

## CHAPTER 2

# ANALYZING BUSINESS TRANSACTIONS

### **Chapter Opener: Thinking Critically**

The individuals in charge of keeping track of these transactions at Southwest as well as in other companies, are known as accountants. When recording the transactions, accountants are required to follow a set of rules and regulations known as GAAP.

For every financial transaction that Southwest has, their accountants determine the accounts that were affected and then they record, report and then analyze these transactions. By doing so they can, at a specific point in time and over a stipulated period, be able to assess the company's financial performance including profitability of the airline, assets owned by the company and of course the amount owed to creditors and owners.

### **Fast Facts**

- Southwest Airlines opened in 1971 with three planes flying between Houston, Dallas, and San Antonio. Southwest Airlines currently flies over 100 million passengers a year to 97 cities all across the country.
- For the fiscal year 2012, the company's net income was \$421 million while its total operating revenue was \$17.09 billion.
- In 2012 Southwest served 63.3 million cans of soda, juices, and water; 14.1 million alcoholic beverages; 37.2 million bags of pretzels; 88.3 million bags of peanuts; 22.9 million Select-A-Snacks; and 45.5million other snacks.

### **Managerial Implications: Thinking Critically**

Answers will vary. Students should mention total assets and the type of assets, the liabilities the business would be responsible for, and whether the business is making a profit.

### **Discussion Questions**

*Note to instructor:* These questions are designed to check students' understanding of new terms, concepts, and procedures presented in the chapter.

1. Assets = Liabilities + Owner's Equity
2. Assets: property owned. Liabilities: debts. Owners' equity: owner's financial interest.
3. Assets, liabilities, and owner's equity.
4. Revenue and expenses; net income or loss
5. Beginning-of-period capital balance, additional investments, net income/loss for period, less **withdrawals ending capital balance.**
6. Firm name, title of statement, date of statement or the period of time covered
7. Balance sheet shows position at particular date; increase of operations for a period of time
8. **Inflow of money/assets resulting from sales or use of property.**
9. Outflow of money/assets for costs used to produce revenue.

**Discussion Questions (continued)**

10. Subtract total expenses from revenue
11. Increases owner's equity
12.
  - a. assets increase, owner's equity increase
  - b. one asset increase and another decrease; no change in total assets
  - c. assets decrease, liabilities decrease
  - d. assets increase, owner's equity increase
  - e. assets decrease, owner's equity decrease
  - f. assets decrease, owner's equity decrease

**EXERCISE 2.1**

Assets:	\$125,900
Liabilities:	\$26,225
Owners' Equity	\$99,675

**EXERCISE 2.2**

1. \$22,240
2. \$19,020
3. \$5,675
4. \$36,725
5. \$8,875

**EXERCISE 2.3**

Transaction	Assets	=	Liabilities	+	Owners' Equity	
1.	<u>I</u>		<u></u>		<u>I</u>	<b>I = Increase (-)</b>
2.	<u>I</u>		<u>I</u>		<u></u>	<b>D = Decrease (+)</b>
3.	<u>I/D</u>		<u></u>		<u></u>	
4.	<u>I/D</u>		<u></u>		<u></u>	
5.	<u>I</u>		<u></u>		<u>I</u>	
6.	<u>D</u>		<u></u>		<u>D</u>	
7.	<u>I</u>		<u></u>		<u>I</u>	
8.	<u>I/D</u>		<u></u>		<u></u>	
9.	<u>D</u>		<u></u>		<u>D</u>	
10.	<u>D</u>		<u>D</u>		<u></u>	

**EXERCISE 2.4**

	Assets	=	Liabilities	+	Owner's Equity
1.	Cash \$13,500		Accounts Payable \$23,180	+	David Malone, Capital \$28,520
2.	Dental Supplies 3,650	=	<u></u>	+	<u></u>
3.	Dental Equipment 26,550	=	<u></u>	+	<u></u>
4.	Office Furniture 8,000	=	<u></u>	+	<u></u>
5.	Total \$51,700	=	<u>\$23,180</u>	+	<u>\$28,520</u>

## **EXERCISE 2.5**

	Assets		=	Liabilities	+	Owner's Equity			
	Cash	+ Accounts Receivable	+	Equipment	=	Payable	+ John Amos Capital	+ Revenue	- Expenses
1.	+\$60,000						+\$60,000		
2.				+22,000		+22,000			
3.	+3,100							+3,100	
4.	-4,600			+4,600					
5.		+5,050						+5,050	
6.	-4,450								4,450
7.	+3,200	-3,200							
8.	-13,000					-13,000			
Totals	\$44,250	+\$1,850	+	\$26,600	=	\$9,000	+\$60,000	+\$8,150	-\$4,450

## **EXERCISE 2.6**

Net income of \$23,000

### **Revenue**

Repair Fees ..... \$51,150

### **Expenses**

Advertising Expense ..... \$6,300

Salaries Expense ..... 19,100

Telephone Expense ..... 1,150

Utilities Expense ..... 1,600

Total Expenses ..... \$28,150

Net Income ..... \$23,000

## **EXERCISE 2.7**

1. Services were performed for cash.
2. Equipment was purchased for cash.
3. A payment was made on the amount owed to a creditor.
4. An expense was paid in cash.
5. Cash was received from charge customer.
6. Services were performed on credit.
7. An expense was paid in cash.

**EXERCISE 2.8**

Perez Investment Services										
Income Statement										
Month Ended September 30, 2016										
Revenue										
Fees Income							77	9	0	00
Expenses										
Advertising Expense	6	5	0	0	00					
Salaries Expense	16	0	0	0	00					
Telephone Expense		8	0	0	00					
Total Expenses						23	3	0	0	00
Net Income						54	6	0	0	00

**EXERCISE 2.9**

Net Loss of \$1,150

Revenue

Service Revenue ..... \$5,800

Expenses

Advertising Expense..... \$3,100

Telephone Expense..... 800

Salaries Expense ..... 2,600

Cleaning Expense ..... 450

Total Expense ..... \$6,950

Net Loss ..... -\$1,150

**EXERCISE 2.10**

Perez Investment Services										
Statement of Owner's Equity										
Month Ended September 30, 2016										
Alexandria Perez, Capital, September 1, 2016										
Net Income for September	54	6	0	0	00					
Less Withdrawals for September	9	0	0	0	00					
Increase in Capital						45	6	0	0	00
Alexandria Perez, Capital, September 30, 2016						72	3	0	0	00

**EXERCISE 2.10 (continued)****Perez Investment Services**

## Balance Sheet

September 30, 2016

Assets						Liabilities					
Cash	33	1	0	0	00	Accounts Payable	5	7	0	0	00
Accounts Receivable	4	0	0	0	00						
Office Supplies	3	4	0	0	00	Owner's Equity					
Office Equipment	37	5	0	0	00	Alexandria Perez, Capital	72	3	0	0	00
Total Assets	78	0	0	0	00	Total Liabilities and Owner's Equity	78	0	0	0	00

**PROBLEM 2.1A**

	Assets				=	Liabilities	+	Owner's Equity			
	Cash	+	Accounts Receivable	+	Supplies	+	Equipment	=	Accounts Payable	+	Owner's Capital
1.	+\$97,000										+\$97,000
2.	-\$19,750						+\$19,750				
3.							+\$14,400		+\$14,400		
4.	-\$11,800								-\$11,800		
5.	+\$30,000										+\$30,000
6.	+\$8,200										+\$8,200
7.			+\$6,300								+\$6,300
8.	-\$4,000										-\$4,000
9.	+\$3,500		-\$3,500								
10.	-\$6,460						+\$6,460				
11.	-\$9,000										-\$9,000
Totals	\$87,690	+	\$2,800	+	\$6,460	+	\$34,150	=	\$2,600	+	\$128,500

Analyze: The ending balance in the Cash account is \$87,690.

**PROBLEM 2.2A**

Assets							=	Liabilities	+	Owner's Equity					
	Cash	+	Accounts Receivable	+	Office Furniture	+	Auto	=	Accounts Payable	+	M. Dickey Capital	+	Revenue	-	Expenses
Beginning Balances	\$61,000	+	\$16,600	+	\$35,800	+	\$23,500	=	\$11,200	+	\$91,500	+	\$58,600	-	\$24,400
1.			+6,680										+6,680		
New Balances	61,000	+	23,280	+	35,800	+	\$23,500	=	11,200	+	91,500	+	65,280	-	24,400
2.	-1,700				+1,700										
New Balances	59,300	+	23,280	+	37,500	+	\$23,500	=	11,200	+	91,500	+	65,280	-	24,400
3.	+11,200		-11,200												

**PROBLEM 2.2A (continued)**

	Assets						=	Liabilities	+	Owner's Equity					
	Cash	+	Accounts Receivable	+	Office Furniture	+	Auto	=	Accounts Payable	+	M. Dickey Capital	+	Revenue	-	Expenses
New															
Balances	70,500	+	12,080	+	37,500	+	\$23,500	=	11,200	+	91,500	+	65,280	-	24,400
4.	-880														+880
New															
Balances	69,620	+	12,080	+	37,500	+	\$23,500	=	11,200	+	91,500	+	65,280	-	25,280
5.	-4,500								-4,500						
New															
Balances	65,120	+	12,080	+	37,500	+	\$23,500	=	6,700	+	91,500	+	65,280	-	25,280
6.	-9,700														+9,700
New															
Balances	55,420	+	12,080	+	37,500	+	\$23,500	=	6,700	+	91,500	+	65,280	-	34,980
7.	-1,120														+1,120
New															
Balances	54,300	+	12,080	+	37,500	+	\$23,500	=	6,700	+	91,500	+	65,280	-	36,100
8.	+10,500												+10,500		
New															
Balances	64,800	+	12,080	+	37,500	+	\$23,500	=	6,700	+	91,500	+	75,780	-	36,100
9.	-2,350														+2,350
New															
Balances	62,450	+	12,080	+	37,500	+	\$23,500	=	6,700	+	91,500	+	75,780	-	38,450
10.		+	+12,500										+12,500		
New															
Balances	\$62,450	+	\$24,580	+	\$37,500	+	\$23,500	=	\$6,700	+	\$91,500	+	\$88,280	-	\$38,450

Analyze: Total assets equal \$148,030.

**PROBLEM 2.3A**

Brown Equipment Repair Service												
Balance Sheet												
February 29, 2016												
Assets					Liabilities							
Cash	34	3	0	0	00	Accounts Payable	24	0	0	0	00	
Supplies	6	3	8	0	00							
Accounts Receivable	13	2	0	0	00	Owner's Equity						
Equipment	78	0	0	0	00	James Brown, Capital	107	8	8	0	00	
Total Assets	131	8	8	0	00	Total Liabilities and Owner's Equity	131	8	8	0	00	

Analyze: Owner's Equity is \$107,880 at February 29, 2016.

**PROBLEM 2.4A**

Cotton Cleaning Service												
Income Statement												
Month Ended May 31, 2016												
Revenue												
Fees Income						7	8	8	0	00		
Expenses												
Utilities Expense		9	8	0	00							
Salaries Expense	8	9	0	0	00							
Telephone Expense		3	1	4	00							
Total Expenses						10	1	9	4	00		
Net Loss						(2	3	1	4	00)		

Cotton Cleaning Service												
Statement of Owner's Equity												
Month Ended May 31, 2016												
Taylor Cotton, Capital, May 1, 2016						50	6	0	0	00		
Net Loss for May	(2	3	1	4	00)							
Less Withdrawal for May	3	0	0	0	00							
Decrease in Capital						5	3	1	4	00)		
Taylor Cotton, Capital, May 31, 2016						45	2	8	6	00		



**PROBLEM 2.4A (continued)**

Cotton Cleaning Service											
Balance Sheet											
May 31, 2016											
Assets					Liabilities						
Cash	4	6	8	6	00	Accounts Payable	4	9	0	0	00
Accounts Receivable	5	9	0	0	00						
Supplies	5	8	0	0	00	Owner's Equity					
Equipment	33	8	0	0	00	Taylor Cotton, Capital	45	2	8	6	00
Total Assets	50	1	8	6	00	Total Liabilities and Owner's Equity	50	1	8	6	00

Analyze: The amount of \$45,286 (Taylor Cotton, Capital) was transferred to the balance sheet.

**PROBLEM 2.1B**

	Assets				=	Liabilities	+	Owner's Equity
	Cash	Accounts Receivable	Supplies	Equipment	=	Accounts Payable	+	Owner's Capital
1.	+\$72,000							+\$72,000
2.	-\$32,000			+\$32,000				
3.				+\$12,000		+\$12,000		
4.	-\$6,000					-\$6,000		
5.	+\$12,000							+\$12,000
6.	+\$8,400							+\$8,400
7.		+\$7,300						+\$7,300
8.	-\$5,200							-\$5,200
9.	+\$5,000	-\$5,000						
10.	-\$6,300		+\$6,300					
11.	-\$10,000							-\$10,000
Totals	\$37,900	+\$2,300	+\$6,300	+\$44,000	=	\$6,000	+	\$84,500

Analyze: Transaction 3 increased the Company's debt by \$12,000.

**PROBLEM 2.2B**

	Assets				=	Liabilities	+	Owner's Equity		
	Cash	Accounts Receivable	Supplies	Office Furniture	=	Accounts Payable	+	S. Cravens Capital	+	Revenue - Expenses
Beginning Balances	\$38,000	+\$12,000	+\$12,800	+\$24,000	=	\$10,000	+	\$49,800	+	\$52,000 - \$25,000
1.		+\$8,000								+\$8,000
New Balances	38,000	20,000	12,800	24,000	=	10,000	+	49,800	+	60,000 - 25,000
2.	-2,880									+2,880
New Balances	35,120	20,000	12,800	24,000	=	10,000	+	49,800	+	60,000 - 27,880
3.	+10,000									+10,000

**PROBLEM 2.2B (continued)**

	Assets					=	Liabilities	+	Owner's Equity			
	Cash	+ Accounts Receivable	+ Supplies	+ Office Furniture	=	Accounts Payable	+ S. Cravens Capital	+ Revenue	- Expenses			
New Balances	45,120	+ 20,000	+ 12,800	+ 24,000	=	10,000	+ 49,800	+ 70,000	- 27,880			
4.	-1,600											+1,600
New Balances	43,520	+ 20,000	+ 12,800	+ 24,000	=	10,000	+ 49,800	+ 70,000	- 29,480			
5.	-4,800					-4,800						
New Balances	38,720	+ 20,000	+ 12,800	+ 24,000	=	5,200	+ 49,800	+ 70,000	- 29,480			
6.	-1,920											+1,920
New Balances	36,800	+ 20,000	+ 12,800	+ 24,000	=	5,200	+ 49,800	+ 70,000	- 31,400			
7.	-14,000											+14,000
New Balances	22,800	+ 20,000	+ 12,800	+ 24,000	=	5,200	+ 49,800	+ 70,000	- 45,400			
8.	+11,200											+11,200
New Balances	34,000	+ 20,000	+ 12,800	+ 24,000	=	5,200	+ 49,800	+ 81,200	- 45,400			
9.			+2,000			+2,000						
New Balances	34,000	+ 20,000	+ 14,800	+ 24,000	=	7,200	+ 49,800	+ 81,200	- 45,400			
10.	+6,000	+ -6,000										
New Balances	\$40,000	+ \$14,000	+ \$14,800	+ \$24,000	=	\$7,200	+ \$49,800	+ \$81,200	- \$45,400			

Analyze: Owner's Equity balance is \$85,600; \$49,800 + (\$81,200 - \$45,400).

**PROBLEM 2.3B**

Smith's Tax Service												
Balance Sheet												
December 1, 2016												
Assets												
Cash	50	0	0	0	00							
Furniture	10	0	0	0	00							
Equipment	12	0	0	0	00							
Total Assets	72	0	0	0	00							
Liabilities												
Owner's Equity												
Douglas Smith, Capital						72	0	0	0	00		
Total Liabilities and Owner's Equity						72	0	0	0	00		

Analyze: The amount reported on the balance sheet for owner's equity would be \$56,000.

**PROBLEM 2.4B**

Kathryn Proctor, Attorney and Counselor of Law												
Income Statement												
Month Ended August 31, 2016												
Revenue												
Fees Income						10	8	0	0	00		
Expenses												
Utilities Expense			6	0	00							
Salaries Expense		5	4	0	00							
Telephone Expense			6	0	00							
Total Expenses						6	6	0	0	00		
Net Income						4	2	0	0	00		

Kathryn Proctor, Attorney and Counselor of Law												
Statement of Owner's Equity												
Month Ended August 31, 2016												
Kathryn Proctor, Capital, Aug. 1, 2016							23	2	0	0	00	
Net Income for August	4	2	0	0	00							
Less Withdrawals for August	1	2	0	0	00							
Increase in Capital							3	0	0	0	00	
Kathryn Proctor, Capital, Aug. 31, 2016							26	2	0	0	00	

Analyze: Net Income of \$4,200 was transferred from the income statement.

**PROBLEM 2.4B (continued)**

Kathryn Proctor, Attorney and Counselor at Law

Balance Sheet

August 31, 2016

Assets							Liabilities						
Cash	4	8	0	0	00		Accounts Payable		6	0	0	00	
Accounts Receivable	6	6	0	0	00								
Supplies	5	4	0	0	00		Owner's Equity						
Equipment	10	0	0	0	00		Kathryn Proctor, Capital	26	2	0	0	00	
Total Assets	26	8	0	0	00		Total Liabilities and Owner's Equity	26	8	0	0	00	

Analyze: Net income of \$4,200 was transferred from the income statement.

## CRITICAL THINKING PROBLEM 2.1

Determine the balance for Carl Nicholson, April 30, 2016.

Assets						=	Liabilities	+	Owner's Equity						
							C.								
							C. Nicholson			C. Nicholson					
Cash	+	Accounts Receivable	+	Machinery	=	Accounts Payable	+	Capital	-	Drawing	+	Revenue	-	Expenses	
\$30,000	+	\$12,000	+	\$21,000	=	\$13,200	+	?	-	\$6,800	+	\$26,800	-	\$21,490	

Let Carl Nicholson, Capital = X.

Solving for X:

\$63,000 (Total Assets) = \$13,200 (Accounts Payable) - \$6,800 (Drawing) + \$26,800 (Revenue) - \$21,490 (Expenses) + X

$$\begin{aligned}
 & \$63,000 - \$11,710 = \$51,290 = X \\
 & \text{Carl Nicholson, Capital, April 1, 2016} = \underline{\underline{\$51,290}}
 \end{aligned}$$

Advertising Expense	\$3,890
Maintenance Expense	4,600
Salaries Expense	13,000
Total Expenses	<u><u>\$21,490</u></u>

**CRITICAL THINKING PROBLEM 2.1 (continued)**

Carl Nicholson, Certified Public Accountant

**Income Statement**

Month Ended April 30, 2016

Revenue										
Fees Earned						26	8	0	0	00
Expenses										
Advertising Expense	3	8	9	0	00					
Maintenance Expense	4	6	0	0	00					
Salaries Expense	13	0	0	0	00					
Total Expenses						21	4	9	0	00
Net Income						5	3	1	0	00

Carl Nicholson, Certified Public Accountant

**Statement of Owner's Equity**

Month Ended April 30, 2016

Carl Nicholson, Capital, April 1, 2016						51	2	9	0	00
Net Income for April	5	3	1	0	00					
Less Withdrawals for April	6	8	0	0	00					
Decrease in Capital						(1	4	9	0	00)
Carl Nicholson, Capital, April 30, 2016						49	8	0	0	00

Carl Nicholson, Certified Public Accountant

**Balance Sheet**

April 30, 2016

Assets						Liabilities					
Cash	30	0	0	0	00	Accounts Payable	13	2	0	0	00
Accounts Receivable	12	0	0	0	00	Owner's Equity					
Equipment	21	0	0	0	00	Carl Nicholson, Capital	49	8	0	0	00
Total Assets	63	0	0	0	00	Total Liabilities and Owner's Equity	63	0	0	0	00

/ Analyze: The decrease in owner's equity was \$1,490.

## **CRITICAL THINKING PROBLEM 2.2**

Body Builders Fitness Center												
Income Statement												
Two Months Ended December 31, 2016												
Revenue												
Fees Earned								9	7	6	0	00
Expenses												
Rent Expense		8	0	0	0	00						
Cleaning Expense		2	1	0	0	00						
Advertising Expense			8	0	0	00						
Total Expenses								10	9	0	0	00
Net Loss								(1	1	4	0	00)

Some students may include the warm-up suits as a business expense. If the suits are a type of uniform, their inclusion is appropriate; if they are to be worn at home and at work, their cost is not a business expense.

The parking ticket is a personal expense. The cleaning of the studio and the printing of the flyers are business expenses. Payment of expenses with the owner's personal credit card would be considered an additional investment by the owner.

It is not unusual for new businesses to operate at a loss. James should project his income and expenses for the next several months to determine how much new business he will need to earn an income. Students' suggestions for improving the accounting system might include opening a business checking account, not using a personal credit card for business expenses, setting up a filing system for business records, and purchasing a computer to maintain financial records.



## **SOLUTIONS TO BUSINESS CONNECTIONS**

### **Managerial Focus:**

1. Not necessarily. Reinvestments in assets or use of cash to pay debts affect cash. In addition, sales or revenue may have been "on account."
2. No. Early development is expensive, risky, and time consuming. Profits may not be achieved for a year or more.
3. The firm's obligations must be met as they become due.
4. Organized financial information can be used to evaluate operating efficiency and to make decisions about current and future activities.

### **Ethical Dilemma:**

goods are shipped. If she enters the sale and for some reason the customer doesn't make the order or the goods are not available for shipment, Carol would need to pay the bonus back. Julia's job would be in jeopardy.

### **Financial Statement Analysis:**

1. Southwest Airlines Co., Consolidated Statement of Income, Years Ended December 31,
2. Passenger, Freight, Other.
3. Statement of Owner's Equity (Consolidated Statement of Stockholders' Equity).
4. Total operating revenue was \$4.2 billion for the quarter ended December 31, 2012.
5. See current topic on website.

### **Internet Connection:**

Macy's, Bloomingdales, and now May is included in the Federated Corporation. Shopping online is on every home page. To record an online sale it must debit a credit card receivable and credit sales. A general job announcement and requirements are given at the site.

### **Team Work:**

Accounts Payable Clerk would use Purchases (Increase), A/P (increase and decrease) and Cash (decrease). Accounts Receivable Clerk would use Sales (increase), A/R (increase and decrease) and Cash (increase). Full charge bookkeeper would use accounts Cash (increase and decrease), Bank Charges (increase) and Miscellaneous account (increase), Interest Income (increase), Interest Expense (increase). Accurate numbers are developed when it is determined that all transactions have been entered and that total assets equal total liabilities plus owner's equity.

# SOLUTIONS TO PRACTICE TEST

## **Part A True-False**

1. TRUE
2. TRUE
3. FALSE
4. TRUE
5. FALSE
6. TRUE
7. FALSE
8. TRUE
9. FALSE
10. TRUE

## **Part B Matching**

1. b
2. f
3. e
4. c
5. h
6. d
7. g
8. a

## **Part C Completion**

1. profit
2. credit or on account
3. reduced or decreased
4. assets
5. asset or property
6. equal
7. accounts payable or liability
8. analyze