * Analyze:  Assets = Liabilities + Stockholders’ Equity Cash –5,000 = Accounts Payable –5,000 |  |
| (f) Order Software for App––Noodlecake signs a contract with a programmer for program code for the Tiny Warriors game app for $9,000. No code has been received yet. |  |
| * Name: An exchange of only promises is not a transaction. This does not affect the accounting equation. | *Not all business activities are considered accounting transactions.* |
| * Analyze:  Assets = Liabilities + Stockholders’ Equity No change = No change |  |
| (g) Receive Software––Noodlecake receives the $9,000 of app game code ordered in (f); pays $4,000 cash, and promises to pay the remaining $5,000 next month. |  |
| * Name: Noodlecake has received software costing $9,000. Noodlecake gave $4,000 cash and a promise to pay $5,000 on account. |  |
| * Analyze:  Assets = Liabilities + Stockholders’ Equity Cash (A) –4,000 + Software (A) +9,000 = Accounts Payable (L) +5,000 | * Supplemental Enrichment Activity (Activity) #1 * Activity #2 |
| (h) Receive Supplies––Noodlecake receives supplies costing $600 on account. |  |
| * Name: Noodlecake has received supplies costing $600. Noodlecake gave a promise to pay $600 on account. |  |
| * Analyze:  Assets = Liabilities + Stockholders’ Equity Supplies (A) +600 = Accounts Payable (L) +600 |  |

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| Chapter Outline | Teaching Notes |
| B. Steps 2 and 3: Record and Summarize |  |
| 1. One method for recording and summarizing the financial effects of accounting transactions is to prepare a spreadsheet. | Illustrated in Exhibit 2.5 |
| a. By summing each spreadsheet column, the new balances can be computed at the end of the month and reported on a balance sheet. |  |
| b. This method is impractical for most large organizations. |  |
| 2. Most companies use computerized accounting systems, which can handle a large number of transactions. |  |
| a. These systems follow the accounting cycle, which is repeated month-after-month and year-after-year. |  |
| b. Three-step analyze-record-summarize process is applied to daily transactions, as well as adjustments at the end of each month, before preparing a trial balance and financial statements; same three steps are part of the closing processes that occurs at the end of each year. | *Focus here is on applying the three-step process during the period to activities that affect only balance sheet accounts.* |
| 3. Transactions are analyzed, and their financial effects are entered into journals each day they occur; later, these journal entries are summarized in ledger accounts that keep track of the financial effects on each account. | Illustrated in Exhibit 2.6 |
| a. **Journal**––A record of each day’s transactions. |  |
| b. **Ledger**––A collection of records that summarizes, for each account, the effects of transactions entered in the journal. |  |
| ***LO 2-3 Use journal entries and T-accounts to show how transactions affect the balance sheet.*** | |
| C. The Debit/Credit Framework | * Activity #3 |
| 1. Think of the accounting equation (A = L + SE) as an old-fashioned scale that tips at the equals sign; assets are put on the left side of the scale and liabilities and stockholders’ equity accounts are put on the right. | * Activity #4 |
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| 2. Each individual account has two sides, with one side used for increases and the other for decreases. |  |
| 3. Accounts increase on the same side as they appear in A = L + SE (decreases are the opposite side): |  |
| a. Assets increase on the left side of the account. |  |
| b. Liabilities increase on the right side of the account. |  |
| c. Stockholders’ equity accounts increase on the right side of the account. |  |
| 4. Left is debit (*dr*); right is credit (*cr*). |  |
| a. **Debit** (dr)––When used as a noun, debit is the left side of an account; when used as a verb, debit is the act of recording the debit portion of a journal entry to a particular account. |  |

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| Chapter Outline | Teaching Notes |
| b. **Credit** (cr)–– When used as a noun, credit is the right side of an account; when used as a verb, credit is the act of recording the credit portion of a journal entry to a particular account. |  |
| 5. When combined with how increases and decreases are entered into accounts, the following rules emerge: |  |
| a. Use debits for increases in assets (and for decreases in liabilities and stockholders’ equity accounts). | Illustrated in Exhibit 2.7 |
| b. Use credits for increases in liabilities and stockholders’ equity accounts (and for decreases in assets). |  |
| 6. Normal balance for an account is the side on which it increases. |  |
| a. Assets accounts normally have debit balances. |  |
| b. Liabilities and stockholders’ equity accounts normally have credit balances. |  |
| 7. In addition to requiring that A = L + SE, the double-entry system also requires that debits = credits. |  |
| a. Step 1: Analyzing Transactions––The debit/credit framework does not change this step. |  |
| b. Step 2: Recording Journal Entries––The financial effects of transactions are entered into a journal using a debits-equal-credits format. |  |
| 8. **Journal entries**––An accounting method for expressing the effects of a transaction in a debits-equal-credits format. | Illustrated in Exhibit 2.8 |
| a. A date is included for each transaction. |  |
| b. Debits appear first; credits are written below the debits and are indented to the right (words and amounts). |  |
| c. Total debits must equal total credits. |  |
| d. Dollar signs are not used. |  |
| e. The reference column (Ref.) will be used later (in step 3) to indicate when the journal entry has been summarized in the ledger accounts. |  |
| f. A brief explanation of the transaction is written below the debits and credits. |  |
| g. The line after the description is left blank before showing the next journal entry. |  |
| D. Step 3: Summarizing in Ledger Accounts: |  |
| 1. After journal entries have been recorded (in step 2), their dollar amounts are copied (“posted”) to each ledger account affected by the transaction so that account balances can be computed. | Illustrated in Exhibit 2.9 |
| 2. The posting of journal entries to general ledger accounts is kept track of by writing the account number in the Ref. column of the journal and the journal page number in the Ref. column of the ledger. | * Activity #5 |

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| Chapter Outline | Teaching Notes |
| 3. **T-account**––A simplified version of a ledger account used for summarizing transaction effects and determining balances for each account. | | Illustrated in Exhibit 2.10 |
| a. Every account starts with a beginning balance, normally on the side where increases are summarized. | |  |
| b. Dollar signs are not needed in journal entries and T-accounts. | |  |
| c. Each amount is accompanied by a reference to the related journal entry, which makes it easy to trace back to the original transaction should errors occur. | | “Spotlight on Business |
| d. To find ending account balance, express the T-account as equations: Beginning balance plus the “+” side minus the “–” side equals the ending balance | | Decisions” feature addresses the automation of mundane accounting tasks |
| e. Ending balance is double underlined to distinguish it; it is shown on the side that has the greater total dollar amount. | |  |
| E. Noodlecake’s Accounting Records | | Illustrated in Exhibit 2.11 |
| (a) Issue Stock to Owners––Jordan incorporates Noodlecake Studios, Inc., and the company issues common stock to Jordan and Ty as evidence of their total contribution of $10,000 cash, which is deposited in the company’s bank account. | |  |
| 1. Analyze: Assets = Liabilities + Stockholders’ Equity Cash (A) +10,000 = Common Stock (SE) +10,000 | | *Refer to illustrations of transactions (a) through (g)* |
| 2. Record: | | *in textbook for Step 3—* |
| |  |  |  | | --- | --- | --- | |  | Debit | Credit | | Cash (+A) | 10,000 |  | | Common Stock (+SE) |  | 10,000 | | | *Summarize (which includes posting to T-accounts).* |
| (b) Invest in Equipment––Noodlecake pays $300 cash to create the company’s logo. | |  |
| 1. Analyze: Assets = Liabilities + Stockholders’ Equity Cash (A) –300; Logo and Trademarks (A) +300 = 0 | |  |
| 2. Record: | |  |
| |  |  |  | | --- | --- | --- | |  | Debit | Credit | | Logo and Trademarks (+A) | 300 |  | | Cash (–A) |  | 300 | | |  |
| (c) Obtain Loan from Bank––Noodlecake borrows $20,000 from a bank and signs a formal agreement to repay the loan in two years. | |  |
| 1. Analyze: Assets = Liabilities + Stockholders’ Equity Cash (A) +20,000 = Note Payable (long-term) (L) +20,000 | |  |
| 2. Record: | |  |
| |  |  |  | | --- | --- | --- | |  | Debit | Credit | | Cash (+A) | 20,000 |  | | Note Payable (long-term) (+L) |  | 20,000 | | |  |

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| Chapter Outline | Teaching Notes | |
| (d) Invest in Equipment––Noodlecake purchases and receives $9,600 in computers, printers, and desks, signing a purchase order to indicate its promise to pay $9,600 at the end of the month. | |  | |
| 1. Analyze: Assets = Liabilities + Stockholders’ Equity Equipment (A) +9,600 = Accounts Payable +9,600 | |  | |
| 2. Record: | |  | |
| |  |  |  | | --- | --- | --- | |  | Debit | Credit | | Equipment (+A) | 9,600 |  | | Accounts Payable (+L) |  | 9,600 | | |  | |
| (e) Pay Supplier––Noodlecake pays $5,000 to the equipment supplier in (d). | |  | |
| 1. Analyze: Assets = Liabilities + Stockholders’ Equity Cash –5,000 = Accounts Payable –5,000 | |  | |
| 2. Record: | |  | |
| |  |  |  | | --- | --- | --- | |  | Debit | Credit | | Accounts Payable (–L) | 5,000 |  | | Cash (–A) |  | 5,000 | | |  | |
| (f) Order Software––Noodlecake signs a contract for program code for a game app for $9,000. No code has been received yet. | |  | |
| 1. Analyze: Assets = Liabilities + Stockholders’ Equity No change = No change | |  | |
| 2. Record––No journal entry is needed. | |  | |
| (g) Receive Software––Noodlecake receives the $9,000 of app game code ordered in (f); pays $4,000 cash, and promises to pay the remaining $5,000 next month. | |  | |
| 1. Analyze: Assets = Liabilities + Stockholders’ Equity Cash (A) –4,000 + Software (A) +9,000 = Accounts Payable (L) +5,000 | |  | |
| 2. Record: | |  | |
| |  |  |  | | --- | --- | --- | |  | Debit | Credit | | Software (+A) | 9,000 |  | | Cash (–A) |  | 4,000 | | Accounts Payable (+L) |  | 5,000 | | |  | |
| (h) Receive Supplies––Noodlecake receives supplies costing $600 on account. | |  | |
| 1. Analyze:  Assets = Liabilities + Stockholders’ Equity Supplies (A) +600 = Accounts Payable (L) +600 | |  | |
| 2. Record: | |  | |
| |  |  |  | | --- | --- | --- | |  | Debit | Credit | | Supplies (+A) | 600 |  | | Accounts Payable (+L) |  | 600 | | |  | |

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| Chapter Outline | | Teaching Notes | |
| ***LO 2-4 Prepare a trial balance and a classified balance sheet.*** | | | | |
| F. Preparing a Trial Balance and a Balance Sheet | | | * Activity #6 | |
| 1. **Trial balance**––A list of all accounts with their balances to provide a check on the equality of the debits and credits; if the column totals are equal, a balance sheet can be prepared. | | | Illustrated in Exhibit 2.12 | |
| 2. **Classified balance sheet**––A balance sheet that classifies assets and liabilities into current and other (long-term) categories. | | | Illustrated in Exhibit 2.13 | |
| a. Categories: | | |  | |
| i. **Current assets**––Assets that will be used up or turned into cash within 12 months or the next operating cycle, whichever is longer. | | |  | |
| ii. **Current liabilities**––Short-term obligations that will be paid in cash (or fulfilled with other current assets) within 12 months or the next operating cycle, whichever is longer. | | |  | |
| iii. **Noncurrent**––Long-term; assets and liabilities that do not meet the definition of current. | | |  | |
| b. Companies list assets in order of liquidity (how soon they will be used up or turned into cash) and liabilities in order of maturity (how soon they will be paid in cash or fulfilled by providing a service). | | |  | |
| ***LO 2-5 Interpret the balance sheet using the current ratio and an understanding of related concepts.*** | | | |
| III. Evaluate the Results | |  | |
| A. Assessing the Ability to Pay | |  | |
| 1. The classified balance sheet format makes it easy to see whether current assets are sufficient to pay current liabilities. | | The “Spotlight on Financial Reporting” feature explains how analysts reacted to | |
| 2. The only problem with this approach is that looking at total dollar amounts can be awkward, especially if we want to compare across several companies. | | Facebook’s high current ratio and Expedia’s low current ratio. | |
| 3. Current Ratio | | * Activity #7 | |
| a. Current assets divided by current liabilities. | |  | |
| b. Used to evaluate the ability to pay liabilities as they come due in the short run. | |  | |
| c. Generally speaking, a high ratio suggests good liquidity. | | Illustrated in Exhibit 2.14 | |
| B. Balance Sheet Concepts and Values | |  | |
| 1. Some mistakenly believe the purpose of a balance sheet is to report what a business is actually worth. | |  | |
| 2. In fact, *net worth* is a term that many accountants and analysts use when referring to stockholders’ equity. | |  | |

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| Chapter Outline | | Teaching Notes | |
| 3. The answer comes from knowing that accounting is based on recording and reporting transactions: | |  | |
| a. What is (and is not) recorded? | |  | |
| i. Only measurable exchanges are recorded. | |  | |
| ii. Items not acquired in an exchange are not listed on the balance sheet but they can still affect the value of a company. | |  | |
| b. What amounts are assigned to recorded items? | |  | |
| i. Following the cost principle, assets and liabilities are first recorded at cost, which is their cash equivalent value on the date of the transaction. | |  | |
| * Later, if an asset’s value increases, the increase is generally not recorded under GAAP unless it is a particular type of financial investment (as discussed in Appendix D). | |  | |
| * If an asset’s value falls, it is generally reported at that lower value. | |  | |
| ii. Thus, the amount reported on the balance sheet may not be the asset’s current value. | |  | |
| C. Summary of the Accounting Cycle | | Summarized in Exhibit 2.15 | |
| 1. During the accounting period, transactions take place. | |  | |
| a. Picture the documented activity. | |  | |
| b. Name what’s exchanged. | |  | |
| c. Analyze the financial effects. | |  | |
| d. Record a journal entry. | |  | |
| e. Summarize in T-accounts. | |  | |
| 2. At the end of accounting period: | |  | |
| a. Prepare a trial balance. | |  | |
| b. Adjust the accounts. | | *Covered in Chapter 4* | |
| c. Prepare financial statements from the trial balance and distribute to users. | |  | |
| d. Close the books | | *Covered in Chapter 4* | |
| ***LO 2-S1 Describe examples of common career paths in accounting.*** | | | |
| IV. Accounting Careers | |  | |
| A. Every business, government, and not-for-profit organization needs financial advice from an accountant. | |  | |
| 1. Accountants provide advice as an employee in a single organization (private accounting) or in a CPA firm (public accounting). | | Overviewed in Exhibit 2A.1 | |
| 2. Accountants may pursue a variety of certifications, including: | |  | |
| i. CPA (Certified Public Accountant) | |  | |
| ii. CFE (Certified Fraud Examiner) | |  | |
| iii. CMA (Certified Management Accountant) | |  | |
| iv. CIA (Certified Internal Auditor) | |  | |
| v. CFM (Certified Financial Manager) | |  | |
| vi. Cr. FA (Certified Forensic Accountant) | |  | |
| vii. CFA (Chartered Financial Analyst) | |  | |

**Supplemental Enrichment Activities**

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

1. Handout 2**–**1

Use this handout for an in-class activity designed to review the analysis of various business transactions that affect the balance sheet. The solution follows the handout master.

1. Handout 2**–**2

This activity is a continuation of Activity #1. Use this handout for an in-class activity designed to continue the review of the analysis of various business transactions that affect the balance sheet. The solution follows the handout master.

1. Handout 2**–**3

Use Handout 2-3 for an in-class activity designed to review the debit/credit framework. Note that these transactions are the same as those analyzed on Handout 2-1. However, it can be assigned even if Activity #1 was not assigned. The solution follows the handout master.

1. Handout 2**–**4

This activity is a continuation of Activity #3. Use this handout for an in-class activity designed to review the debit/credit framework. Note that these transactions are the same as those analyzed on Handout 2**–**2. However, it can be assigned even if Activity #2 was not assigned. The solution follows the handout master.

1. Handout 2**–**5

Use this handout for an in-class activity designed to review the posting of various balance sheet transactions to T-accounts. This activity is a continuation of Activity #3 and Activity #4; it should be assigned only if both of those activities were assigned. The solution follows the handout master.

1. Handout 2**–**6

Use this handout for an in-class activity designed to review the preparation of a trial balance and a classified balance sheet. This activity is a continuation of Activity #5; it should be assigned only if that activity was assigned. The solution follows the handout master.

1. Use Handout 2**–**7

Use this handout for an in-class activity designed to review the calculation and interpretation of the current ratio. This activity is a continuation of Activity #6; it should be assigned only if that activity was assigned. The solution follows the handout master.

# HANDOUT 2–1

# ANALYZING TRANSACTIONS

Analyze each of the following transactions by answering each of the questions. Use the spreadsheet on the following page to keep track of the amount in each account:

(a) Stockholder invests $10,000 into the business in exchange for common stock.

|  |  |  |
| --- | --- | --- |
| 1. | Does a transaction exist? |  |
| 2. | Examine it for accounts affected. |  |
| 3. | Classify each account affected. |  |
| 4. | Identify direction and amount. |  |
| 5. | Ensure the equation still balances. |  |

(b) Company borrows $15,000 signing a note payable to the bank that is due in three months.

|  |  |  |
| --- | --- | --- |
| 1. | Does a transaction exist? |  |
| 2. | Examine it for accounts affected. |  |
| 3. | Classify each account affected. |  |
| 4. | Identify direction and amount. |  |
| 5. | Ensure the equation still balances. |  |

(c) Receives and pays for a $15,000 truck and $5,000 of equipment.

|  |  |  |
| --- | --- | --- |
| 1. | Does a transaction exist? |  |
| 2. | Examine it for accounts affected. |  |
| 3. | Classify each account affected. |  |
| 4. | Identify direction and amount. |  |
| 5. | Ensure the equation still balances. |  |

# HANDOUT 2–1, continued

(d) Purchases $300 of supplies on account.

|  |  |  |
| --- | --- | --- |
| 1. | Does a transaction exist? |  |
| 2. | Examine it for accounts affected. |  |
| 3. | Classify each account affected. |  |
| 4. | Identify direction and amount. |  |
| 5. | Ensure the equation still balances. |  |

(e) Signs contract for first website design for $10,000.

|  |  |  |
| --- | --- | --- |
| 1. | Does a transaction exist? |  |
| 2. | Examine it for accounts affected. |  |
| 3. | Classify each account affected. |  |
| 4. | Identify direction and amount. |  |
| 5. | Ensure the equation still balances. |  |

# Spreadsheet

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | Assets | | | | | = | Liabilities | | | + | | SE | |
| Ref. | Cash | + | Supplies | + | Property, Plant & Equipment | = | Accounts Payable | + | Notes Payable (short-term) | + | Common Stock | |
| (a) |  |  |  |  |  |  |  |  |  |  |  | |
| (b) |  |  |  |  |  |  |  |  |  |  |  | |
| (c) |  |  |  |  |  |  |  |  |  |  |  | |
| (d) |  |  |  |  |  |  |  |  |  |  |  | |
| (e) |  |  |  |  |  |  |  |  |  |  |  | |

# HANDOUT 2–1 SOLUTION, continued

# ANALYZING TRANSACTIONS

Analyze each of the following transactions by answering each of the questions. Use the spreadsheet on the following page to keep track of the amount in each account:

(a) Stockholder invests $10,000 into the business in exchange for common stock.

|  |  |  |
| --- | --- | --- |
| 1. | Does a transaction exist? | Yes—received cash and gave stock. |
| 2. | Examine it for accounts affected. | Cash and Common Stock |
| 3. | Classify each account affected. | Cash is an Asset (A) and Common Stock is Stockholders’ Equity (SE) |
| 4. | Identify direction and amount. | Cash (A) + $10,000 = Stockholders’ Equity (SE) + $10,000. |
| 5. | Ensure the equation still balances. | Yes—see below. |

(b) Company borrows $15,000 signing a note payable to the bank that is due in three months.

|  |  |  |
| --- | --- | --- |
| 1. | Does a transaction exist? | Yes—received cash and gave a note payable. |
| 2. | Examine it for accounts affected. | Cash and Notes Payable (short-term) |
| 3. | Classify each account affected. | Cash is an Asset (A) and Notes Payable (short-term) is a Liability (L) |
| 4. | Identify direction and amount. | Cash (A) + $15,000 = Notes Payable (short-term) + $15,000. |
| 5. | Ensure the equation still balances. | Yes—see below. |

(c) Receives and pays for a $15,000 truck and $5,000 of equipment.

|  |  |  |
| --- | --- | --- |
| 1. | Does a transaction exist? | Yes—paid cash and received truck and equipment. |
| 2. | Examine it for accounts affected. | Cash and Equipment |
| 3. | Classify each account affected. | Cash is an Asset (A) and Equipment is an Asset (A) |
| 4. | Identify direction and amount. | Cash (A) − $20,000 and Equipment (A) + 20,000 |
| 5. | Ensure the equation still balances. | Yes—see below. |

# HANDOUT 2–1 SOLUTION, continued

(d) Purchases $300 of supplies on account.

|  |  |  |
| --- | --- | --- |
| 1. | Does a transaction exist? | Yes—received supplies and obligated to pay for them. |
| 2. | Examine it for accounts affected. | Supplies and Accounts Payable |
| 3. | Classify each account affected. | Supplies is an Asset (A) and Accounts Payable is a Liability (L) |
| 4. | Identify direction and amount. | Supplies (A) + $300 and Accounts Payable (L) + $300. |
| 5. | Ensure the equation still balances. | Yes—see below. |

(e) Signs contract for first website design for $10,000.

|  |  |  |
| --- | --- | --- |
| 1. | Does a transaction exist? | No—no exchange took place. |
| 2. | Examine it for accounts affected. |  |
| 3. | Classify each account affected. |  |
| 4. | Identify direction and amount. |  |
| 5. | Ensure the equation still balances. |  |

# Spreadsheet

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | Assets | | | | | = | Liabilities | | | + | Stockholders’ Equity |
| Ref. | Cash | + | Supplies | + | Equipment | = | Accounts Payable | + | Notes Payable (short-term) | + | Common Stock |
| (a) | +10,000 |  |  |  |  | = |  |  |  |  | +10,000 |
| (b) | +15,000 |  |  |  |  | = |  |  | +15,000 |  |  |
| (c) | –20,000 |  |  |  | +20,000 | = |  |  |  |  |  |
| (d) |  |  | +300 |  |  | = | +300 |  |  |  |  |
| Total | 5,000 |  | 300 |  | 20,000 |  | 300 |  | 15,000 |  | 10,000 |
|  | $25,300 | | | | |  | $15,300 | | |  | $10,000 |

# HANDOUT 2–2

# ANALYZING TRANSACTIONS

Analyze the following transactions as set forth below. Use the spreadsheet on the next page to keep track of the amount in each account:

(f) Pays $300 to the supplier in (d).

|  |  |  |
| --- | --- | --- |
| 1. | Does a transaction exist? |  |
| 2. | Examine it for accounts affected. |  |
| 3. | Classify each account affected. |  |
| 4. | Identify direction and amount. |  |
| 5. | Ensure the equation still balances. |  |

(g) Purchases and pays for $600 of supplies.

|  |  |  |
| --- | --- | --- |
| 1. | Does a transaction exist? |  |
| 2. | Examine it for accounts affected. |  |
| 3. | Classify each account affected. |  |
| 4. | Identify direction and amount. |  |
| 5. | Ensure the equation still balances. |  |

(h) Purchases and pays for equipment costing $1,000.

|  |  |  |
| --- | --- | --- |
| 1. | Does a transaction exist? |  |
| 2. | Examine it for accounts affected. |  |
| 3. | Classify each account affected. |  |
| 4. | Identify direction and amount. |  |
| 5. | Ensure the equation still balances. |  |

(i) Orders a $900 lawn mower, to be delivered next month.

|  |  |  |
| --- | --- | --- |
| 1. | Does a transaction exist? |  |
| 2. | Examine it for accounts affected. |  |
| 3. | Classify each account affected. |  |
| 4. | Identify direction and amount. |  |
| 5. | Ensure the equation still balances. |  |

# HANDOUT 2–2, continued

# Spreadsheet

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | Assets | | | | | = | Liabilities | | | + | Stockholders’ Equity |
| Ref. | Cash | + | Supplies | + | Equipment | = | Accounts Payable | + | Notes Payable (short-term) | + | Common Stock |
| (a) | +10,000 |  |  |  |  | = |  |  |  |  | +10,000 |
| (b) | +15,000 |  |  |  |  | = |  |  | +15,000 |  |  |
| (c) | –20,000 |  |  |  | +20,000 | = |  |  |  |  |  |
| (d) |  |  | +300 |  |  | = | +300 |  |  |  |  |
| (f) |  |  |  |  |  |  |  |  |  |  |  |
| (g) |  |  |  |  |  |  |  |  |  |  |  |
| (h) |  |  |  |  |  |  |  |  |  |  |  |
| (i) |  |  |  |  |  |  |  |  |  |  |  |

# HANDOUT 2–2 SOLUTION

# ANALYZING TRANSACTIONS

Analyze the following transactions as set forth below. Use the spreadsheet on the next page to keep track of the amount in each account:

(f) Pays $300 to the supplier in (d).

|  |  |  |
| --- | --- | --- |
| 1. | Does a transaction exist? | Yes—paid cash to reduce accounts payable. |
| 2. | Examine it for accounts affected. | Cash and Accounts Payable |
| 3. | Classify each account affected. | Cash is an Asset (A) and Accounts Payable is a Liability (L) |
| 4. | Identify direction and amount. | Cash (A) – $300 = Liabilities (L) – $300 |
| 5. | Ensure the equation still balances. | Yes—see below. |

(g) Purchases and pays for $600 of supplies.

|  |  |  |
| --- | --- | --- |
| 1. | Does a transaction exist? | Yes—paid cash to purchase supplies. |
| 2. | Examine it for accounts affected. | Cash and Supplies |
| 3. | Classify each account affected. | Cash is an Asset (A) and Supplies is an Asset |
| 4. | Identify direction and amount. | Cash (A) – $600 and Supplies (A) – $600. |
| 5. | Ensure the equation still balances. | Yes—see below. |

(h) Purchases and pays for equipment costing $1,000.

|  |  |  |
| --- | --- | --- |
| 1. | Does a transaction exist? | Yes—paid cash to purchase equipment |
| 2. | Examine it for accounts affected. | Cash and Equipment |
| 3. | Classify each account affected. | Cash is an Asset (A) and Equipment is an Asset (A) |
| 4. | Identify direction and amount. | Cash (A) – $1,000 and Equipment (A) ­– $1,000 |
| 5. | Ensure the equation still balances. | Yes—see below. |

(i) Orders a $900 computer, to be delivered next month.

|  |  |  |
| --- | --- | --- |
| 1. | Does a transaction exist? | No. |
| 2. | Examine it for accounts affected. |  |
| 3. | Classify each account affected. |  |
| 4. | Identify direction and amount. |  |
| 5. | Ensure the equation still balances. |  |

# HANDOUT 2–2 SOLUTION, continued

# Spreadsheet

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | Assets | | | | | = | Liabilities | | | + | Stockholders’ Equity |
| Ref. | Cash | + | Supplies | + | Equipment | = | Accounts Payable | + | Notes Payable (short-term) | + | Common Stock |
| (a) | +10,000 |  |  |  |  | = |  |  |  |  | +10,000 |
| (b) | +15,000 |  |  |  |  | = |  |  | +15,000 |  |  |
| (c) | –20,000 |  |  |  | +20,000 | = |  |  |  |  |  |
| (d) |  |  | +300 |  |  | = | +300 |  |  |  |  |
| (f) | –300 |  |  |  |  |  | –300 |  |  |  |  |
| (g) | –600 |  | +600 |  |  |  |  |  |  |  |  |
| (h) | –1,000 |  |  |  | +1,000 |  |  |  |  |  |  |
| (i) |  |  |  |  |  |  |  |  |  |  |  |

# HANDOUT 2–3

# THE DEBIT/CREDIT FRAMEWORK

## The following activities occurred during January Year 1. Prepare a journal entry to ensure that the basic accounting equation balances for each transaction.

(a) Stockholder invests $10,000 into the business in exchange for common stock.

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

(b) Company borrows $15,000 signing a note payable to the bank that is due in three months.

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

(c) Receives and pays for a $15,000 truck and $5,000 of equipment.

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

# HANDOUT 2–3, continued

(d) Purchases $300 of supplies on account.

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

(e) Signs contract for first website design for $10,000.

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

# HANDOUT 2–3 SOLUTION

# THE DEBIT/CREDIT FRAMEWORK

## The following activities occurred during January Year 1. Prepare a journal entry to ensure that the basic accounting equation balances for each transaction.

(a) Stockholder invests $10,000 into the business.

|  |
| --- |
| Debit and credit the accounts affected |
| |  |  |  |  | | --- | --- | --- | --- | | (a) | Cash (+A) | 10,000 |  | |  | Common Stock (+SE) |  | 10,000 | |
| Ensure the equation still balances and debits = credits |
| |  |  |  |  |  |  |  |  | | --- | --- | --- | --- | --- | --- | --- | --- | | Assets | | = | Liabilities | | + | Stockholders’ Equity | | | Cash | +10,000 |  |  |  |  | Common Stock | +10,000 | |

(b) Company borrows $15,000 signing a note payable to the bank that is due in three months.

|  |
| --- |
| Debit and credit the accounts affected |
| |  |  |  |  | | --- | --- | --- | --- | | (b) | Cash (+A) | 15,000 |  | |  | Note Payable (+L) |  | 15,000 | |
| Ensure the equation still balances and debits = credits |
| |  |  |  |  |  |  |  |  | | --- | --- | --- | --- | --- | --- | --- | --- | | Assets | | = | Liabilities | | + | Stockholders’ Equity | | | Cash | +15,000 |  | Note Payable | +15,000 |  |  |  | |

(c) Receives and pays for a $15,000 truck and $5,000 of equipment.

|  |
| --- |
| Debit and credit the accounts affected |
| |  |  |  |  | | --- | --- | --- | --- | | (c) | Equipment (+A) | 20,000 |  | |  | Cash (–A) |  | 20,000 | |
| Ensure the equation still balances and debits = credits |
| |  |  |  |  |  |  |  |  | | --- | --- | --- | --- | --- | --- | --- | --- | | Assets | | = | Liabilities | | + | Stockholders’ Equity | | | Cash  Equipment | –20,000  +20,000 |  |  |  |  |  |  | |

# HANDOUT 2–3 SOLUTION, continued

(d) Purchases $300 of supplies on account.

|  |
| --- |
| Debit and credit the accounts affected |
| |  |  |  |  | | --- | --- | --- | --- | | (d) | Supplies (+A) | 300 |  | |  | Accounts Payable (+A) |  | 300 | |
| Ensure the equation still balances and debits = credits |
| |  |  |  |  |  |  |  |  | | --- | --- | --- | --- | --- | --- | --- | --- | | Assets | | = | Liabilities | | + | Stockholders’ Equity | | | Supplies | +300 |  | Accounts Payable | +300 |  |  |  | |

(e) Signs contract for first website design for $10,000.

No entry—this is not a transaction.

# HANDOUT 2–4

# THE DEBIT/CREDIT FRAMEWORK

(f) Pays $300 to the supplier in (d).

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

(g) Purchases and pays for $600 of supplies.

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

(h) Purchases and pays for equipment costing $1,000.

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

# HANDOUT 2–4, continued

(i) Orders a $900 computer, to be delivered in 90 days.

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

# HANDOUT 2–4 SOLUTION

# THE DEBIT/CREDIT FRAMEWORK

(f) Pays $300 to the supplier in (d).

|  |
| --- |
| Debit and credit the accounts affected |
| |  |  |  |  | | --- | --- | --- | --- | | (f) | Accounts Payable (–L) | 300 |  | |  | Cash (–A) |  | 300 | |
| Ensure the equation still balances and debits = credits |
| |  |  |  |  |  |  |  |  | | --- | --- | --- | --- | --- | --- | --- | --- | | Assets | | = | Liabilities | | + | Stockholders’ Equity | | | Cash | –300 |  | Accounts Payable | –300 |  |  |  | |

(g) Purchases and pays for $600 of supplies.

|  |
| --- |
| Debit and credit the accounts affected |
| |  |  |  |  | | --- | --- | --- | --- | | (g) | Supplies (+A) | 600 |  | |  | Cash (–A) |  | 600 | |
| Ensure the equation still balances and debits = credits |
| |  |  |  |  |  |  |  |  | | --- | --- | --- | --- | --- | --- | --- | --- | | Assets | | = | Liabilities | | + | Stockholders’ Equity | | | Supplies | +600 |  |  |  |  |  |  | | Cash | –600 |  |  |  |  |  |  | |

(h) Purchases and pays for equipment costing $1,000.

|  |
| --- |
| Debit and credit the accounts affected |
| |  |  |  |  | | --- | --- | --- | --- | | (h) | Equipment (+A) | 1,000 |  | |  | Cash (–A) |  | 1,000 | |
| Ensure the equation still balances and debits = credits |
| |  |  |  |  |  |  |  |  | | --- | --- | --- | --- | --- | --- | --- | --- | | Assets | | = | Liabilities | | + | Stockholders’ Equity | | | Equipment | +1,000 |  |  |  |  |  |  | | Cash | –1,000 |  |  |  |  |  |  | |

(i) Orders a $900 computer, to be delivered in 90 days.

No entry—this is not a transaction.

# HANDOUT 2–5

# POSTING TO T-ACCOUNTS

## Post the transactions from Handouts 2-3 and 2-4 to and then determine the ending balances of each of the following T-accounts.

|  |  |  |
| --- | --- | --- |
| Assets | Liabilities | Stockholders’ Equity |
| + Cash –   |  |  |  |  | | --- | --- | --- | --- | |  |  |  |  | |  |  |  |  | |  |  |  |  | |  |  |  |  | |  |  |  |  | |  |  |  |  | |  |  |  |  | | − Accounts Payable +   |  |  |  |  | | --- | --- | --- | --- | |  |  |  |  | |  |  |  |  | |  |  |  |  | |  |  |  |  | | − Common Stock +   |  |  |  |  | | --- | --- | --- | --- | |  |  |  |  | |  |  |  |  | |  |  |  |  | |  |  |  |  | |
| + Supplies –   |  |  |  |  | | --- | --- | --- | --- | |  |  |  |  | |  |  |  |  | |  |  |  |  | |  |  |  |  | | − Notes Payable (short-term) +   |  |  |  |  | | --- | --- | --- | --- | |  |  |  |  | |  |  |  |  | |  |  |  |  | |  |  |  |  | | − Retained Earnings +   |  |  |  |  | | --- | --- | --- | --- | |  |  |  |  | |  |  |  |  | |  |  |  |  | |  |  |  |  | |
| + Equipment –   |  |  |  |  | | --- | --- | --- | --- | |  |  |  |  | |  |  |  |  | |  |  |  |  | |  |  |  |  | |  |  |

# HANDOUT 2–5 SOLUTION

# POSTING TO T-ACCOUNTS

## Post the transactions from Handouts 2-3 and 2-4 to and then determine the ending balances of each of the following T-accounts.

|  |  |  |
| --- | --- | --- |
| Assets | Liabilities | Stockholders’ Equity |
| + Cash –   |  |  |  |  | | --- | --- | --- | --- | | BegBal | 0 |  |  | | (a) | 10,000 |  |  | | (b) | 15,000 | 20,000 | (c) | |  |  | 300 | (f) | |  |  | 600 | (g) | |  |  | 1,000 | (h) | | EndBal | 3,100 |  |  | | − Accounts Payable +   |  |  |  |  | | --- | --- | --- | --- | |  |  | 0 | BegBal | | (f) | 300 | 300 | (d) | |  |  | 0 | EndBal | |  |  |  |  | | − Common Stock +   |  |  |  |  | | --- | --- | --- | --- | |  |  | 0 | BegBal | |  |  | 10,000 | (a) | |  |  |  |  | |  |  | 10,000 | EndBal | |
| + Supplies –   |  |  |  |  | | --- | --- | --- | --- | | BegBal | 0 |  |  | | (d) | 300 |  |  | | (g) | 600 |  |  | | EndBal | 900 |  |  | | − Notes Payable (short-term) +   |  |  |  |  | | --- | --- | --- | --- | |  |  | 0 | BegBal | |  |  | 15,000 | (b) | |  |  | 15,000 | EndBal | |  |  |  |  | | − Retained Earnings +   |  |  |  |  | | --- | --- | --- | --- | |  |  | 0 | BegBal | |  |  |  |  | |  |  |  |  | |  |  | 0 | EndBal | |
| + Equipment –   |  |  |  |  | | --- | --- | --- | --- | | BegBal | 0 |  |  | | (c) | 20,000 |  |  | | (h) | 1,000 |  |  | | EndBal | 21,000 |  |  | |  |  |

# HANDOUT 2–6

# PREPARING A TRIAL BALANCE AND A BALANCE SHEET

## Use the ending balances from the T-accounts on Handout 2-5 to prepare a trial balance as of December 31, Year 1.

World Wide Webster

Trial Balance

At December 31, Year 1

|  |  |  |
| --- | --- | --- |
|  | Debit | Credit |
| Cash |  |  |
| Supplies |  |  |
| Equipment |  |  |
| Notes Payable (short-term) |  |  |
| Common Stock |  |  |
| Retained Earnings |  |  |
| **Totals** |  |  |

## Use the trial balance to prepare a classified balance sheet.

# HANDOUT 2–6 SOLUTION

# PREPARING A TRIAL BALANCE AND A BALANCE SHEET

## Use the ending balances from the T-accounts on Handout 2-5 to prepare a trial balance as of December 31, Year 1.

World Wide Webster

Trial Balance

At December 31, Year 1

|  |  |  |  |
| --- | --- | --- | --- |
|  | Debit |  | Credit |
| Cash | $ 3,100 |  |  |
| Supplies | 900 |  |  |
| Equipment | 21,000 |  |  |
| Notes Payable (short-term) |  |  | $15,000 |
| Common Stock |  |  | 10,000 |
| Retained Earnings |  |  | 0 |
| **Totals** | $25,000 |  | $25,000 |

## Use the trial balance to prepare a classified balance sheet.

World Wide Webster

Balance Sheet

At December 31, Year 1

|  |  |
| --- | --- |
| Assets | |
| Current Assets: |  |
| Cash | $ 3,100 |
| Supplies | 900 |
| Total Current Assets | 4,000 |
| Equipment | 21,000 |
| Total Assets | $25,000 |
|  |  |
| Liabilities | |
| Current Liabilities: |  |
| Notes Payable (short-term) | $15,000 |
| Total Current Liabilities | 15,000 |
|  |  |
| Stockholders’ Equity | |
| Common Stock | 10,000 |
| Retained Earnings | 0 |
| Total Stockholders’ Equity | 10,000 |
| Total Liabilities and Stockholders’ Equity | $25,000 |
|  |  |

# HANDOUT 2–7

# CURRENT RATIO

# Refer to the classified balance sheet from Handout 2-6 and calculate the current ratio of World Wide Webster as of December 31, Year 1. Then, interpret the current ratio.

# Calculation:

Interpretation:

# HANDOUT 2–7 SOLUTION

# CURRENT RATIO

# Refer to the classified balance sheet from Handout 2-6 and calculate the current ratio of World Wide Webster as of December 31, Year 1. Then, interpret the current ratio.

# Calculation:

# Current ratio = Current assets ÷ Current liabilities

# Current ratio = $4,000 ÷ $15,000 = 0.27

Interpretation:

A current ratio of 0.27 indicates that the company has $0.27 of current assets for $1.00 of current liabilities as of December 31, Year 1. It does not appear that the company’s current assets are sufficient to pay its current liabilities.