

CHAPTER 2

Analyzing Business Transactions

PLANNING MATRIX

| | Learning Objective | | Building Your Basic Knowledge and Skills | | Enhancing Your Knowledge, Skills, and Critical Thinking |
|-------------------------------|--|--------------|--|-----------------------|---|
| 1. | Explain how the concepts of recognition, valuation, and classification apply to business transactions and why they are important factors in ethical financial reporting. | SE 1, 2, 3 | E 1, 3, 4 | P 4, 7 | C 1 C 5 C 7 C 8 C 9 C 10 |
| 2. | Explain the double-entry system and the usefulness of T accounts in analyzing business transactions. | SE 4 | E 1, 5, 6 | P 1, 6 | C 3 |
| 3. | Demonstrate how the double-entry system is applied to common business transactions. | SE 2, 5, 6 | E 1, 7, 8, 9, 11, 17 | P 2, 3, 4, 5, 7, 8 | C 1 C 2 C 3 C 9 |
| 4. | Prepare a trial balance, and describe its value and limitations. | SE 7 | E 2, 10, 12, 13, 14 | P 3, 4, 5, 7, 8 | |
| 5. | Show how the timing of transactions affects cash flows and liquidity. | SE 8 | E 2, 15 | P 3, 5, 8 | C 4 |
| Supplemental Objective | | | | | |
| 6. | Define the <i>chart of accounts</i> , record transactions in the general journal, and post transactions to the ledger. | SE 9, 10, 11 | E 16, 17, 18 | P 5, 8 | |

MEMORANDA:

SE: Short Exercises

E: Exercises

P: Problems (Each problem has a User Insight question.)

C: Cases

All questions are in the text with related Learning Objectives (Stop, Think, and Apply).

SUGGESTED INSTRUCTIONAL STRATEGY

Output Skills Developed:

Technical

Related Learning Objectives:

2, 5

Instructional Strategy

Learning activity: Game, team tasks

Learning environment: Interactive groups within the classroom

Learning tool: Textbook assignment Exercise 6

Steps to Implement

1. Use a *Jeopardy* game format to reinforce student comprehension of account classifications and normal balances. At least one class prior to the game, let students know about the game and the learning objectives to be covered.
2. Students could form their own teams between classes. Specify team size. (Three is recommended.) Remind teams that they must sit together in class. The first group member to class picks team seats, which have been labeled by the instructor with tags showing large-print numbers. Students wear tags during the game to make scoring easier.
3. Using information from the exercise (and elsewhere), prepare a list of account items, such as “accounts payable classification” or “inventory normal balance.” Responses could be in *Jeopardy* form, such as “What is a liability?” or “What has a normal debit balance?” Particularly tough questions could be identified as Double Jeopardy items worth double points—for example, having to answer both account classification and normal balance within the time limit.
4. As a preliminary round, each student participates by writing his or her own answers on a piece of paper. Each individual score is treated as part of a team grade. Each team member answers several items on a sheet of paper. It must be legible because another team will grade it. If it can’t be read, it is counted as incorrect. As the instructor calls out the account, each group member writes the classification and/or normal balance. If you want to make it tougher, make the time limit to answer ten seconds or less. A stopwatch is helpful.
5. To determine who moves on to the final round, have Team 1 give its answer sheet to Team 2, Team 2 to Team 3, etc., until the last team gives its answer sheet to Team 1. Each correct answer wins one point. Double Jeopardy answers are worth two points.
6. The teams with the highest scores for round one move on to the final round. Assign a team name or keep the same number. Tags with the group number should be easily visible from the scorer’s viewpoint. Ask one or two trusted students to keep score.
7. Final round format is the instructor asking one team at a time a different question to be answered within five seconds. A limited use of recycled questions is OK as long as the same team does not get the same question. This process continues for a stated number of rounds. Sudden death could be played if more than one team remains.
8. Consider performance-based rewards; for example, the team with the highest score could earn bonus quiz points or have a quiz waived. If only one team has the top score, honor winners as reigning team champions. Present first-place ribbons.

Evaluation

Technical skills: Ask related questions on the next examination or quiz

RESOURCE MATERIALS AND OUTLINES

OBJECTIVE 1: Explain how the concepts of recognition, valuation, and classification apply to business transactions and why they are important factors in ethical financial reporting.

Summary Statement

Before recording a business transaction, the accountant must determine three things:

1. When the transaction occurred (the *recognition* issue)
2. What value to place on the transaction (the *valuation* issue)
3. How the components of the transaction should be categorized (the *classification* issue)

A sale is recognized (entered in the accounting records) when the title to merchandise passes from the supplier to the purchaser, regardless of when payment is made or received. This is called the *recognition point*.

The dollar value of any item involved in a business transaction is its original *cost* (also called *historical cost*). Generally, any change in value subsequent to the transaction is not reflected in the accounting records. This practice, which conforms to the *cost principle*, is preferred by accountants because the cost, or exchange price, is verifiable and objective. The *exchange price* results from an agreement between the buyer and seller that can be verified by evidence created at the time of the transaction.

Every business transaction is classified by means of categories called *accounts*. Each asset, liability, stockholders' equity, revenue, and expense has a separate account.

Recognition, valuation, and classification are important factors in ethical financial reporting. These guidelines are intended to help managers meet their obligations to the company's owners and to the public.

New Concepts and Terminology

recognition; recognition point; valuation; fair value; cost principle; classification

Related Text Illustrations

Focus on Business Practice: Accounting Policies: Where Do You Find Them?

Figure 1: The Role of Measurement Issues

Focus on Business Practice: The Challenge of Fair Value Accounting

Focus on Business Practice: No Dollar Amount: How Can That Be?

Lecture Outline

- I. Three measurement issues must be resolved before a business transaction is recorded.
 - A. **Recognition** issue—When should the transaction be recorded?
 - B. **Valuation** issue—What dollar amount should be recorded?
 - C. **Classification** issue—Which accounts are affected?
- II. A sale is recognized when title passes to the buyer (recognition point).
- III. Transactions should be recorded at their original cost (historical cost).

- A. The **fair value** is the exchange price, which results from an agreement between the buyer and seller that can be verified by evidence at the time of the transaction.
- B. Assets are valued at the initial fair value or cost unless there is evidence that the fair value has changed and an adjustment must be made.

IV. Transactions must be classified according to the appropriate categories or accounts.

IVIVV. Recognition, valuation, and classification are important factors in ethical financial reporting.

Teaching Strategy

Many students approach the topic of measurement (as well as accounting itself) as though it is fairly cut-and-dried. Nevertheless, they must realize that there are often several ways to approach the recognition, valuation, and classification issues, only one of which typically follows GAAP. Emphasize that the recognition problem is not always easily solved and that the historical cost principle is somewhat controversial.

Explain why a business transaction cannot be recorded until the three measurement issues have been addressed.

Emphasize that as a user of financial statements, it is important to understand that the balance sheet does not aim to show what a business is worth. Give an example using land or a building, which generally increases in value over time.

Mention some exceptions to the basic recognition rule of recording transactions only when title transfers. Cases 1 and 3, Exercises 3 and 4, or Short Exercise 1 in the text illustrate this learning objective. You may also present a basic journal entry and ask students to point out the portion of the journal entry that refers to recognition, valuation, and classification. Short Exercise 2 provides an excellent opportunity for students to integrate recognition, valuation, and classification issues.

OBJECTIVE 2: Explain the double-entry system and the usefulness of T accounts in analyzing business transactions.

Summary Statement

The *double-entry system* of accounting requires that each transaction be recorded with at least one debit and one credit, and that the total dollar amount of the debits must equal the total amount of the credits.

Accounts are the basic storage units for accounting data and are used to accumulate amounts from similar transactions. An account in its simplest form, a *T account*, has three parts:

1. A title, which identifies the asset, liability, or stockholders' equity account
2. A left side, which is called the *debit* side
3. A right side, which is called the *credit* side

At the end of an accounting period, the accountant must determine the *balance* in each account to prepare the financial statements. Three steps are followed to determine these account balances:

1. Foot (add up) the debit entries. The *footing* (total) should be written in small numbers beneath the last entry.
2. Foot the credit entries.
3. Subtract the smaller total from the larger. A debit balance exists when total debits exceed total credits; a credit balance exists when the opposite is the case.

To determine which accounts are debited and which are credited in a given transaction, the accountant uses the following rules:

1. Increases in assets are debited.
2. Decreases in assets are credited.
3. Increases in liabilities and stockholders' equity are credited.
4. Decreases in liabilities and stockholders' equity are debited.
5. Revenues increase stockholders' equity and are therefore credited.
6. Expenses decrease stockholders' equity and are therefore debited.

When more increases than decreases have been recorded for an account (the usual case), then its balance (debit or credit) is referred to as its *normal balance*. For example, assets have a normal debit balance. Typical stockholders' equity accounts are Stockholders' Capital and Withdrawals. A separate account is kept for each type of revenue and expense. The exact revenue and expense accounts used vary depending on the type of business and the nature of its operations.

New Concepts and Terminology

double-entry system; accounts; T account; debit; credit; footings; balance; normal balance

Related Text Illustrations

Table 1: Normal Account Balances of Major Account Categories

Figure 2: Relationships of Stockholders' Equity Accounts

Lecture Outline

- I. Describe the nature of the double-entry system of accounting.
 - A. Principle of duality
- II. Accounts are the basic storage units for accounting data and are used to accumulate amounts from similar transactions.
- III. A T account (the simplest form of an account) has three parts.
 - A. A title expressing the name of the asset, liability, etc.
 - B. A debit (left) side
 - C. A credit (right) side
- IV. Demonstrate how account balances are determined.
- V. State the rules of double entry.
 - A. Increases in assets are debited.
 - B. Decreases in assets are credited.
 - C. Increases in liabilities and stockholders' equity are credited.
 - D. Decreases in liabilities and stockholders' equity are debited.
 - E. Increases in revenues are credited.
 - F. Increases in expenses are debited.
- VI. The normal balance of an account is what it takes (debit or credit) to increase the account.
- VII. Discuss typical stockholders' equity accounts, such as Stockholders' Capital and Withdrawals.

Teaching Strategy

Students will wonder why the rules of debit and credit are as they are. Simply state that they are an arbitrary set of rules whose careful interrelationships make them work. In addition, students need to dispel any preconceived notions as to what debit and credit imply (good, bad, and so on). One way to accomplish this is to make an imaginary T account of the classroom. Students are assigned roles (debit or credit) depending on which side of the room they are seated. Ask the debits if they like being debits or would they rather be credits. If a student indicates a preference, ask why. It may indicate a

misconception about what debit and credit really mean. Tell students who work in a bank to reverse what they have learned about debits and credits. Finally, explain the beauty of the double-entry system.

Students need to know that transactions are not recorded in T accounts in practice, but T accounts are used by accountants to analyze complex transactions.

Memorization and repetition are the keys to mastering the rules of debit and credit. Drill students until they know the rules perfectly. The double-entry rules do not require as much memorization as students often think. Point out that if they know the accounting equation and that assets are increased with debits, they can reason through the rest of it. For example, liabilities and stockholders' equity must be increased with credits because they are on the opposite side of the equation. Accounts that increase equity (e.g., revenues) have the same rules, whereas accounts that decrease equity (e.g., expenses, withdrawals) have the opposite rules.

Lead students through the process of determining account balances. Point out that negative balances do not exist. The balance in an account is simply the absolute difference between the debits and credits. Exercise 6 is excellent for reinforcing account terminology, classification, and normal balances.

OBJECTIVE 3: Demonstrate how the double-entry system is applied to common business transactions.

Summary Statement

Analyzing and applying transactions is a five-step process:

1. State the transaction.
2. Analyze the transaction to determine which accounts are affected. Information about transactions comes from *source documents* such as invoices, checks, receipts, and contracts.
3. Apply the rules of double-entry accounting by using T accounts to show how the transaction affects the accounting equation.
4. Show the transaction in *journal form*. In journal form, the date, the debit account, and the debit amount are recorded on one line and the credit account (indented) and credit amount are recorded on the next line.
5. Provide a comment that will help you apply the rules of double-entry accounting.

The following journal entries are introduced in this learning objective:

| | |
|---------------------------------------|------------------------|
| Cash | XX (amount invested) |
| Common Stock | XX (amount invested) |
| Stockholder invested cash in business | |
| Office Supplies | XX (purchase price) |
| Accounts Payable | XX (amount to be paid) |
| Purchased office supplies on credit | |
| Prepaid Rent | XX (amount paid) |
| Cash | XX (amount paid) |
| Paid rent in advance | |
| Office Supplies | XX (amount paid) |
| Accounts Payable | XX (amount paid) |
| Purchase of office supplies on credit | |

| | |
|---|----------------------------|
| Office Equipment | XX (purchase price) |
| Cash | XX (amount paid) |
| Accounts Payable | XX (amount to be paid) |
| Purchased office equipment with partial payment | |
| Accounts Payable | XX (amount paid) |
| Cash | XX (amount paid) |
| Paid partial payment on a liability | |
| Cash | XX (amount received) |
| Design Revenue | XX (amount earned) |
| Received payment for services rendered | |
| Accounts Receivable | XX (amount to be received) |
| Design Revenue | XX (amount earned) |
| Rendered service, payment to be received at later time | |
| Cash | XX (amount received) |
| Unearned Design Revenue | XX (amount to be earned) |
| Received payment for services to be performed | |
| Cash | XX (amount received) |
| Accounts Receivable | XX (amount received) |
| Received payment for services previously performed | |
| Wages Expense | XX (amount incurred) |
| Cash | XX (amount paid) |
| Paid wages for the period | |
| Utilities Expense | XX (amount incurred) |
| Accounts Payable | XX (amount to be paid) |
| Recorded utility bill, payment to be made at later time | |
| Dividends | XX (amount withdrawn) |
| Cash | XX (amount paid) |
| Stockholder paid cash from business | |

(No entry is made when an order is placed.)

New Concepts and Terminology

source documents; journal form

Related Text Illustration

Exhibit 1: Summary of Transactions of Miller Design Studio

Lecture Outline

- I. Explain the five-step process for analyzing and applying transactions.
 - A. State the transaction.

- B. Analyze the transaction to determine which accounts are affected and how (increased or decreased).
- C. Apply the rules of double-entry accounting using T accounts to show how the transaction affects the accounting equation.
- D. Show the transaction in journal form.
- E. Provide a comment that will help you apply the rules of double-entry accounting.

Teaching Strategy

Tell students they must answer (at least in their minds) the following questions before preparing a journal entry:

1. What is the transaction in words?
2. Which accounts are involved, and how are they classified (asset, liability, etc.)?
3. Is each account increased or decreased?
4. Based on the foregoing answers, which rules of debit and credit apply, and what is the correct journal entry?

Writing out the answers to these four questions for every transaction analyzed is helpful at first. Short Exercise 5 or 6 and Exercise 7 or 9 are helpful to quickly illustrate this learning objective. Analyzing the transactions in Problems 2, 3, 4, 5, 7, and 8 in terms of debits and credits is helpful for driving home the point. Case 4 is a good application of this learning objective to real-world companies.

OBJECTIVE 4: Prepare a trial balance, and describe its value and limitations.

Summary Statement

Before financial statements are prepared, the accountant must double-check the equality of the debits and credits in the accounts. This is done formally by means of a *trial balance*. If the trial balance does not balance, one or more errors have been made in the journal, ledger, or trial balance. Once the errors have been located and the trial balance is in balance, the financial statements can be prepared. It is possible, however, to make errors that do not cause the trial balance to be out of balance (that is, errors that are not detected through the trial balance).

To summarize, proper accounting procedure requires that certain steps be followed (additional steps are introduced in subsequent chapters):

1. Journalize transactions as they occur.
2. Post the journal entries to the ledger accounts when convenient.
3. Prepare a trial balance at the end of each accounting period.
4. Use the trial balance to prepare the financial statements.

New Concepts and Terminology

trial balance

Related Text Illustrations

Exhibit 2: Trial Balance

Focus on Business Practice: Are All Trial Balances Created Equal?

Lecture Outline

- I. A **trial balance** tests the equality of debits and credits in the ledger before the financial statements are prepared. A three-step process is followed.
 - A. List each ledger account and its debit or credit balance.
 - B. Add each column.
 - C. Compare the column totals.
- II. If the trial balance does not balance, one or more of the following has occurred:
 - A. A debit was entered as a credit, or vice versa.
 - B. The balance was computed incorrectly.
 - C. The balance was carried to the trial balance incorrectly.
 - D. The trial balance was summed incorrectly.
- III. It is possible to make an error in the records that does not cause the trial balance to be out of balance, such as the following:
 - A. A transaction was omitted or entered twice.
 - B. Both debit and credit amounts are incorrect but equal.
 - C. The wrong account was debited or credited.

Teaching Strategy

Students need to know that a trial balance is not a financial statement to be published and that it is prepared only at the end of the accounting period. They also need to know that it tests the equality of the ledger before financial statement preparation and that, even if it balances, it may show an incorrect balance.

Point out that the accounts are listed in Exhibit 2 in the same order in which they are listed in the ledger. Emphasize that only account balances are entered, not footings. Tell students that if a zero balance exists, the account need not be listed in the trial balance.

Short Exercise 7 and Exercises 10, 12, 13, and 14 give students the opportunity to prepare a trial balance and to recognize which errors cause it to be out of balance. Assigning Problem 5 or 8 is an excellent way to tie all the concepts together.

OBJECTIVE 5: Show how the timing of transactions affects cash flows and liquidity.**Summary Statement**

Because the timing of cash flows is critical to maintaining adequate liquidity to pay bills, users of financial information must understand the difference between transactions that generate cash and those that do not. To maintain liquidity, the management of a company must carefully plan the company's needs for cash.

Related Text Illustrations

Focus on Business Practice: Should Earnings Be Aligned with Cash Flows?

Figure 3: Transactions of Miller Design Studio

Lecture Outline

- I. Discuss the importance of maintaining good liquidity.
- II. Discuss the timing of cash flows in maintaining a company's adequate liquidity to pay bills.

Teaching Strategy

Walk students through Figure 3, stressing the roles of Accounts Receivable and Accounts Payable in managing cash flows and liquidity. Then assign Exercise 15 and use Case 2 for class discussion.

SUPPLEMENTAL OBJECTIVE 6: Define the *chart of accounts*, record transactions in the general journal, and post transactions to the ledger.

Summary Statement

All of a company's accounts are contained in a book called the *general ledger*, or simply the *ledger*. In a manual system, each account appears on a separate page, and the accounts generally are in the following order: assets, liabilities, stockholders' equity, revenues, and expenses. A listing of the accounts with their respective account numbers, called a *chart of accounts*, is presented at the beginning of the ledger for easy reference.

Although the accounts used by companies vary, some are common to most businesses. Typical asset accounts are Cash, Accounts Receivable, Notes Receivable, Prepaid Expenses, Land, Buildings, and Equipment. Typical liability accounts are Accounts Payable and Notes Payable.

As transactions occur, they are recorded initially and chronologically in a book called the *journal*. The *general journal* is the simplest and most flexible type of journal. Each transaction *journalized* (recorded) in the general journal contains (1) the date, (2) the account names, (3) the dollar amounts debited and credited, (4) an explanation, and (5) the account identification numbers, if appropriate. A line should be skipped between each *journal entry*, and more than one debit or credit may be entered for a single transaction.

In the construction of a ledger in practice, the *ledger account form*, rather than the T account form, is used. The four-column type is illustrated in the text.

All journal entries must be posted to the ledger accounts. *Posting* is a transferring process that results in an updated balance for each account. Not only must the dates and amounts be transferred and new account balances computed, but the Post. Ref. columns must also be used for cross-referencing between the journal and the ledger.

Ruled lines appear in financial reports before each subtotal, and a double line is customarily placed below the final amount. Although dollar signs are required in financial statements, they are omitted in journals and ledgers. On ruled paper, commas and periods are omitted, and a dash is customarily used to designate zero cents.

New Concepts and Terminology

general ledger; chart of accounts; journal; journal entry; journalizing; general journal; ledger account form; posting

Related Text Illustrations

Figure 4: Analyzing and Processing Transactions

Exhibit 3: Chart of Accounts for a Small Business

Exhibit 4: The General Journal

Exhibit 5: Accounts Payable in the General Ledger

Exhibit 6: Posting from the General Journal to the Ledger

Lecture Outline

- I. Chart of Accounts
 - A. An account is the basic storage unit for accounting data.
 - B. An account occupies its own page in the **general ledger**.
 - C. A **chart of accounts** lists all the accounts in the ledger.

- D. Discuss typical asset accounts, such as Cash, Accounts Receivable, Notes Receivable, Supplies, Inventory, Prepaid Expenses, Land, Buildings, and Equipment.
- E. Discuss typical liability accounts, such as Accounts Payable, Notes Payable, Wages Payable, Income Taxes Payable, Rent Payable, Interest Payable, and Unearned Revenue.
- II. General Journal
 - A. Transactions are initially recorded in the journal (book of original entry).
 - B. Every journal entry contains five components.
 - 1. The date
 - 2. The account names
 - 3. The dollar amounts debited and credited
 - 4. An explanation
 - 5. The account identification number, if appropriate
 - C. A space should be skipped between journal entries.
 - D. A compound entry is an entry with more than one debit or credit.
 - E. Illustrate the ledger account form, and state its advantage over the T account form.
- III. Journal entries are posted (transferred) to the ledger when convenient (usually daily).
 - A. Post the date and amounts.
 - B. Compute a new account balance.
 - C. Place the journal page number in the Post. Ref. column of the ledger account.
 - D. Place the account number in the Post. Ref. column of the journal.
- IV. Rules and customs regarding ruled lines, dollar signs, commas, and periods should be followed.

Teaching Strategy

It is assumed that students have read the entire chapter and thus have knowledge of a journal and a ledger. Point out how difficult, if not impossible, it would be to prepare financial statements directly from the journal (that is, without the use of a ledger). In effect, a ledger is merely a filing system in which each account occupies its own page. Pass around a general ledger from a manual system and one from a computerized system.

Refer students to Exhibit 3, stressing that the chart of accounts is merely a table of contents to the ledger. Point out the traditional order of accounts (the same as in the ledger) and the need for flexibility in the numbering scheme. In addition, state the restrictive nature of the accounts—that is, students must use the exact titles that have been established and cannot use phrases for account names (such as “cash paid” or “equipment purchased”).

It may be useful to again define asset, liability, and stockholders’ equity before discussing the individual accounts. While you discuss the accounts, emphasize that establishing account names for a business is a flexible process (and that similar items are frequently “lumped together” into one account). Students often do not distinguish accounts from transactions at this point. Clarify the difference.

Ask students to differentiate between supplies and equipment and between inventory and equipment. Students will have difficulty understanding the difference between Accounts Receivable and Notes Receivable and between Accounts Payable and Notes Payable. Simply state that the difference lies in the existence or nonexistence of a promissory note.

Students invariably misunderstand the nature of unearned revenues. Explain how they arise, and indicate that they are liabilities, not revenues.

Students often have difficulty differentiating between an asset and a revenue and between a liability and an expense. Explain that because we use a double-entry system, a single transaction such as a cash sale results in the recording of both an asset (cash) and a revenue. Providing goods or services results in a revenue; what you receive in exchange results in an asset.

Short Exercise 3 and Exercise 6 are excellent classroom exercises to reinforce the classification of accounts.

At this point, students may be confused about the proper order of procedure. Explain that, even though the financial statements and ledger were introduced before the journal, the correct order of procedure at this point is (1) analyze the transactions, (2) enter transactions into the general journal, (3) post from the journal to the ledger, and (4) prepare the trial balance.

Students need to be shown the variety of conventions normally employed with the general journal (such as proper use of the money columns, placement of all debits first, indention of credits, skipping of a space between entries, and so on). They will worry about what exactly to include in the explanation. Exercise 18 and Problems 5 and 8 provide good practice in preparing journal entries.

Contrast the general journal form (Exhibit 4) with the general ledger form (Exhibit 5). Acknowledge that transactions are recorded twice.

Suggest to students that we do away with the journal and just keep a ledger. What would be missing? Then suggest we do away with the ledger. What information would be lacking? A helpful analogy is to have them picture the general journal as a bagful of mail and the general ledger as several slots into which the mail (journal entries) is sorted.

Point out that posting is not difficult. All of the analysis has already been done. Posting is a clerical process. Explain that journalizing and posting occur simultaneously in a computerized system.

Common errors that students make regarding the ledger are to skip a line between postings and to make use of the “item” column when it is normally ignored.

When posting, students may either forget to use or be confused about the Post. Ref. columns in the general journal and ledger. In addition, they need to know how to compute an account balance (that is, how to add a debit to a debit balance, a credit to a credit balance, and a debit-credit posting combination). Use of Exhibit 6 helps to explain the posting procedure.

Exercise 18 provides an excellent classroom exercise for the posting aspects of this learning objective.

REVIEW QUIZ

True-False

1. T F The Revenue from Services account is increased with a debit.
2. T F The accounts in the trial balance are normally listed in the same order as in the general ledger.
3. T F The balance sheet figure for buildings should be based on the buildings' current market value.
4. T F The recognition issue refers to the difficulty in deciding when a business transaction should be recorded.
5. T F Unearned Art Fees is classified as a liability.
6. T F Notes Payable is an account used by a company that issues a promissory note to a creditor.
7. T F All transactions are initially recorded in the general ledger.

Multiple Choice

8. Which of the following accounts is increased with a debit?
 - a. Unearned Revenue
 - b. J. Jones, Capital
 - c. Advertising Fees Earned
 - d. Withdrawals
 - e. Wages Payable
9. If Accounts Payable has debit postings of \$32,000, credit postings of \$25,000, and an ending normal balance of \$47,000, which of the following was its beginning balance?
 - a. \$7,000
 - b. \$39,000
 - c. \$40,000
 - d. \$47,000
 - e. \$54,000
10. When cash is received in advance of performing a service, the accountant
 - a. makes no journal entry because performance of the service has not yet begun.
 - b. debits Unearned Revenue and credits Cash.
 - c. debits Cash and credits Revenue from Services.
 - d. debits Unearned Revenue and credits Revenue from Services.
 - e. debits Cash and credits Unearned Revenue.
11. Net income does not appear on which of these financial statements?
 - a. Income statement
 - b. Statement of Cash Flows
 - c. Balance Sheet
 - d. Statement of Stockholders' Equity
 - e. Statement of Cash Flows and Statement of Stockholders' Equity
12. The journal entry to record the completion of a service for which payment has *not* been received is a debit to
 - a. Revenue from Services and a credit to Accounts Payable.
 - b. Accounts Receivable and a credit to Revenue from Services.
 - c. Revenue from Services and a credit to Unearned Revenue.
 - d. Cash and a credit to Revenue from Services.
 - e. none of the above; no entry is made until the cash has been received.
13. Prepaid Insurance is classified as a(n)
 - a. asset.
 - b. liability.
 - c. stockholders' equity account.
 - d. revenue.
 - e. expense.

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14. Which of the following errors can cause the trial balance to be out of balance?
- An entire journal entry has been omitted from the posting procedure.
 - The debit portion of an entry is posted as a credit, and the credit portion is posted as a debit.
 - The debit balance of an account is transferred to the credit column of the trial balance.
 - A credit entry is entered into the wrong credit account.
 - An entire transaction is entered in the general journal incorrectly as \$127 instead of \$172.
15. Stockholders' Capital appears on which pair of financial statements?
- Balance sheet and income statement
 - Income statement and Statement of Cash Flows
 - Statement of Retained Earnings and Income Statement
 - Statement of Stockholders' Equity and Balance sheet
 - Statement of Stockholders' Equity and Statement of Cash Flows
16. Which of the following does *not* result in the recording of an expense?
- The expiration of insurance
 - Payment of an account payable
 - The recording of wages incurred
 - The receipt of a utility bill
 - The purchase of gasoline for a company vehicle
17. Which of the following lists gives the correct sequence of accounting procedures?
- Ledger, journal, trial balance, financial statements
 - Financial statements, journal, ledger, trial balance
 - Journal, ledger, trial balance, financial statements
 - Trial balance, financial statements, ledger, journal
 - Journal, ledger, financial statements, trial balance

ANSWERS TO REVIEW QUIZ**True-False**

- F
- T
- F
- T
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Multiple Choice

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