Chapter 2

Analyzing Transactions

Study Guide Solutions

Fill-in-the-Blank Equations

1. Credit
2. Debit
3. Debit
4. Credit
5. Debit
6. Credit
7. Owner’s drawing account

Exercises

1. Determine which type of account is being described in each of the following definitions.
    a. Assets
    b. Owner’s equity
    c. Revenues
    d. Liabilities
    e. Expenses
2. Determine whether each of the following accounts is an asset, liability, revenue, expense, or owner’s equity account.
    a. Asset
    b. Expense
    c. Liability
    d. Revenue
    e. Owner’s equity

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3. Would each of the following accounts be an example of an asset, liability, revenue, expense, or owner's equity account?

a. Liability

b. Expense

c. Owner's equity

d. Asset

e. Revenue

Strategy: *Assets are resources of the company that are financed with the liabilities or owner's equity. Revenues are produced by incurring expenses for the company.*

4. Would the following accounts be found in a balance sheet or income statement?

a. Balance sheet

b. Income statement

c. Balance sheet

5. Which financial statements would include the following accounts?

a. Balance sheet

b. Income statement

c. Income statement

6. Which financial statements would include the following accounts?

a. Balance sheet

b. Balance sheet

c. Income statement

Strategy: *The balance sheet shows everything that is owned or owed to produce the income and expenses incurred that are shown on the income statement.*

7. What is the effect of a debit and credit (increase or decrease) on the following account balances?

a. Debit increases, credit decreases

b. Debit decreases, credit increases

c. Debit increases, credit decreases

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8. Would a debit or credit increase the following account balances?

a. Credit

b. Debit

c. Credit

9. Would a debit and credit increase or decrease the following account balances?

a. Debit increases, credit decreases

b. Credit increases, only credits to the account, unless closing

c. Debit decreases, credit increases

Strategy: *Balance sheet accounts can be both debited and credited, while income statement accounts can only be debited or credited. The normal balance of the account determines how the account will be increased (the normal balance of an asset account is a debt, so debiting an asset account will increase the balance).*

10. Is the normal balance a debit or credit for the following accounts?

a. Debit

b. Credit

c. Credit

11. Do the following accounts have a normal debit or credit balance?

a. Credit

b. Debit

c. Credit

12. Would the following accounts have a normal debit or credit balance?

a. Debit

b. Credit

c. Debit

Strategy: *Since assets must equal liabilities and owner's equity combined, the normal balances will be opposite. Assets require a debit balance, so liabilities and owner's equity will have a credit balance. Revenues will increase owner's equity, so to show the increase the normal balance will also be a credit, while expenses will have a debit balance, as they decrease owner's equity.*

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13. Prepare the journal entry to record payment in cash of salaries for $750, rent for $675, utilities for $250, and legal expenses for $130 on January 15, 20Y5.

Jan. 15	Salaries Expense	750	
	Rent Expense	675	
	Utilities Expense	250	
	Legal Expense	130	
	Cash		1,805
	Expenses paid.		

14. Record the journal entry to record the purchase of inventory on account for $1,200 on September 22, 20Y5.

Sept. 22	Inventory	1,200	
	Accounts Payable		1,200
	Purchased inventory on account.		

15. What would the journal entry look like for rental revenue earned on August 9, 20Y5, for $890 that the customers paid for on account?

Aug. 9	Accounts Receivable	890	
	Rental Revenue		890
	Rental revenue earned.		

Strategy: *First, determine which accounts are affected. Next, consider the effect of the transaction on the accounts (increasing or decreasing) and how to show the effect (will the account be debited or credited).*

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16. Post the journal entry from Exercise 13 to the related accounts.

Account: Salaries Expense					
Date	*Item*	*Dr.*	*Cr.*	*Balance: Dr.*	*Balance: Cr.*
Jan. 15	Expense paid	750		750	

Account: Rent Expense					
Date	*Item*	*Dr.*	*Cr.*	*Balance: Dr.*	*Balance: Cr.*
Jan. 15	Expense paid	675		675	

Account: Utilities Expense					
Date	*Item*	*Dr.*	*Cr.*	*Balance: Dr.*	*Balance: Cr.*
Jan. 15	Expense paid	250		250	

Account: Legal Expense					
Date	*Item*	*Dr.*	*Cr.*	*Balance: Dr.*	*Balance: Cr.*
Jan. 15	Expense paid	130		130	

Account: Cash					
Date	*Item*	*Dr.*	*Cr.*	*Balance: Dr.*	*Balance: Cr.*
Jan. 15	Expenses paid		1,805		1,805

17. Show how the journal entry from Exercise 14 would be posted to the related accounts.

Account: Inventory					
Date	*Item*	*Dr.*	*Cr.*	*Balance: Dr.*	*Balance: Cr.*
Sept. 22	Inventory purchased	1,200		1,200	

Account: Accounts Payable					
Date	*Item*	*Dr.*	*Cr.*	*Balance: Dr.*	*Balance: Cr.*
Sept. 22	Inventory purchased		1,200		1,200

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18. Post the journal entry from Exercise 15 to the related accounts.

Account: Accounts Receivable					
Date	*Item*	*Dr.*	*Cr.*	*Balance: Dr.*	*Balance: Cr.*
Aug. 9	Earned revenue	890		890	

Account: Rental Revenue					
Date	*Item*	*Dr.*	*Cr.*	*Balance: Dr.*	*Balance: Cr.*
Aug. 9	Earned revenue		890		890

Strategy: *Each journal entry will have at least two accounts to post amounts. After posting the amount for the transaction, determine the effect on the balance.*

19. At the beginning of the year, Duck Co.'s Accounts Payable had a credit balance of $1,300. The company made purchases of $1,700 on account. If the ending balance was a credit of $600, what were the cash payments to suppliers?

The company made cash payments of $2,400 ($1,300 + $1,700 – x = $600) to suppliers.

Accounts Payable	
	1,300
	1,700
??	
	600

20. During the year, Keowee Corp. sold $1,550 of inventory. The company's beginning inventory was $1,200, and the ending inventory was $740. How much inventory did the company purchase during the year?

The company purchased $1,090 in inventory ($1,200 + x – $1,550 = $740).

Inventory	
1,200	
??	
	1,550
740	

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21. Pepin Co. had an ending balance of $1,900 for Equipment. The company purchased $2,300 of equipment and retired $750 of equipment during the year. What was the beginning balance of the account?

The beginning balance in Equipment was $350 (x + $2,300 – $750 = $1,900).

Equipment	
??	
2,300	
	750
1,900	

Strategy: *The ending balance of an account can be found by combining the beginning balance with increases and subtracting decreases. For example, if the account is an asset, the balance will be a debit, additional debits will increase the balance, and credits will decrease the balance. If an item is unknown, a formula can be created to find the missing amount.*

22. Given the following account balances, prepare an unadjusted trial balance for Bakeshop Corp. as of December 31, 20Y5.

- Income Taxes Payable, credit balance $1,200
- Sales Revenue, credit balance $8,750
- PP&E, debit balance $7,500
- Cost of Sales, debit balance $5,500
- Accounts Payable, credit balance $1,240
- Interest Revenue, credit balance $1,500
- Cash, debit balance $2,000
- Rental Expense, debit balance $3,550
- Kim Akinson, Capital, credit balance $2,460
- Long-Term Debt, credit balance $7,400
- Accounts Receivable, debit balance $1,500
- Salaries Expense, debit balance $1,200
- Inventory, debit balance $1,300

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Bakeshop Corp.
Unadjusted Trial Balance
December 31, 20Y5

	Debit Balances	Credit Balances
Cash	2,000	
Accounts Receivable	1,500	
Inventory	1,300	
PP&E	7,500	
Accounts Payable		1,240
Income Taxes Payable		1,200
Long-Term Debt		7,400
Kim Akinson, Capital		2,460
Sales Revenue		8,750
Interest Revenue		1,500
Cost of Sales	5,500	
Rental Expense	3,550	
Salaries Expense	1,200	
	22,550	22,550

23. Fill in the missing items for the following unadjusted trial balance for Ferris Co. as of September 30, 20Y5.

Ferris Co.
Unadjusted Trial Balance
September 30, 20Y5

	Debit Balances	Credit Balances
Cash	1,600	
Accounts Receivable	1,300	
Inventory	**2,400**	
PP&E	8,750	
Accounts Payable		5,050
Short-Term Loans		2,300
Notes Payable		1,700
Allie Cobb, Capital		5,000
Sales		10,000
Rental Revenue		6,800
Cost of Sales	8,000	
Rental Expense	4,500	
Wages Expense	2,300	
Utilities Expense	2,000	
	30,850	**30,850**

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24. Create Red Road Co.'s unadjusted trial balance for March 31, 20Y5, given the following balances (assume all accounts have a normal balance):

- Property, Plant, and Equipment, $15,500
- Wages Expense, $8,750
- Rental Revenue, $3,500
- Unearned Revenue, $4,270
- Noah Gosling, Capital, $6,500
- Accounts Payable, $3,280
- Prepaid Expenses, $1,200
- Notes Payable, $3,950
- Fees Earned, $12,500
- Cash, $2,250
- Wages Payable, $4,150
- Rental Expense, $7,250
- Accounts Receivable, $3,200

Red Road Co.
Unadjusted Trial Balance
March 31, 20Y5

	Debit Balances	Credit Balances
Cash	2,250	
Accounts Receivable	3,200	
Prepaid Expenses	1,200	
PP&E	15,500	
Accounts Payable		3,280
Unearned Revenue		4,270
Wages Payable		4,150
Notes Payable		3,950
Noah Gosling, Capital		6,500
Fees Earned		12,500
Rental Revenue		3,500
Rental Expense	7,250	
Wages Expense	8,750	
	38,150	**38,150**

Strategy: *First, separate the balance sheet accounts from the income statement accounts. Next, list the balance sheet accounts, starting with assets, then liabilities, and owner's equity, as in a balance sheet. After the balance sheet accounts, the income statement accounts are listed, starting with revenues, just like an income statement.*

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25. Determine the dollar effect, if any, of the following errors on the unadjusted trial balance.

a. No effect; the debits will still equal the credits.

b. The debits will be higher than the credits by $900.

c. The credits will be higher than the debits by $1,845.

26. Will the following errors cause debits or credits to be higher on the unadjusted trial balance? If so, by how much?

a. The debits will be higher by $24,000.

b. The unadjusted trial balance will be equal since debits still equal credits.

c. The debits will be higher by $4,050.

27. What is the dollar effect on the company's unadjusted trial balance from the following errors?

a. Debits will be higher by $3,600.

b. Credits will be higher by $50.

c. Debits will be higher by $270.

Strategy: *Unequal debits and credits in a journal entry will cause the unadjusted trial balance to be unbalanced. The effect from the journal entry (debits or credits are higher) will have the same effect on the unadjusted trial balance.*

28. Prepare the journal entry to correct an error for a journal entry showing a debit to Inventory and a credit to Accounts Payable for $1,400. The company actually paid for the purchase with cash.

Accounts Payable	1,400	
Cash		1,400

29. When recording the journal entry for the purchase of new equipment for $5,500, the accountant made a debit to Land for $5,500.

Land	5,500	
Equipment		5,500

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30. To record new long-term debt for $2,750, the company's accountant credited Accounts Payable instead.

Accounts Payable	2,750	
Long-Term Debt		2,750

Strategy: *First, determine the effect of the error and how the journal entry should have been recorded. If the error increased an account, the opposite should occur to reverse the error. The correct account should be debited or credited accordingly in the correcting journal entry.*

31. Perform a horizontal analysis of the income statement below, showing changes in dollars and percentages (rounded to the nearest whole percentage). Determine if changes are favorable or unfavorable.

Jeffy's Bike Store
Income Statements
For the Years Ended September 30

			Increase (Decrease)		
	Year 2	Year 1	Amount	Percent	Favorable?
Rental revenue	$100,000	$92,000	$8,000	9%	Yes
Operating expenses:					
Rent expense	$ 12,000	$11,500	$ 500	4	No
Interest expense	1,500	1,600	(100)	(6)	Yes
Utilities expense	3,200	2,660	540	20	No
Wages expense	5,500	5,000	500	10	No
Total operating expenses	$ 22,200	$20,760	$1,440	7	No
Net income	$ 77,800	$71,240	$6,560	9	Yes

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32. Identify favorable and unfavorable trends from the income statements below by performing a horizontal analysis. Show changes in amounts and percentages (rounded to the nearest whole percentage).

Wheeler & Fetch, CPA
Income Statements
For the Years Ended June 30

			Increase (Decrease)		
	Year 2	Year 1	Amount	Percent	Favorable?
Fees earned	$185,000	$179,500	$ 5,500	3%	Yes
Operating expenses:					
Rent expense	$ 15,000	$ 13,400	$ 1,600	12	No
Salaries expense	25,000	19,500	5,500	28	No
Utilities expense	6,700	6,500	200	3	No
Supplies expense	9,000	9,700	(700)	(7)	Yes
Total operating expenses	$ 55,700	$ 49,100	$ 6,600	13	No
Net income	$129,300	$130,400	$(1,100)	(1)	No

33. By performing a horizontal analysis on the following income statements, identify favorable and unfavorable trends. Show changes in amounts and percentages (rounded to the nearest whole percentage).

Mig's Market
Income Statements
For the Years Ended October 31

			Increase (Decrease)		
	Year 2	Year 1	Amount	Percent	Favorable?
Sales	$79,000	$68,500	$10,500	15%	Yes
Cost of sales	$17,550	$15,750	$ 1,800	11	No
Operating expenses:					
Rent expense	$13,200	$12,000	$ 1,200	10	No
Salaries expense	11,500	13,000	(1,500)	(12)	Yes
Utilities expense	4,200	3,600	600	17	No
Legal expense	10,000	13,200	(3,200)	(24)	Yes
Total operating expenses	$38,900	$41,800	$ (2,900)	(7)	Yes
Net income	$22,550	$10,950	$11,600	105	Yes

***Strategy:** Favorable trends help to increase net income by increasing revenues or decreasing expenses. Unfavorable trends cause net income to be lower due to decreasing revenues or increasing expenses.*

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