What You’ll Learn

1. Describe the relationship between property and financial claims.
2. Explain the meaning of the term equities as it is used in accounting.
3. List and define each part of the accounting equation.
4. Demonstrate the effects of transactions on the accounting equation.
5. Check the balance of the accounting equation after a business transaction has been analyzed and recorded.
6. Define the accounting terms introduced in this chapter.

Why It’s Important

To understand the financial condition of any business, you must first understand the accounting equation.

Predict

1. What does the chapter title tell you?
2. What do you already know about this subject from personal experience?
3. What have you learned about this in the earlier chapters?
4. What gaps exist in your knowledge of this subject?

Exploring the Real World of Business

INVESTING CAPITAL

HARPO Productions, Inc.

Time magazine called her one of the “100 Most Influential People of the 20th Century,” but millions of daytime television viewers know her as Oprah. Breaking records at every turn, Oprah Winfrey was the youngest person to anchor the news at Nashville’s WTVF-TV. She was the first woman to own and produce her own talk show and the first African-American woman to become a billionaire.

In 1986, investing her own money, Winfrey created HARPO Productions, Inc., the company that produces The Oprah Winfrey Show. Guests have included celebrities such as Gwyneth Paltrow and Denzel Washington. The talk show generates a tidy $104 million each year. HARPO also produces movies, videos, books, and O: The Oprah Magazine.

What Do You Think?

What kinds of assets do you think might have been purchased with the capital that Oprah Winfrey invested in HARPO Productions, Inc.?
Every business has assets, liabilities, and owner’s equity—the elements in the basic accounting equation that you will study in this chapter. A television studio’s assets include cameras and computers. Its liabilities may include unpaid bills to videotape suppliers. The owner’s equity of a business is what the business is worth.

**Personal Connection**

1. In your workplace what types of assets does the business have?
2. What types of debts or liabilities would you imagine the business to have?

**Online Connection**

Go to [glencoeaccounting.glencoe.com](http://glencoeaccounting.glencoe.com) and click on Student Center. Click on Working in the Real World and select Chapter 3.
SECTION 1

Property and Financial Claims

In Chapter 2 you learned that accounting is the language of business. In this chapter you will learn how to apply basic accounting concepts and terminology. You will also learn how the accounting equation expresses the relationship between property and the rights, or claims, to the property.

United Parcel Service (UPS), a corporation that provides global delivery services, uses accounting reports to communicate with its managers, employees, and investors. The UPS financial reports identify the property used in the business, such as airplanes, trucks, and computers. The reports also show how the company obtained the property, either from loans or from funds provided by investors.

Property

What Is Property?

The right to own property is basic to a free enterprise system. Property is anything of value that a person or business owns and therefore controls. When you own an item of property, you have a legal right to that item. For example, suppose you paid $600 for a mountain bike. As a result of the payment, you own the bike. If you had rented the bike for the weekend instead of buying it, you would pay a much smaller amount of money, but you would have the bike for only a limited time. You would have the right to use the bike for the weekend, but you would not own it.

Property

What Is Property?

The right to own property is basic to a free enterprise system. Property is anything of value that a person or business owns and therefore controls. When you own an item of property, you have a legal right to that item. For example, suppose you paid $600 for a mountain bike. As a result of the payment, you own the bike. If you had rented the bike for the weekend instead of buying it, you would pay a much smaller amount of money, but you would have the bike for only a limited time. You would have the right to use the bike for the weekend, but you would not own it.

Businesses also own property. One of the purposes of accounting is to provide financial information about property and financial claims to that property. A financial claim is a legal right to an item. In accounting, property and financial claims are measured in dollar amounts. Dollar amounts measure both the cost of the property and the financial claims to the property. In our mountain bike example, since you paid $600 cash to buy the bike, you have ownership and a financial claim of $600 to the bike. This relationship between property and financial claims is shown in the following equation.

<table>
<thead>
<tr>
<th>Property (Cost)</th>
<th>=</th>
<th>Financial Claims</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bike</td>
<td>=</td>
<td>Your Claim to the Bike</td>
</tr>
<tr>
<td>$600</td>
<td>=</td>
<td>$600</td>
</tr>
</tbody>
</table>

When you buy property with cash, you acquire all of the financial claims to that property at the time of purchase. What happens to the
financial claim, however, when you don’t pay for the property right away?

When you buy something and agree to pay for it later, you are buying on credit. The business or person selling you the item on credit is called a creditor. A creditor can be any person or business to which you owe money. When you buy property on credit, you do not have the only financial claim to the property. You share the financial claim to that property with your creditor. For example, suppose you want to buy a $100 lock for the mountain bike, but you have only $60. You pay the store $60 and sign an agreement to pay the remaining $40 over the next two months. Since you owe the store (the creditor) $40, you share the financial claim to the lock with the creditor. The creditor’s financial claim to the lock is $40 and your claim is $60. The combined claims equal the cost of the property. Your purchase of the lock can be expressed as an equation:

\[
\text{PROPERTY} = \text{FINANCIAL CLAIMS}
\]

\[
\begin{array}{c|c|c|c}
\text{Property} & = & \text{Financial Claims} \\
\hline
\text{Bike Lock} & = & \text{Creditor’s Financial Claim} + \text{Owner’s Financial Claim} \\
\$100 & = & $40 + $60
\end{array}
\]

As you can see, two (or more) people can have financial claims to the same property.

Only the property owner has control of the property. For example, suppose that you buy a used vehicle for $8,000. You pay $1,200 in cash and take out a loan from the credit union for the remaining $6,800.

\[
\begin{array}{c|c|c|c}
\text{Property} & = & \text{Financial Claims} \\
\hline
\text{Vehicle} & = & \text{Creditor’s Financial Claim} + \text{Owner’s Financial Claim} \\
\$8,000 & = & $6,800 + $1,200
\end{array}
\]

As the owner, you have control of the vehicle. However, if you don’t make the payments to the credit union, the credit union can exercise its legal claim to the vehicle and you will lose ownership.

**Financial Claims in Accounting**

*What Are the Two Types of Equities?*

Property or items of value owned by a business are referred to as assets. Businesses can have various types of assets, such as:

- cash
- office equipment
- manufacturing equipment
- buildings
- land

**Section 1** Property and Financial Claims

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The accounting term for the financial claims to these assets is **equities**. Let’s explore the meaning of the term *equities* by introducing Maria Sanchez and her new business, Roadrunner Delivery Service, organized as a sole proprietorship.

Suppose Roadrunner Delivery Service purchases a delivery truck for $10,000. Roadrunner makes a cash down payment of $3,000 to the seller. A local bank loans Roadrunner the remaining $7,000. Both Roadrunner and the bank now have financial claims to the truck.

<table>
<thead>
<tr>
<th>Property</th>
<th>Creditor's Financial Claim</th>
<th>Owner's Financial Claim</th>
</tr>
</thead>
<tbody>
<tr>
<td>Truck</td>
<td>$10,000</td>
<td>$7,000</td>
</tr>
<tr>
<td></td>
<td></td>
<td>$3,000</td>
</tr>
</tbody>
</table>

Over the years as Roadrunner repays the loan, its financial claim will increase. As less money is owed, the financial claim of the creditor (the bank) will decrease.

For example, after Roadrunner pays one-half of the loan ($7,000 \times \frac{1}{2} = $3,500), the financial claims to the property will change as follows:

<table>
<thead>
<tr>
<th>Property</th>
<th>Creditor's Financial Claim</th>
<th>Owner's Financial Claim</th>
</tr>
</thead>
<tbody>
<tr>
<td>Truck</td>
<td>$10,000</td>
<td>$3,500</td>
</tr>
<tr>
<td></td>
<td></td>
<td>$6,500</td>
</tr>
</tbody>
</table>

When the loan is completely repaid, the creditor’s financial claim will be canceled. In other words the owner’s financial claim will then equal the cost of the truck.

In accounting there are separate terms for owner’s claims and creditor’s claims. The owner’s claims to the assets of the business are called **owner’s equity**. Owner’s equity is measured by the dollar amount of the owner’s claims to the total assets of the business.

The creditor’s claims to the assets of the business are called **liabilities**. Liabilities are the debts of a business. They are measured by the amount of money owed by a business to its creditors. The relationship between assets and the two types of equities (liabilities and owner’s equity) is shown in the **accounting equation**:

\[
ASSETS = LIABILITIES + OWNER'S EQUITY
\]
Do the Math

Owner's equity can be expressed as a fraction of the total equities. It can also be expressed as a decimal. Consider the following example:

Assets = Liabilities + Owner's Equity
$10,000 = $9,000 + $1,000

Owner's equity is equal to 1/10, or 10 percent, of the total equities:

Owner's Equity / Total Equities
= $1,000 / $10,000
= 1/10
= 0.10

Convert the following fractions into decimals.
1. 1/2
2. 1/5
3. 1/3
4. 3/5
5. 7/8
6. 7/10

Convert the following decimals into fractions.
7. 0.889
8. 0.60
9. 0.375
10. 0.25
11. 0.667
12. 0.75

Problem 3–1 Balancing the Accounting Equation

Instructions: Determine the missing dollar amount indicated by the question mark in each equation. Write each missing amount in your working papers.

ASSETS = LIABILITIES + OWNER'S EQUITY

1. $17,000 = $7,000 + ?
2. ? = $6,000 + $20,000
3. $10,000 = ? + $7,000
4. ? = $9,000 + $17,000
5. $8,000 = $2,000 + ?
6. $20,000 = $7,000 + ?
7. ? = $12,000 + $4,000
8. $30,000 = ? + $22,000
9. $22,000 = $1,000 + ?
10. $25,000 = $5,000 + ?
11. ? = $10,000 + $25,000
12. $7,500 = ? + $3,000
SECTION 2

Transactions That Affect Owner’s Investment, Cash, and Credit

When you purchased a new sweater, bought popcorn at the movies, or put cash in your savings account, you were participating in business transactions. Business transactions involve the purchase, sale, or exchange of goods and services.

Business Transactions
How Are Accounts Used?

A business transaction is an economic event that causes a change—either an increase or a decrease—in assets, liabilities, or owner’s equity. The change is reflected in the accounting system of the business.

When a business buys a computer with cash, its cash decreases, but its computer equipment increases. It records increases and decreases caused by business transactions in specific accounts. An account is a subdivision under assets, liabilities, or owner’s equity. It shows the balance for a specific item and is a record of the increases or decreases for that item. Accounts represent things in the real world, such as money invested in a business or owed to a creditor. An account for office furniture represents the dollar cost of all office furniture the business owns.

Every business sets up its accounts and its accounting system to meet its needs. The number of accounts needed varies. Some businesses use only a few accounts, but others use hundreds. No matter how many accounts a business has, all of its accounts may be classified as either assets, liabilities, or owner’s equity. Roadrunner Delivery Service uses these accounts:

<table>
<thead>
<tr>
<th>Assets</th>
<th>Liabilities</th>
<th>Owner’s Equity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash in Bank</td>
<td>Accounts Payable</td>
<td>Maria Sanchez, Capital</td>
</tr>
<tr>
<td>Accounts Receivable</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Computer Equipment</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Office Equipment</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Delivery Equipment</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

The second asset account listed is Accounts Receivable. Accounts receivable is the total amount of money owed to a business—money to be received later because of the sale of goods or services on credit. The Accounts Receivable account is an asset because it represents a claim to the assets of other people or businesses. It represents a future value that eventually will bring cash into the business. When the business receives payment, it cancels the claim.
The liability account is **Accounts Payable**. *Accounts payable* is the amount owed, or payable, to the creditors of a business. The owner’s equity account title is the owner’s name, a comma, and then the word *Capital*.

### Effects of Transactions on the Accounting Equation

#### What Happens to the Accounting Equation?

When a business transaction occurs, an accounting clerk analyzes the transaction to see how it affects each part of the accounting equation. Analyzing business transactions is simple. Use the following steps.

<table>
<thead>
<tr>
<th>Business Transaction</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>ANALYSIS</strong></td>
</tr>
<tr>
<td><strong>Classify</strong></td>
</tr>
<tr>
<td><strong>+/-</strong></td>
</tr>
<tr>
<td><strong>Balance</strong></td>
</tr>
</tbody>
</table>

Most businesses have the following types of transactions: investments by the owner, cash transactions, credit transactions, revenue and expense transactions, and withdrawals by the owner.

#### Investments by the Owner

An **investment** is money or other property paid out in order to produce profit. Owner Maria Sanchez made two investments in her business, Roadrunner Delivery Service. The first was a cash investment; the second was a transfer of property.

#### Business Transaction 1

*Maria Sanchez took $25,000 from personal savings and deposited that amount to open a business checking account in the name of Roadrunner Delivery Service.*

<table>
<thead>
<tr>
<th>ANALYSIS</th>
<th>Identify</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Cash in Bank</strong></td>
<td><strong>1.</strong> Cash transactions are recorded in the account <em>Cash in Bank</em>. Maria Sanchez is investing personal funds in the business. Her investment in the business is recorded in the account called <em>Maria Sanchez, Capital</em>.</td>
</tr>
<tr>
<td><strong>Classify</strong></td>
<td><strong>2.</strong> <em>Cash in Bank</em> is an asset account. <em>Maria Sanchez, Capital</em> is an owner’s equity account.</td>
</tr>
<tr>
<td><strong>+/-</strong></td>
<td><strong>3.</strong> <em>Cash in Bank</em> is increased by $25,000. <em>Maria Sanchez, Capital</em> is increased by $25,000.</td>
</tr>
<tr>
<td><strong>Balance</strong></td>
<td><strong>4.</strong> The accounting equation remains in balance.</td>
</tr>
</tbody>
</table>

\[
\begin{align*}
\text{Assets} & = \text{Liabilities} + \text{Owner’s Equity} \\
\text{Cash in Bank} & + \$25,000 = 0 + \$25,000 \\
\text{Trans. 1} & \end{align*}
\]
### Business Transaction 2

Maria Sanchez transferred two telephones valued at $200 each from her home to the business.

**ANALYSIS**

**Identify**
1. Maria Sanchez gave two telephones to the business. This affects the account **Office Equipment**. The investment of these assets affects the account **Maria Sanchez, Capital**.

**Classify**
2. **Office Equipment** is an asset account. **Maria Sanchez, Capital** is an owner’s equity account.

**+/−**
3. **Office Equipment** is increased by $400. **Maria Sanchez, Capital** is increased by $400.

**Balance**
4. The accounting equation remains in balance.

<table>
<thead>
<tr>
<th>Assets</th>
<th>Liabilities</th>
<th>Owner’s Equity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash in Bank</td>
<td>Office Equipment</td>
<td>Maria Sanchez, Capital</td>
</tr>
<tr>
<td>Prev. Bal.</td>
<td>0</td>
<td>$25,000</td>
</tr>
<tr>
<td>Trans.</td>
<td>+$400</td>
<td></td>
</tr>
<tr>
<td>Balance</td>
<td>$25,000</td>
<td>+$400</td>
</tr>
</tbody>
</table>

### Cash Payment Transactions

Transaction 3 is the cash purchase of an asset. Any asset purchased for cash is recorded this way, but the account name of the asset purchased may vary. Transaction 3 affects only the assets side of the equation. Roadrunner exchanged one asset (cash) for another asset (computer equipment).

### Business Transaction 3

Roadrunner issued a $3,000 check to purchase a computer system.

**ANALYSIS**

**Identify**
1. Transactions involving any type of computer equipment are recorded in the **Computer Equipment** account. The business paid cash for the computer system, so the account **Cash in Bank** is affected. Check payments are treated as cash payments and are recorded in **Cash in Bank**.

**Classify**
2. **Computer Equipment** and **Cash in Bank** are both asset accounts.

**+/−**
3. **Computer Equipment** is increased by $3,000. **Cash in Bank** is decreased by $3,000.

**Balance**
4. The accounting equation remains in balance.

<table>
<thead>
<tr>
<th>Assets</th>
<th>Liabilities</th>
<th>Owner’s Equity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash in Bank</td>
<td>Computer Equipment</td>
<td>Office Equipment</td>
</tr>
<tr>
<td>Prev. Bal.</td>
<td>0</td>
<td>$400</td>
</tr>
<tr>
<td>Trans.</td>
<td>-$3,000</td>
<td>+$3,000</td>
</tr>
<tr>
<td>Balance</td>
<td>$22,000</td>
<td>+$3,000</td>
</tr>
</tbody>
</table>
Credit Transactions

Now that you have learned about cash transactions, let’s look at how the use of credit affects the accounting equation. When a business buys an item on credit, it is buying on account. In the next four transactions, you will learn about a purchase on account, a sale on account, a payment made on account, and a payment received on account.

### Business Transaction 4

Roadrunner bought a used truck on account from North Shore Auto for $12,000.

<table>
<thead>
<tr>
<th>ANALYSIS</th>
<th>Identify</th>
</tr>
</thead>
<tbody>
<tr>
<td>Classify</td>
<td>+/-</td>
</tr>
<tr>
<td>Balance</td>
<td></td>
</tr>
</tbody>
</table>

1. Roadrunner purchased a truck to be used as a delivery vehicle, so the account **Delivery Equipment** is affected. The business promised to pay for the truck at a later time. The promise to pay is a liability; therefore, the **Accounts Payable** account is affected.

2. **Delivery Equipment** is an asset account. **Accounts Payable** is a liability account.

3. **Delivery Equipment** is increased by $12,000. **Accounts Payable** is also increased by $12,000.

4. The accounting equation remains in balance.

### Business Transaction 5

Roadrunner sold one telephone to Green Company for $200 on account.

<table>
<thead>
<tr>
<th>ANALYSIS</th>
<th>Identify</th>
</tr>
</thead>
<tbody>
<tr>
<td>Classify</td>
<td>+/-</td>
</tr>
<tr>
<td>Balance</td>
<td></td>
</tr>
</tbody>
</table>

1. Since Roadrunner has agreed to receive payment for the telephone at a later time, the **Accounts Receivable** account is affected. The business sold the telephone, so the account **Office Equipment** is also affected.

2. Both **Accounts Receivable** and **Office Equipment** are asset accounts.

3. **Accounts Receivable** is increased by $200. **Office Equipment** is decreased by $200.

4. The accounting equation remains in balance.
### Business Transaction 6

Roadrunner issued a check for $350 in partial payment of the amount owed to its creditor, North Shore Auto.

<table>
<thead>
<tr>
<th>ANALYSIS</th>
<th>Identify</th>
<th>Classify</th>
<th>+/−</th>
<th>Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1. The payment decreased the total amount owed to the creditor, so Accounts Payable is affected. Payment was made by check, so the account Cash in Bank is affected.</td>
<td>2. Accounts Payable is a liability account. Cash in Bank is an asset account.</td>
<td>3. Accounts Payable is decreased by $350. Cash in Bank is also decreased by $350.</td>
<td>4. The accounting equation remains in balance.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Assets</th>
<th>Liabilities</th>
<th>Owner’s Equity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash in Bank</td>
<td>Accounts Payable</td>
<td>Maria Sanchez, Capital</td>
</tr>
<tr>
<td>Accounts Receivable</td>
<td>Computer Equipment</td>
<td>Office Equipment</td>
</tr>
<tr>
<td>Prev. Bal.</td>
<td>$22,000</td>
<td>$12,000</td>
</tr>
<tr>
<td>Trans. 6</td>
<td>−350</td>
<td>−350</td>
</tr>
<tr>
<td>Balance</td>
<td>$21,650</td>
<td>$11,650</td>
</tr>
</tbody>
</table>

### Business Transaction 7

Roadrunner received and deposited a check for $200 from Green Co. The check received is full payment for the telephone sold on account in Transaction 5.

<table>
<thead>
<tr>
<th>ANALYSIS</th>
<th>Identify</th>
<th>Classify</th>
<th>+/−</th>
<th>Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1. The check decreases the amount owed to Roadrunner, so Accounts Receivable is affected. A check is given in payment, so Cash in Bank is affected.</td>
<td>2. Accounts Receivable and Cash in Bank are asset accounts.</td>
<td>3. Accounts Receivable is decreased by $200. Cash in Bank is increased by $200.</td>
<td>4. The accounting equation remains in balance.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Assets</th>
<th>Liabilities</th>
<th>Owner’s Equity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash in Bank</td>
<td>Accounts Payable</td>
<td>Maria Sanchez, Capital</td>
</tr>
<tr>
<td>Accounts Receivable</td>
<td>Computer Equipment</td>
<td>Office Equipment</td>
</tr>
<tr>
<td>Prev. Bal.</td>
<td>$21,650</td>
<td>$11,650</td>
</tr>
<tr>
<td>Trans. 7</td>
<td>+200</td>
<td>−200</td>
</tr>
<tr>
<td>Balance</td>
<td>$21,850</td>
<td>$11,650</td>
</tr>
</tbody>
</table>

As you can see, each business transaction causes a change in assets, liabilities, or owner’s equity. Analyzing each transaction to see how it affects the accounting equation keeps everything in balance.
Do the Math

The basic accounting equation is in the form of \( A = L + OE \)

1. What is the algebra equation to find \( L \)?
2. What is the algebra equation to find \( OE \)?

Using the rules of algebra, determine the missing dollar amount in each equation.

\[
\begin{array}{ccc}
\text{Assets} & = & \text{Liabilities} + \text{Owner's Equity} \\
? & = & $9,000 + $21,000 \\
$25,000 & = & ? + $11,000 \\
$10,000 & = & $2,000 + ?
\end{array}
\]

Problem 3–2 Determining the Effects of Transactions on the Accounting Equation

Instructions Use these accounts to analyze the business transactions of WordService.

\[
\begin{array}{ccc}
\text{Assets} & = & \text{Liabilities} + \text{Owner's Equity} \\
\text{Cash in Bank} & = & \text{Accounts Payable} + \text{Jan Swift, Capital} \\
\text{Accounts Receivable} & & \\
\text{Computer Equipment} & & \\
\text{Office Furniture} & & 
\end{array}
\]

On the form provided in your working papers, identify the accounts affected by each transaction and the amount of increase or decrease in each account. Make sure the accounting equation is in balance after each transaction.

1. Jan Swift, owner, deposited $30,000 in the business checking account.
2. The owner transferred to the business a desk and chair valued at $700.
3. WordService issued a check for $4,000 for the purchase of a computer.
4. The business bought office furniture on account for $5,000 from Eastern Furniture.
5. The desk and chair previously transferred to the business by the owner were sold on account for $700.
6. WordService wrote a check for $2,000 in partial payment of the amount owed to Eastern Furniture Company.
United Parcel Service (UPS) has thousands of shareholders who expect a return on their investment in the business. The most common way for a business to provide a return is by selling goods or providing services. UPS earns revenue by providing a global delivery service. To provide the delivery service, UPS incurs expenses like salaries, transportation, and insurance. In this section you will learn about revenue and expense transactions as well as owner’s withdrawals.

Revenue and Expense Transactions

What Are Revenue and Expenses?

Income earned from the sale of goods or services is called revenue. Examples of revenue are fees earned for services performed and cash received from the sale of merchandise. Revenue increases owner’s equity because it increases the assets of the business.

Both revenues and investments by the owner increase owner’s equity, but these represent very different transactions:

- Revenue is income from the sale of goods and services.
- Investment by the owner is the dollar amount contributed to the business by the owner.

To generate revenue most businesses must also incur expenses to buy goods, materials, and services. An expense is the cost of products or services used to operate a business. Examples of business expenses are:

- rent,
- utilities, and
- advertising.

Expenses decrease owner’s equity because they decrease the assets of the business or increase liabilities.

The effects of revenue and expenses are summarized as follows:

- Revenue increases assets and increases owner’s equity.
- Expenses decrease assets and decrease owner’s equity or increase liabilities and decrease owner’s equity.
### Business Transaction 8

Roadrunner received a check for $1,200 from a customer, Sims Corporation, for delivery services.

<table>
<thead>
<tr>
<th><strong>ANALYSIS</strong></th>
<th><strong>Identify</strong></th>
<th><strong>Classify</strong></th>
<th><strong>+/−</strong></th>
<th><strong>Balance</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1. Roadrunner received cash, so <strong>Cash in Bank</strong> is affected. The payment received is revenue. Revenue increases owner’s equity, so <strong>Maria Sanchez, Capital</strong> is also affected.</td>
<td><strong>Cash in Bank</strong> is an asset account. <strong>Maria Sanchez, Capital</strong> is an owner’s equity account.</td>
<td><strong>Cash in Bank</strong> is increased by $1,200. <strong>Maria Sanchez, Capital</strong> is also increased by $1,200.</td>
<td><strong>The accounting equation remains in balance.</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th><strong>Assets</strong></th>
<th><strong>Liabilities</strong></th>
<th><strong>Owner’s Equity</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Cash in Bank</strong></td>
<td><strong>Accounts Payable</strong></td>
<td><strong>Maria Sanchez, Capital</strong></td>
</tr>
<tr>
<td><strong>Accounts Receivable</strong></td>
<td><strong>Computer Equipment</strong></td>
<td><strong>Office Equipment</strong></td>
</tr>
<tr>
<td>+ <strong>Trans. 8</strong></td>
<td>+ 1,200</td>
<td>+ 1,200</td>
</tr>
<tr>
<td><strong>Balance</strong></td>
<td><strong>Cash in Bank</strong></td>
<td><strong>Accounts Payable</strong></td>
</tr>
<tr>
<td><strong>$23,050</strong></td>
<td>+ <strong>$0</strong></td>
<td>+ <strong>$3,000</strong></td>
</tr>
</tbody>
</table>

### Business Transaction 9

Roadrunner wrote a check for $700 to pay the rent for the month.

<table>
<thead>
<tr>
<th><strong>ANALYSIS</strong></th>
<th><strong>Identify</strong></th>
<th><strong>Classify</strong></th>
<th><strong>+/−</strong></th>
<th><strong>Balance</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1. Roadrunner pays rent for use of building space. Rent is an expense. Expenses decrease owner’s equity, so the account <strong>Maria Sanchez, Capital</strong> is affected. The business is paying cash for the use of the building, so <strong>Cash in Bank</strong> is affected.</td>
<td><strong>Maria Sanchez, Capital</strong> is an owner’s equity account. <strong>Cash in Bank</strong> is an asset account.</td>
<td><strong>Maria Sanchez, Capital</strong> is decreased by $700. <strong>Cash in Bank</strong> is decreased by $700.</td>
<td><strong>The accounting equation remains in balance.</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th><strong>Assets</strong></th>
<th><strong>Liabilities</strong></th>
<th><strong>Owner’s Equity</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Cash in Bank</strong></td>
<td><strong>Accounts Payable</strong></td>
<td><strong>Maria Sanchez, Capital</strong></td>
</tr>
<tr>
<td><strong>Accounts Receivable</strong></td>
<td><strong>Computer Equipment</strong></td>
<td><strong>Office Equipment</strong></td>
</tr>
<tr>
<td>- <strong>Trans. 9</strong></td>
<td>- 700</td>
<td>- 700</td>
</tr>
<tr>
<td><strong>Balance</strong></td>
<td><strong>Cash in Bank</strong></td>
<td><strong>Accounts Payable</strong></td>
</tr>
<tr>
<td><strong>$22,350</strong></td>
<td>+ <strong>$0</strong></td>
<td>+ <strong>$3,000</strong></td>
</tr>
</tbody>
</table>

### Withdrawals by the Owner

**What Is a Withdrawal?**

If a business earns revenue, the owner will take cash or other assets from the business for personal use. This transaction is called a
**Withdrawal.** Withdrawals and investments have opposite effects. A withdrawal decreases both assets and owner’s equity.

A withdrawal is not the same as an expense. Both decrease owner’s equity, but each represents a different transaction. An expense is the price paid for goods and services used to operate a business. For example, a gardening service purchases fertilizer and lawncare supplies to conduct daily operations. Withdrawals by the owner are cash or other assets taken from the business for the owner’s personal use. Transaction 10 illustrates the impact of a withdrawal on the accounting equation.

### Business Transaction 10

Maria Sanchez withdrew $500 from the business for her personal use.

**ANALYSIS**

1. A withdrawal decreases the owner’s claim to the assets of the business, so **Maria Sanchez, Capital** is affected. Cash is paid out, so the **Cash in Bank** account is affected.
2. **Maria Sanchez, Capital** is an owner’s equity account. **Cash in Bank** is an asset account.
3. **Maria Sanchez, Capital** is decreased by $500. **Cash in Bank** is decreased by $500.
4. The accounting equation remains in balance.

### Business Transaction 10

Maria Sanchez withdrew $500 from the business for her personal use.

**ANALYSIS**

1. A withdrawal decreases the owner’s claim to the assets of the business, so **Maria Sanchez, Capital** is affected. Cash is paid out, so the **Cash in Bank** account is affected.
2. **Maria Sanchez, Capital** is an owner’s equity account. **Cash in Bank** is an asset account.
3. **Maria Sanchez, Capital** is decreased by $500. **Cash in Bank** is decreased by $500.
4. The accounting equation remains in balance.

The following summarizes the transactions of this chapter. Can you describe what is happening in each line?

<table>
<thead>
<tr>
<th>Cash in Bank</th>
<th>Accounts Receivable</th>
<th>Computer Equipment</th>
<th>Office Equipment</th>
<th>Delivery Equipment</th>
<th>Accounts Payable</th>
<th>Maria Sanchez, Capital</th>
</tr>
</thead>
<tbody>
<tr>
<td>Prev. Bal.</td>
<td>$22,350</td>
<td>$0</td>
<td>$3,000</td>
<td>$200</td>
<td>$12,000</td>
<td>$11,650</td>
</tr>
<tr>
<td>Trans. 10</td>
<td>−500</td>
<td>$0</td>
<td>$3,000</td>
<td>$200</td>
<td>$12,000</td>
<td>$11,650</td>
</tr>
<tr>
<td>Balance</td>
<td>$21,850</td>
<td>$0</td>
<td>$3,000</td>
<td>$200</td>
<td>$12,000</td>
<td>$11,650</td>
</tr>
</tbody>
</table>

The following summarizes the transactions of this chapter. Can you describe what is happening in each line?

<table>
<thead>
<tr>
<th>Cash in Bank</th>
<th>Accounts Receivable</th>
<th>Computer Equipment</th>
<th>Office Equipment</th>
<th>Delivery Equipment</th>
<th>Accounts Payable</th>
<th>Maria Sanchez, Capital</th>
</tr>
</thead>
<tbody>
<tr>
<td>Prev. Bal.</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Trans. 1</td>
<td>+25,000</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>+25,000</td>
</tr>
<tr>
<td>Trans. 2</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>+400</td>
<td>+400</td>
</tr>
<tr>
<td>Trans. 3</td>
<td></td>
<td></td>
<td>−3,000</td>
<td>+3,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Trans. 4</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>+12,000</td>
<td>12,000</td>
</tr>
<tr>
<td>Trans. 5</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>+200</td>
<td>200</td>
</tr>
<tr>
<td>Trans. 6</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>−350</td>
<td>350</td>
</tr>
<tr>
<td>Trans. 7</td>
<td></td>
<td>+200</td>
<td>−200</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Trans. 8</td>
<td></td>
<td></td>
<td></td>
<td>+1,200</td>
<td></td>
<td>1,200</td>
</tr>
<tr>
<td>Trans. 9</td>
<td></td>
<td></td>
<td>−700</td>
<td>−200</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Trans. 10</td>
<td></td>
<td></td>
<td></td>
<td>−500</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Balance</td>
<td>$21,850</td>
<td>$0</td>
<td>$3,000</td>
<td>$200</td>
<td>$12,000</td>
<td>$11,650</td>
</tr>
</tbody>
</table>
**Do the Math**

Determine the Cash in Bank balance for Wiemack Landscape Designs after the third transaction that follows. All three transactions occurred on the same day. The Cash in Bank balance before the first transaction was $10,000.

1. John Wiemack, the owner, withdrew $1,000 from personal savings and deposited that amount in the business checking account.
2. Purchased computer equipment for $5,000; issued a check for 20 percent of the price and agreed to pay the balance at a later date.
3. Issued a check for $100 to buy tools.

**Problem 3–3 Determining the Effect of Transactions on the Accounting Equation**

**Instructions** Use the accounts of WordService to analyze these business transactions. The beginning balance for each account is shown following the account name.

<table>
<thead>
<tr>
<th>Assets</th>
<th>Liabilities</th>
<th>Owner’s Equity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash in Bank, $24,000</td>
<td>Accounts Payable, $3,000</td>
<td>Jan Swift, Capital, $30,700</td>
</tr>
<tr>
<td>Accounts Receivable, $700</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Computer Equipment, $4,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Office Equipment, $5,000</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

On the form provided in your working papers, identify the accounts affected by each transaction and the amount of the increase or decrease for each account. Make sure the accounting equation is in balance after each transaction.

1. Paid $50 for advertising in the local newspaper.
2. Received $1,000 as payment for preparing a report.
3. Wrote a $600 check for the month’s rent.
4. Jan Swift withdrew $800 for her personal use.
5. Received $200 on account from the person who had purchased the old office furniture.

---

**Reinforce the Main Idea**

Use a table like the one shown here to describe four transactions of a home decorating business. Indicate how each transaction affects owner’s equity.

<table>
<thead>
<tr>
<th>Type of Transaction</th>
<th>Transaction Description</th>
<th>Does Owner’s Equity Increase or Decrease?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Expense</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Investment</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Withdrawal</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Key Concepts

1. Property is anything of value that a person or business owns and therefore controls. Property is measured in dollars. In accounting, property appears in the records at the amount it cost the owner. Financial claims are the legal rights to property and are also measured in dollars. The relationship between property and financial claims is shown in the following equation:

\[
\text{PROPERTY} = \text{FINANCIAL CLAIMS}
\]

2. As it is used in accounting, the term equities refers to the financial claims on assets (property). The two types of equities in a business are
   - creditors’ financial claims, called liabilities, and
   - the owner’s financial claims, called owner’s equity.

3. The accounting equation is \( \text{ASSETS} = \text{LIABILITIES} + \text{OWNER’S EQUITY} \)

\[
\begin{align*}
\text{Property} & = \text{Financial Claims} \\
\text{ASSETS} & = \text{LIABILITIES} + \text{OWNER’S EQUITY} \\
\text{Items of value owned by the business} & = \text{Financial claims of creditors} + \text{Financial claims of owners}
\end{align*}
\]

4. A business transaction is an economic event that causes a change—either an increase or a decrease—in assets, liabilities, or owner’s equity. The accounting equation remains in balance after each transaction:

<table>
<thead>
<tr>
<th>Assets</th>
<th>Liabilities</th>
<th>Owner’s Equity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash in Bank</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Computer</td>
<td>0</td>
<td>+$600</td>
</tr>
<tr>
<td>Office Equipment</td>
<td>+$3,000</td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>+$3,000</td>
<td>+$600 + $3,000</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Trans. 1</th>
<th>Trans. 2</th>
<th>Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>$15,000</td>
<td>$15,000</td>
<td>$15,600</td>
</tr>
<tr>
<td>0</td>
<td>+$600</td>
<td>0 + $15,600</td>
</tr>
<tr>
<td>$15,000 + $600</td>
<td>0</td>
<td>0 + $15,600</td>
</tr>
<tr>
<td>$18,600</td>
<td>$18,600</td>
<td></td>
</tr>
</tbody>
</table>

Serge Toblek, Capital
The following table shows the effects of typical business transactions on the parts of the accounting equation.

<table>
<thead>
<tr>
<th>Transaction</th>
<th>Effects On:</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Assets</td>
</tr>
<tr>
<td>Investment of cash by owner</td>
<td>+</td>
</tr>
<tr>
<td>Investment of property</td>
<td>+</td>
</tr>
<tr>
<td>Cash payment for office equipment</td>
<td>-,+</td>
</tr>
<tr>
<td>Purchase of an asset on account</td>
<td>+</td>
</tr>
<tr>
<td>Sale of office equipment on account</td>
<td>-,+</td>
</tr>
<tr>
<td>Make a payment on account</td>
<td>-</td>
</tr>
<tr>
<td>Record revenue from a cash sale</td>
<td>+</td>
</tr>
<tr>
<td>Record a cash payment for an expense</td>
<td>-</td>
</tr>
<tr>
<td>Record a cash withdrawal by the owner</td>
<td>-</td>
</tr>
</tbody>
</table>

5. Use the following steps to analyze a business transaction:

**ANALYSIS**

Identify
Classify
 +/- Balance

1. Identify the accounts affected.
2. Classify the accounts affected.
3. Determine the amount of increase or decrease for each account affected.
4. Make sure the accounting equation remains in balance.

**Key Terms**

- account (p. 54)
- accounting equation (p. 52)
- accounts payable (p. 55)
- accounts receivable (p. 54)
- assets (p. 51)
- business transaction (p. 54)
- credit (p. 51)
- creditor (p. 51)
- equities (p. 52)
- expense (p. 60)
- financial claim (p. 50)
- investment (p. 55)
- liabilities (p. 52)
- on account (p. 57)
- owner’s equity (p. 52)
- property (p. 50)
- revenue (p. 60)
- withdrawal (p. 62)
Check Your Understanding

1. **Property and Financial Claims**
   a. Define the terms *property* and *financial claim*.
   b. What is the relationship between property and financial claims?

2. **Equities**
   a. Describe the relationship between assets and equities.
   b. Name the two types of equities in a business, and give an example of an account that is used for each type.

3. **The Accounting Equation**
   a. What is the accounting equation?
   b. Give an example of an account for each part of the accounting equation.

4. **Effects of Transactions**
   a. What is a business transaction?
   b. How does each of the following transactions affect the three parts of the accounting equation?
   - Trans. 1: Owner transferred cash from personal savings account to the business.
   - Trans. 2: Owner withdrew cash from the business for personal use.
   - Trans. 3: Purchased equipment for cash.
   - Trans. 4: Purchased equipment on credit.
   - Trans. 5: Issued a check for the first monthly payment for equipment purchased in Transaction 4.
   - Trans. 6: Received payment on the date of service for design consulting.
   - Trans. 7: Issued a check to pay the telephone bill.

5. **Accounting Equation in Balance**
   a. At least how many accounts must be affected by each business transaction? Why?
   b. Describe the four-step process described in this chapter used to analyze business transactions.

---

**Apply Key Terms**

Which of the following terms can be considered assets? Which terms relate to liabilities? Which terms do not fall easily into either category?

- accounts payable
- accounts receivable
- credit
- creditor
- expense
- investment
- on account
- property
- revenue
- withdrawal
Exploring Electronic Spreadsheets

Computer spreadsheets are important tools for organizing and analyzing data. A spreadsheet is made up of rows and columns. The columns are identified by letters and the rows are identified by numbers. As you create a spreadsheet, you will enter numbers, labels, and formulas into cells. Microsoft Excel® is the most commonly used spreadsheet application in the business world. The following is an example of a basic electronic spreadsheet:

<table>
<thead>
<tr>
<th>A</th>
<th>B</th>
<th>C</th>
<th>D</th>
<th>E</th>
<th>F</th>
<th>G</th>
<th>H</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Jan</td>
<td>Feb</td>
<td>March</td>
<td>April</td>
<td>May</td>
<td>June</td>
<td>July</td>
</tr>
<tr>
<td>2</td>
<td>Sales</td>
<td>2,500</td>
<td>5,000</td>
<td>1,650</td>
<td>10,000</td>
<td>3,100</td>
<td>8,200</td>
</tr>
<tr>
<td>3</td>
<td>Expenses</td>
<td>700</td>
<td>1,200</td>
<td>225</td>
<td>3,550</td>
<td>1,800</td>
<td>2,300</td>
</tr>
<tr>
<td>4</td>
<td>Net income</td>
<td>1,800</td>
<td>3,800</td>
<td>1,425</td>
<td>6,450</td>
<td>1,300</td>
<td>5,900</td>
</tr>
<tr>
<td>5</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>6</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Before you create a computer spreadsheet, review the following spreadsheet terms.

<table>
<thead>
<tr>
<th>Spreadsheet Terms</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Row</td>
<td>Identified by numbers down the left side of the spreadsheet.</td>
</tr>
<tr>
<td>2 Column</td>
<td>Identified by letters along the top of the spreadsheet.</td>
</tr>
<tr>
<td>3 Cell address</td>
<td>Identified by a column letter and row number. For example, the cell address B4 indicates the cell where the number 1,800 is found.</td>
</tr>
<tr>
<td>4 Active cell</td>
<td>Indicated by a dark border.</td>
</tr>
<tr>
<td>5 Scroll arrows</td>
<td>Allows you to view other parts of the spreadsheet.</td>
</tr>
<tr>
<td>6 Labels</td>
<td>Text that identifies columns or rows of information; cannot be used for calculations.</td>
</tr>
<tr>
<td>7 Values</td>
<td>Numbers inserted in cells that can be used for calculations.</td>
</tr>
<tr>
<td>8 Formulas</td>
<td>Mathematical functions entered in a particular cell that tells the software to add, subtract, divide, or multiply values. For example, E2 – E3 represents 10,000 – 3,550, or 6,450</td>
</tr>
</tbody>
</table>
Problem 3–4 Classifying Accounts
All accounts belong in one of the following classifications: Asset, Liability, Owner’s Equity.

**Instructions** In your working papers, indicate the classification for each of the following accounts.

1. John Jones, Capital
2. Cash in Bank
3. Accounts Receivable
4. Accounts Payable
5. Office Equipment
6. Delivery Equipment
7. Camping Equipment
8. Building
9. Land
10. Computer Equipment

---

Problem 3–5 Completing the Accounting Equation
A business owned and operated by Mike Murray uses these accounts.

**Instructions** Look at the following list of accounts, and determine the missing amount for each of the question marks.

\[
\text{Assets} = \text{Liabilities} + \text{Owner’s Equity}
\]

\[
\begin{align*}
\text{Cash in Bank} & = 4,500 \\
\text{Accounts Receivable} & = 1,350 \\
\text{Office Equipment} & = 5,000 \\
\text{Accounts Payable} & = ? \\
\text{Mike Murray, Capital} & = 9,250
\end{align*}
\]

**Analyze** Identify the accounts that represent financial claims to property.

---

Problem 3–6 Classifying Accounts Within the Accounting Equation
Listed here are the account names and balances for Wilderness Rentals.

\[
\begin{align*}
\text{Accounts Payable} & = 7,000 \\
\text{Accounts Receivable} & = 2,000 \\
\text{Camping Equipment} & = 12,000 \\
\text{Cash in Bank} & = 5,000 \\
\text{Office Equipment} & = 3,000 \\
\text{Ronald Hicks, Capital} & = 15,000
\end{align*}
\]

**Instructions** Using these account names and balances:

1. List and total the assets of the business.
2. Determine the amount owed by the business.
3. Give the amount of the owner’s equity in the business.

**Analyze** Design a diagram that shows the accounting equation for Wilderness Rentals.
Problem 3–7 Determining Increases and Decreases in Accounts

Hot Suds Car Wash uses the following accounts:

\[
\text{Assets} = \text{Liabilities} + \text{Owner's Equity}
\]

- Cash in Bank
- Accounts Receivable
- Office Equipment
- Office Furniture
- Car Wash Equipment
- Accounts Payable
- Regina Delgado, Capital

**Instructions** Use a form similar to the one that follows. For each transaction:

1. Identify the accounts affected.
2. Classify the accounts.
3. Determine the amount of the increase (+) or decrease (−) for each account affected.

The first transaction is completed as an example.

<table>
<thead>
<tr>
<th>Trans.</th>
<th>Accounts Affected</th>
<th>Classification</th>
<th>Amount of Increase (+) or Decrease (−)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Cash in Bank Regina Delgado, Capital</td>
<td>Asset</td>
<td>+$25,000</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Owner's Equity</td>
<td>+$25,000</td>
</tr>
</tbody>
</table>

**Date Transactions**

<table>
<thead>
<tr>
<th>Date</th>
<th>Transactions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Jan. 1</td>
<td>1. Regina Delgado, the owner, invested $25,000 cash in the business.</td>
</tr>
<tr>
<td></td>
<td>2. Bought car wash equipment with cash for $12,000.</td>
</tr>
<tr>
<td></td>
<td>3. Purchased, on account, $2,500 of office equipment.</td>
</tr>
<tr>
<td>10</td>
<td>4. Wrote a check for the monthly rent, $800.</td>
</tr>
<tr>
<td>12</td>
<td>5. Received cash for services performed, $1,000.</td>
</tr>
<tr>
<td>15</td>
<td>6. The owner withdrew $600 cash from the business for personal use.</td>
</tr>
<tr>
<td>20</td>
<td>7. Purchased a desk for $1,000, paying $200 cash and agreeing to pay the balance of $800 in 30 days.</td>
</tr>
<tr>
<td>25</td>
<td>8. Provided services worth $600 on account.</td>
</tr>
</tbody>
</table>

**Analyze** Identify the transaction that affects the most accounts.
Problem 3–8 Determining the Effects of Transactions on the Accounting Equation

After graduating from college, Abe Shultz decided to start a pet grooming service called Kits & Pups Grooming.

Instructions Use a form similar to the one that follows. For each of the following transactions:

1. Identify the accounts affected, using the account names on the form.
2. Determine the amount of the increase or decrease for each account.
3. Write the amount of the increase (+) or decrease (−) in the space under each account affected.
4. On the following line, write the new balance for each account.
5. Transaction 1 is completed as an example.

<table>
<thead>
<tr>
<th>Date</th>
<th>Transactions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Jan. 2</td>
<td>1. Abe Shultz began the business by depositing $10,000 in a checking account at the Shoreline National Bank in the name of the business, Kits &amp; Pups Grooming.</td>
</tr>
<tr>
<td>3</td>
<td>2. Bought grooming equipment for cash, $1,000.</td>
</tr>
<tr>
<td>8</td>
<td>3. Issued a check for $900 for the monthly rent.</td>
</tr>
<tr>
<td>9</td>
<td>4. Bought $6,000 worth of new office equipment on account for use in the business.</td>
</tr>
<tr>
<td>15</td>
<td>5. Received $700 cash for services performed for customers during the first week of business.</td>
</tr>
<tr>
<td>21</td>
<td>6. Issued a $2,000 check to the creditor as partial payment for the office equipment purchased on account.</td>
</tr>
<tr>
<td>29</td>
<td>7. Performed grooming services and agreed to be paid for them later, $500.</td>
</tr>
</tbody>
</table>

Analyze Explain the difference between Transaction 5 and Transaction 7.

Problem 3–9 Determining the Effects of Transactions on the Accounting Equation

Juanita Ortega is the owner of a professional guide service called Outback Guide Service.
Problems

CHAPTER 3

Instructions Use a form similar to the one below. Complete these steps for each of the following transactions:

1. Identify the accounts affected.
2. Write the amount of the increase (+) or decrease (−) in the space provided on the form in your working papers.
3. Determine the new balance for each account.

<table>
<thead>
<tr>
<th>Date</th>
<th>Transactions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Jan. 3</td>
<td>1. Ms. Ortega, the owner, opened a checking account for the business by depositing $60,000 of her personal funds.</td>
</tr>
<tr>
<td>6</td>
<td>2. Paid by check the monthly rent of $3,000.</td>
</tr>
<tr>
<td>8</td>
<td>3. Bought hiking equipment for the business by writing a check for $3,000.</td>
</tr>
<tr>
<td>9</td>
<td>4. Purchased $24,000 of rafting equipment by writing a check.</td>
</tr>
<tr>
<td>11</td>
<td>5. Purchased office equipment on account for $4,000.</td>
</tr>
<tr>
<td>15</td>
<td>6. Received payment for guide services, $2,500.</td>
</tr>
<tr>
<td>18</td>
<td>7. Ms. Ortega contributed a desk valued at $450 to the business.</td>
</tr>
<tr>
<td>21</td>
<td>8. Withdrew $3,000 cash from the business for personal use.</td>
</tr>
<tr>
<td>26</td>
<td>9. Wrote a check to a creditor as partial payment on account, $1,500.</td>
</tr>
<tr>
<td>30</td>
<td>10. Took a group on a tour and agreed to accept payment later, $1,200.</td>
</tr>
</tbody>
</table>

Analyze Calculate the amount owed to creditors after Transaction 10.

Problem 3–10 Describing Business Transactions

Showbiz Video is a business owned by Greg Failla. The transactions that follow are shown as they would appear in the accounting equation.

Instructions In your working papers, describe what has happened in each transaction. Transaction 1 is completed as an example.

Example:
1. The owner invested $30,000 in the business.
### Problem 3–11 Completing the Accounting Equation

The account names and balances for Job Connect are listed below.

**Instructions** Determine the missing amount for each of the question marks. Use the form in your working papers and write in the missing amounts.

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>?</td>
<td>$2,000</td>
<td>$1,000</td>
<td>$500</td>
<td>$7,500</td>
</tr>
<tr>
<td>2</td>
<td>$3,000</td>
<td>$9,000</td>
<td>?</td>
<td>$2,000</td>
<td>$16,000</td>
</tr>
<tr>
<td>3</td>
<td>$8,000</td>
<td>$1,000</td>
<td>$10,000</td>
<td>?</td>
<td>$15,000</td>
</tr>
<tr>
<td>4</td>
<td>$4,000</td>
<td>?</td>
<td>$4,000</td>
<td>$1,000</td>
<td>$17,000</td>
</tr>
<tr>
<td>5</td>
<td>$9,000</td>
<td>$7,000</td>
<td>$6,000</td>
<td>$5,000</td>
<td>?</td>
</tr>
<tr>
<td>6</td>
<td>$10,000</td>
<td>$14,000</td>
<td>?</td>
<td>$6,000</td>
<td>$32,000</td>
</tr>
<tr>
<td>7</td>
<td>$6,000</td>
<td>$4,000</td>
<td>$10,000</td>
<td>?</td>
<td>$15,000</td>
</tr>
<tr>
<td>8</td>
<td>?</td>
<td>$5,000</td>
<td>$9,000</td>
<td>$1,000</td>
<td>?</td>
</tr>
</tbody>
</table>

 Hint: In line 8, total assets are $18,000.

**Analyze** Explain the mathematical operations used to solve for the accounting equation.
Winning Competitive Events

CHAPTER 3

Practice your test-taking skills! The questions on this page are reprinted with permission from national organizations:
• Future Business Leaders of America
• Business Professionals of America

Use a separate sheet of paper to record your answers.

Future Business Leaders of America
MULTIPLE CHOICE
1. Things of value a business uses to generate income are known as
   a. assets. c. expenses.
   b. capital. d. revenue.

Business Professionals of America
MULTIPLE CHOICE
2. If a customer sends in a payment on his account owed, which of the following statements is true?
   a. One asset increases and another asset decreases.
   b. One asset increases and one liability decreases.
   c. One liability decreases and owner’s equity increases.
   d. One liability increases and owner’s equity increases.

3. Use these account balances to complete the next two questions:
   Cash in Bank $3,200.00   Amy Smith, Capital $6,200.00
   Accounts Receivable ?  Amy Smith, Drawing 1,000.00
   Office Supplies 300.00   Boarding Revenue 1,400.00
   Office Furniture 1,200.00 Grooming Revenue ?
   Office Equipment 1,800.00 Salaries Expense 300.00
   Accounts Payable ?   Miscellaneous Expense 200.00

   If the balance in Accounts Payable is $2,000.00 and Grooming Revenue is $400.00, what is the correct balance for the Accounts Receivable account?
   a. $800.00   c. $2,000.00
   b. $1,500.00 d. $2,500.00

4. Use the above table in #3 to answer this question.
   If the Accounts Receivable balance is $800.00 and Grooming Revenue is $600.00, what is the balance in the Accounts Payable account?
   a. $600.00   c. $1,200.00
   b. $800.00   d. $2,000.00

5. If owner’s equity is $25,500, and assets are $37,600, liabilities are
   a. $25,500.
   b. $37,600.
   c. $63,100.
   d. $12,100.

Need More Help?
Go to glencoeaccounting.glencoe.com and click on Student Center. Click on Winning Competitive Events and select Chapter 3.
• Practice Questions and Test-Taking Tips
• Concept Capsules and Terminology
The Accounting Equation
1. What term identifies the owner’s claims to assets of the business?
2. Does owner’s equity increase every time a business acquires a new asset?
   Explain your answer.
3. You are analyzing transactions when you have to answer the telephone. After
   you finish the conversation, how can you tell whether you completed the
   transaction you were working on when the phone rang?
4. How is an expense similar to a withdrawal? How is it different?
5. Describe a series of transactions that could result in negative owner’s equity.
6. Assess the value of the four-step procedure for analyzing transactions.

Service Business: Health and Fitness
The Fitness Center, owned by Gail Chan, has been in business for two years. The
business is successful with its expanded hours of operation.

You are a local business consultant and have worked with several other small
businesses in the area. Ms. Chan has asked you about possible ways to obtain
money for new equipment. She has already borrowed money from family mem-
bers and cannot use them as a source of more funds.

INSTRUCTIONS
1. Evaluate possible sources of money for your client. Use the Internet and
   other sources to research alternatives with the Small Business Administra-
tion, the Chamber of Commerce, and local banks.
2. Make a list of alternatives. Include costs, interest rates, and advantages or
   disadvantages.
3. Make a recommendation to your client based on your list of alternatives.
4. Explain how the additional money will affect the accounting equation.

Company Property
Many companies provide office supplies for their employees’ use while on the
job. Imagine that you work for a large department store like JC Penney. Several of
your co-workers take company supplies home for their personal use, such as pens,
bags, hangers, and boxes. You need boxes to store some items at home, so you
consider taking them from the supply room.

ETHICAL DECISION MAKING
1. What are the ethical issues?
2. What are the alternatives?
3. Who are the affected parties?
4. How do the alternatives affect the parties?
5. What would you do?

Writing a Tip Sheet
Using the four-step approach to transaction analysis, write a “tip sheet” to help
a new employee remember the steps. Write a brief explanation and give an
example of each step in the analysis. Create a business transaction to use in your
explanation.
Applying Technology
Whether you work in a small or large business, technology is critical to efficiency in the workplace.

ON THE JOB
After graduating from college and working for a year as a junior accountant in a CPA firm, you decide to open an accounting business from your home. You’ll need a computer, software, and office furniture to get started. Complete the activities below to help you select the right software for your needs.

INSTRUCTIONS
1. List the kinds of financial services you would like to provide.
2. Research three accounting software packages that would help you deliver the services you listed. List the name, price, system requirements, and features of each software package. Use the Internet and other sources.
3. Select the software package that best meets your anticipated needs. Write a paragraph explaining why you selected this product.

Money Around the World
If you were on vacation in Mexico, you would pay for your lunch in pesos. Just as different countries use different languages, they also use their own type of money or currency. Many countries in Europe use the euro. India uses the rupee, and China uses the yuan. If you were an accountant recording business transactions in Switzerland, you would use Swiss francs.

INSTRUCTIONS Find a Web site on the Internet that lists world currencies. What currency is used in Japan? In the United Kingdom?

Your Earning Power
Your future income will depend on various things including your career choice, your education, and the region where you live.

PERSONAL FINANCE ACTIVITY List three jobs that are in different fields and different regions of the United States. Use the Internet or your library to research their education requirements and their salary ranges. Create a table to organize the results of your research.

PERSONAL FINANCE ONLINE Log on to glencoeaccounting.glencoe.com and click on Student Center. Click on Making It Personal and select Chapter 3.