

Principles of Accounting

Lecture 4

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Subject code: MGM 227





Principles of Accounting

MGM 227

Chapter 2: Recording Business Transactions

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Learning objectives:

- 1) Explain accounts as they relate to the accounting equation and describe common accounts.
- 2) Define debits, credits, and normal account balances using double-entry accounting and T-accounts.
- 3) Record transactions in a journal and post journal entries to the ledger.
- 4) Prepare the trial balance and illustrate how to use the trial balance to prepare financial statements.
- 5) Use the debt ratio to evaluate business performance.

The Ledger Accounts After Posting

Exhibit 2-7 shows the T-accounts of Smart Touch Learning after posting the journal entries from the journal to the ledger. The accounts are grouped under their headings. Notice that at December 31, Smart Touch Learning has assets of \$114,700 ($\$12,200 + \$1,000 + \$500 + \$3,000 + \$18,000 + \$60,000 + \$20,000$), liabilities of \$60,900 ($\$200 + \$100 + \$600 + \$60,000$), and equity of \$53,800 ($\$48,000 - \$5,000 + \$16,500 - \$2,000 - \$3,600 - \100). The accounting equation is in balance ($\$114,700 = \$60,900 + \$53,800$).

Exhibit 2-7 | Smart Touch Learning's Accounts After Posting Journal Entries in November and December

Assets				Liabilities				Equity			
Cash				Accounts Payable				Bright, Capital			
Nov. 1	30,000	20,000	Nov. 2	Nov. 21	300	500	Nov. 3		30,000	Nov. 1	
Nov. 8	5,500	3,200	Nov. 15			200	Bal.		18,000	Dec. 2	
Nov. 22	2,000	300	Nov. 21	Utilities Payable					48,000	Bal.	
Dec. 21	600	5,000	Nov. 25			100	Dec. 15				
Dec. 28	8,000	3,000	Dec. 1			100	Bal.				
		1,200	Dec. 1	Unearned Revenue							
		1,200	Dec. 15			600	Dec. 21				
Bal.	12,200					600	Bal.				
Accounts Receivable				Notes Payable				Bright, Withdrawals			
Nov. 10	3,000	2,000	Nov. 22			60,000	Dec. 1	Nov. 25	5,000		
Bal.	1,000					60,000	Bal.	Bal.	5,000		
Office Supplies											
Nov. 3	500			Service Revenue				Rent Expense			
Bal.	500								5,500	Nov. 8	
Prepaid Rent											
Dec. 1	3,000										
Bal.	3,000										
Furniture											
Dec. 2	18,000										
Bal.	18,000										
Building											
Dec. 1	60,000										
Bal.	60,000										
Land											
Nov. 2	20,000										
Bal.	20,000										

Exhibit 2-8 | T-Account Versus Four-Column Account

Cash			
Nov. 1	30,000	20,000	Nov. 2
Nov. 8	5,500	3,200	Nov. 15
Nov. 22	2,000	300	Nov. 21
Dec. 21	600	5,000	Nov. 25
Dec. 28	8,000	3,000	Dec. 1
		1,200	Dec. 1
		1,200	Dec. 15
Bal.	12,200		

The Debit or Credit for each transaction.

The balance of the account after each transaction.

CASH					Account No. 101	
Date	Item	Post Ref.	Debit	Credit	Balance	
					Debit	Credit
2014						
Nov. 1		J1	30,000		30,000	
Nov. 2		J1		20,000	10,000	
Nov. 8		J1	5,500		15,500	
Nov. 15		J1		3,200	12,300	
Nov. 21		J1		300	12,000	
Nov. 22		J1	2,000		14,000	
Nov. 25		J1		5,000	9,000	
Dec. 1		J2		3,000	6,000	
Dec. 1		J2		1,200	4,800	
Dec. 15		J2		1,200	3,600	
Dec. 21		J2	600		4,200	
Dec. 28		J2	8,000		12,200	

Exhibit 2-9 | Posting References

The page number from the journal. → Page 1

Date	Accounts and Explanation	Post. Ref.	Debit	Credit
Nov. 1	Cash	101	30,000	
	Bright, Capital	301		30,000
	Owner contribution.			

The account number from the ledger.

CASH

Date	Item	Post. Ref.	Debit	Credit	Balance	
					Debit	Credit
2014						
Nov. 1		J1	30,000		30,000	

Account No. 101

BRIGHT, CAPITAL

Date	Item	Post. Ref.	Debit	Credit	Balance	
					Debit	Credit
2014						
Nov. 1		J1		30,000		30,000

Account No. 301

> Try It!

21. EMB Consulting Services had the following transactions for the month of November. Journalize the transactions and include an explanation with each entry.

Nov. 1	The business received \$10,000 cash and gave capital to Eloise Martinez, the owner.
15	Purchased office supplies on account, \$400.
18	Paid advertising bill, \$150.
20	Received \$1,000 from customers for services rendered.
28	Martinez withdrew \$500 from the business.

Date	Accounts and Explanation	Debit	Credit
Nov. 1	Cash	10,000	
	Martinez, Capital		10,000
	<i>Owner contribution.</i>		
15	Office Supplies	400	
	Accounts Payable		400
	<i>Purchased office supplies on account.</i>		
18	Advertising Expense	150	
	Cash		150
	<i>Paid advertising expense.</i>		
20	Cash	1,000	
	Service Revenue		1,000
	<i>Performed services and received cash.</i>		
28	Martinez, Withdrawals	500	
	Cash		500
	<i>Owner withdrawal.</i>		

4

Prepare the trial balance and illustrate how to use the trial balance to prepare financial statements

What is The Trial Balance?

After the transactions are recorded in the journal and then posted to the ledger, a **trial balance** can be prepared. The trial balance summarizes the ledger by listing all the accounts with their balances—**assets first, followed by liabilities, and then equity**. trial balance is a useful summary of the accounts and their balances because it shows the balances on a specific date for all accounts in a company's accounting system. Exhibit 2-10 is the trial balance of Smart Touch Learning at December 31, 2014.

Trial Balance

A list of all ledger accounts with their balances at a point in time.

Exhibit 2-10 | Trial Balance

SMART TOUCH LEARNING
Trial Balance
December 31, 2014

Account Title	Balance	
	Debit	Credit
Cash	\$ 12,200	
Accounts Receivable	1,000	
Office Supplies	500	
Prepaid Rent	3,000	
Furniture	18,000	
Building	60,000	
Land	20,000	
Accounts Payable		\$ 200
Utilities Payable		100
Unearned Revenue		600
Notes Payable		60,000
Bright, Capital		48,000
Bright, Withdrawals	5,000	
Service Revenue		16,500
Rent Expense	2,000	
Salaries Expense	3,600	
Utilities Expense	100	
Total	\$ 125,400	\$ 125,400

The trial balance and the balance sheet are not the same. Make sure you understand the differences between these two documents. A trial balance verifies the equality of debits and credits and is an internal document used only by employees of the company. The balance sheet, on the other hand, presents the business's accounting equation and is a financial statement that can be used by both internal and external users.

Exhibit 2-11 | Smart Touch Learning's Financial Statements

SMART TOUCH LEARNING Income Statement Two Months Ended December 31, 2014	
Revenues:	
Service Revenue	\$ 16,500
Expenses:	
Salaries Expense	\$ 3,600
Rent Expense	2,000
Utilities Expense	100
Total Expenses	5,700
Net Income	\$ 10,800

SMART TOUCH LEARNING Statement of Owner's Equity Two Months Ended December 31, 2014	
Bright, Capital, November 1, 2014	\$ 0
Owner contribution	48,000
Net income for the two months	10,800
	58,800
Owner withdrawal	(5,000)
Bright, Capital, December 31, 2014	\$ 53,800

SMART TOUCH LEARNING Balance Sheet December 31, 2014			
Assets		Liabilities	
Cash	\$ 12,200	Accounts Payable	\$ 200
Accounts Receivable	1,000	Utilities Payable	100
Office Supplies	500	Unearned Revenue	600
Prepaid Rent	3,000	Notes Payable	60,000
Furniture	18,000	Total Liabilities	60,900
Building	60,000	Owner's Equity	
Land	20,000	Bright, Capital	53,800
Total Assets	\$ 114,700	Total Liabilities and Owner's Equity	\$ 114,700

> Try It!

22. Using the following accounts and their balances, prepare the trial balance for Cooper Furniture Repair as of December 31, 2015.

Cash	\$ 7,000	Advertising Expense	\$ 1,200
Unearned Revenue	4,500	Utilities Expense	800
Equipment	10,000	Rent Expense	5,000
Service Revenue	8,000	Accounts Payable	2,300
Miller, Capital	12,200	Miller, Withdrawals	3,000

COOPER FURNITURE REPAIR
Trial Balance
December 31, 2015

Account Title	Balance	
	Debit	Credit
Cash	\$ 7,000	
Equipment	10,000	
Accounts Payable		\$ 2,300
Unearned Revenue		4,500
Miller, Capital		12,200
Miller, Withdrawals	3,000	
Service Revenue		8,000
Rent Expense	5,000	
Advertising Expense	1,200	
Utilities Expense	800	
Total	<u>\$ 27,000</u>	<u>\$ 27,000</u>



Use the debt ratio to evaluate business performance

How DO you use The DEBT Ratio to Evaluate Business Performance?

Previously you learned that evaluating a company's return on assets (Net income / Average total assets) can help in determining how well a company is performing. In this chapter, you learn about another tool that can be used when reviewing financial statements. The **debt ratio** shows the proportion of assets financed with debt and is calculated by dividing total liabilities by total assets. It can be used to evaluate a business's ability to pay its debts.

$$\text{Debt ratio} = \text{Total liabilities} / \text{Total assets}$$

Debt Ratio

Shows the proportion of assets financed with debt. $\text{Total liabilities} / \text{Total assets}$.

Let's look at **Green Mountain Coffee Roasters, Inc.** and evaluate its ability to pay its debts. On its 2011 balance sheet (located in Appendix A), Green Mountain reported (in thousands) total liabilities of \$1,285,672 (\$471,374 + \$575,969 + \$189,637 + \$27,184 + \$474 + \$21,034) and total assets of \$3,197,887. The debt ratio for Green Mountain as of September 24, 2011 follows:

$$\begin{aligned}\text{Debt ratio} &= \text{Total liabilities} / \text{Total assets} \\ &= \$1,285,672 / \$3,197,887 = 0.40 = 40.0\%\end{aligned}$$

A debt ratio of 40.0% means that a little less than half the assets of Green Mountain are financed with debt. The other 60.0% (100% – 40.0%) are financed by investors of the corporation. What is an acceptable debt ratio depends on the industry average. The coffee and tea manufacturing industry typically has an average debt ratio of around 41.2%. Green Mountain's debt ratio is slightly lower than the industry average. The debt ratio indicates the risk of a company. The higher the debt ratio, the higher the risk. All liabilities must eventually be paid, and the debt ratio is one indication of the ability of the company to fulfill these obligations.

> Try It!

23. Using the following accounts and their balances, calculate the debt ratio for Cooper Furniture Repair as of December 31, 2015.

Cash	\$ 7,000	Advertising Expense	\$ 1,200
Unearned Revenue	4,500	Utilities Expense	800
Equipment	10,000	Rent Expense	5,000
Service Revenue	8,000	Accounts Payable	2,300
Miller, Capital	12,200	Miller, Withdrawals	3,000

> Try It!

23. Using the following accounts and their balances, calculate the debt ratio for Cooper Furniture Repair as of December 31, 2015.

Cash	\$ 7,000	Advertising Expense	\$ 1,200
Unearned Revenue	4,500	Utilities Expense	800
Equipment	10,000	Rent Expense	5,000
Service Revenue	8,000	Accounts Payable	2,300
Miller, Capital	12,200	Miller, Withdrawals	3,000

$$\text{Total assets} = \$7,000 + \$10,000 = \$17,000$$

$$\text{Total liabilities} = \$2,300 + \$4,500 = \$6,800$$

$$\text{Debt ratio} = \text{Total liabilities} / \text{Total assets} = \$6,800 / \$17,000 = 0.40 = 40\%$$

The trial balance of Harper Service Center as of February 28, 2015 follows:

> Summary Problem

HARPER SERVICE CENTER Trial Balance February 28, 2015		
Balance		
Account Title	Debit	Credit
Cash	\$ 26,000	
Accounts Receivable	4,500	
Office Supplies	0	
Land	0	
Accounts Payable		\$ 2,000
Utilities Payable		0
Unearned Revenue		0
Notes Payable		0
Harper, Capital		28,500
Harper, Withdrawals	0	
Service Revenue		0
Salaries Expense	0	
Rent Expense	0	
Interest Expense	0	
Utilities Expense	0	
Total	<u>\$ 30,500</u>	<u>\$ 30,500</u>

During March, the business engaged in the following transactions:

Mar. 2	Borrowed \$45,000 from the bank and signed a note payable in the name of the business.
4	Paid cash of \$40,000 to acquire land.
9	Performed services for a customer and received cash of \$5,000.
13	Purchased office supplies on account, \$300.
15	Performed services for a customer on account, \$2,600.
18	Paid \$1,200 on account.
21	Paid the following cash expenses: salaries, \$3,000; rent, \$1,500; and interest, \$400.
25	Received \$3,100 from customer on account.
27	Received a \$200 utility bill that will be paid next month.
29	Received \$1,500 for services to be performed next month.
30	Harper withdrew cash of \$1,800.

Requirements

1. Open the accounts listed in the trial balance using the balances indicated. Use the T-account format.
2. Journalize each transaction including explanations.
3. Post the journal entries to the ledger (use T-account format).
4. Prepare the trial balance of Harper Service Center as of March 31, 2015.

> Solution

Requirement 1

Assets		=	Liabilities		+	Equity										
Cash		=	Accounts Payable		+	Harper, Capital		-	Harper, Withdrawals		+	Service Revenue		-	Salaries Expense	
Bal.	26,000			2,000	Bal.		28,500	Bal.		0			0	Bal.		0
Accounts Receivable			Utilities Payable												Rent Expense	
Bal.	4,500			0	Bal.										Bal.	0
Office Supplies			Unearned Revenue												Interest Expense	
Bal.	0			0	Bal.										Bal.	0
Land			Notes Payable												Utilities Expense	
Bal.	0			0	Bal.										Bal.	0

Requirement 2

Date	Accounts and Explanation	Debit	Credit
Mar. 2	Cash	45,000	
	Notes Payable		45,000
	<i>Borrowed cash on notes payable.</i>		
4	Land	40,000	
	Cash		40,000
	<i>Purchased land with cash.</i>		
9	Cash	5,000	
	Service Revenue		5,000
	<i>Performed services and received cash.</i>		
13	Office Supplies	300	
	Accounts Payable		300
	<i>Purchased office supplies on account.</i>		
15	Accounts Receivable	2,600	
	Service Revenue		2,600
	<i>Performed services on account.</i>		
18	Accounts Payable	1,200	
	Cash		1,200
	<i>Paid cash on account.</i>		

21	Salaries Expense	3,000	
	Rent Expense	1,500	
	Interest Expense	400	
	Cash		4,900
	<i>Paid cash expenses.</i>		
25	Cash	3,100	
	Accounts Receivable		3,100
	<i>Received cash on account.</i>		
27	Utilities Expense	200	
	Utilities Payable		200
	<i>Received utility bill.</i>		
29	Cash	1,500	
	Unearned Revenue		1,500
	<i>Collected cash for future services.</i>		
30	Harper, Withdrawals	1,800	
	Cash		1,800
	<i>Owner withdrawal.</i>		

Assets				Liabilities				Equity									
Cash				Accounts Payable				Harper, Capital		Harper, Withdrawals		Service Revenue		Salaries Expense			
Bal.	26,000	40,000	Mar. 4	Mar. 18	1,200	2,000	Bal.		28,500	Bal.	Bal.	0		Bal.	Bal.	0	
Mar. 2	45,000	1,200	Mar. 18			300	Mar. 13		28,500	Bal.	Mar. 30	1,800		5,000	Mar. 9	Mar. 21	3,000
Mar. 9	5,000	4,900	Mar. 21								Bal.	1,800		2,600	Mar. 15	Bal.	3,000
Mar. 25	3,100	1,800	Mar. 30			1,100	Bal.							7,600	Bal.		
Mar. 29	1,500																
Bal.	32,700																
Accounts Receivable				Utilities Payable												Rent Expense	
Bal.	4,500	3,100	Mar. 25			0	Bal.								Bal.	0	
Mar. 15	2,600					200	Mar. 27								Mar. 21	1,500	
Bal.	4,000					200	Bal.								Bal.	1,500	
Office Supplies				Unearned Revenue												Interest Expense	
Bal.	0					0	Bal.								Bal.	0	
Mar. 13	300					1,500	Mar. 29								Mar. 21	400	
Bal.	300					1,500	Bal.								Bal.	400	
Land				Notes Payable												Utilities Expense	
Bal.	0					0	Bal.								Bal.	0	
Mar. 4	40,000					45,000	Mar. 2								Mar. 27	200	
Bal.	40,000					45,000	Bal.								Bal.	200	

Requirement 4

HARPER SERVICE CENTER

Trial Balance
March 31, 2015

Balance

Account Title	Debit	Credit
Cash	\$ 32,700	
Accounts Receivable	4,000	
Office Supplies	300	
Land	40,000	
Accounts Payable		\$ 1,100
Utilities Payable		200
Unearned Revenue		1,500
Notes Payable		45,000
Harper, Capital		28,500
Harper, Withdrawals	1,800	
Service Revenue		7,600
Salaries Expense	3,000	
Rent Expense	1,500	
Interest Expense	400	
Utilities Expense	200	
Total	<u>\$ 83,900</u>	<u>\$ 83,900</u>

S2-1 Identifying accounts

Consider the following accounts and identify each account as an asset (A), liability (L), or equity (E).

- | | |
|----------------------|---------------------|
| a. Notes Receivable | f. Taxes Payable |
| b. Common Stock | g. Rent Expense |
| c. Prepaid Insurance | h. Furniture |
| d. Notes Payable | i. Dividends |
| e. Rent Revenue | j. Unearned Revenue |

S2-1

- | | |
|--------------------------|-------------------------|
| a. Notes Receivable (A) | f. Taxes Payable (L) |
| b. Common Stock (E) | g. Rent Expense (E) |
| c. Prepaid Insurance (A) | h. Furniture (A) |
| d. Notes Payable (L) | i. Dividends (E) |
| e. Rent Revenue (E) | j. Unearned Revenue (L) |

10. The proportion of assets financed with debt is shown by the

- a. current ratio.
- b. return on assets.
- c. debt ratio.
- d. return on equity.

10. c

Demonstration of E2-16 & E2-17

The following transactions occurred for Mission Cable Services.

-
- July 2 Received \$20,000 contribution from Thomas in exchange for Common Stock
 - 4 Paid utilities expense of \$800.
 - 5 Purchased equipment on account, \$4,200.
 - 10 Performed services for a client on account, \$4,000.
 - 12 Borrowed \$14,000 cash, signing a notes payable.
 - 19 Cash dividends of \$1,000 were paid to stockholders.
 - 21 Purchased office supplies for \$1,600 and paid cash.
 - 27 Paid the liability from July 5.
-

- E2-16. Journalize the transactions of Mission Cable Services. Include an explanation.
- E2-17.
 - 1. Open T-accounts for Mission Cable Services.
 - 2. Compute the July 31 balance for each account.

Demonstration of E2-16 & E2-17-Req. 1

July 2 Received \$20,000 contribution from Thomas in exchange for common stock.

Date	Accounts and Explanation	Debit	Credit
Jul. 2	Cash	20,000	
	Common Stock		20,000
	<i>Issued common stock in exchange for cash.</i>		

Cash		Common Stock	
Jul. 2	20,000	20,000	Jul. 2

Demonstration of E2-16 & E2-17-Req. 1

July 4 Paid utilities expense of \$800.

Date	Accounts and Explanation	Debit	Credit
Jul. 4	Utilities Expense	800	
	Cash		800
	<i>Paid utility expense.</i>		

Cash			Utilities Expense		
Jul. 2	20,000		Jul. 4	800	
		800			

Demonstration of E2-16 & E2-17-Req. 1

July 5 Purchased equipment on account, \$4,200.

Date	Accounts and Explanation	Debit	Credit
Jul. 5	Equipment	4,200	
	Accounts Payable		4,200
	<i>Purchased equipment on account.</i>		

Equipment		Accounts Payable	
Jul. 5	4,200	4,200	Jul. 5

Demonstration of E2-16 & E2-17-Req. 1

July 10 Performed services for a client on account, \$4,000.

Date	Accounts and Explanation	Debit	Credit
Jul. 10	Accounts Receivable	4,000	
	Service Revenue		4,000
	<i>Performed services for client on account.</i>		

Accounts Receivable		Service Revenue	
Jul. 10	4,000	4,000	Jul. 10

July 12 Borrowed \$14,000 cash, signing a notes payable.

Date	Accounts and Explanation	Debit	Credit
Jul. 12	Cash	14,000	
	Notes Payable		14,000
	<i>Borrowed cash by signing note.</i>		

Cash		Notes Payable	
Jul. 2	20,000		
		800	Jul. 4
12	14,000		
			14,000 Jul. 12

Demonstration of E2-16 & E2-17-Req. 1

July 19 Cash dividends of \$1,000 were paid to stockholders.

Date	Accounts and Explanation	Debit	Credit
Jul. 19	Dividends	1,000	
	Cash		1,000
	<i>Paid cash dividends.</i>		

Cash				Dividends	
Jul. 2	20,000	800	Jul. 4	Jul. 19	1,000
12	14,000	1,000	19		

Demonstration of E2-16 & E2-17-Req. 1

July 21 Purchased office supplies for \$1,600 and paid cash.

Date	Accounts and Explanation	Debit	Credit
Jul. 21	Office Supplies	1,600	
	Cash		1,600
	<i>Purchased office supplies with cash.</i>		

Cash				Office Supplies			
Jul. 2	20,000	800	Jul. 4	Jul. 21	1,600		
12	14,000	1,000	19				
		1,600	21				

Demonstration of E2-16 & E2-17-Req. 1

July 27 Paid the liability from July 5.

Date	Accounts and Explanation	Debit	Credit
Jul. 21	Accounts Payable	4,200	
	Cash		4,200
	<i>Paid cash on account.</i>		

Cash				Accounts Payable			
Jul. 2	20,000	800	Jul. 4	Jul. 27	4,200	4,200	Jul. 5
12	14,000	1,000	19				
		1,600	21				
		4,200	27				

Demonstration of E2-17-Req. 2

Cash

Jul. 2	20,000	800	Jul. 4
12	14,000	1,000	19
		1,600	21
		4,200	27
Bal.	26,400		

Accounts Receivable

Jul. 10	4,000	
Bal.	4,000	

Office Supplies

Jul. 21	1,600	
Bal.	1,600	

Equipment

Jul. 5	4,200	
Bal.	4,200	

Demonstration of E2-17-Req. 2

Accounts Payable

Jul. 27	4,200	4,200	Jul. 5
		0	Bal.

Notes Payable

	14,000	Jul.12
	14,000	Bal.

Common Stock

	20,000	Jul. 2
	20,000	Bal.

Dividends

Jul. 19	1,000
Bal.	1,000

Demonstration of E2-17-Req. 2

Service Revenue		Utilities Expense	
	4,000 Jul.10	Jul. 4 800	
	4,000 Bal.	Bal. 800	



Thank You