

CHAPTERS 1-25

13TH EDITION

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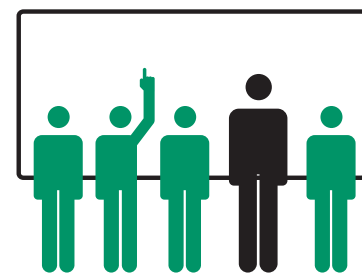
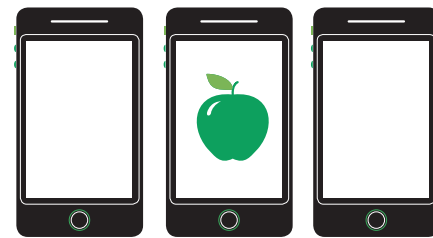
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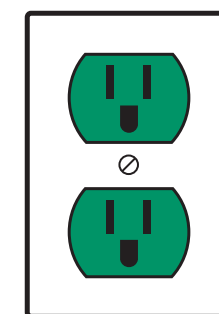
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Thirteenth Edition

Chapters 1–25

Jeffrey Slater

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Library of Congress Cataloging-in-Publication Data

Slater, Jeffrey

College accounting : a practical approach, chapters 1–25 / Jeffrey Slater. — Thirteenth edition.
pages cm

ISBN 978-0-13-379100-6 — ISBN 0-13-379100-9

1. Accounting. I. Title.

HF5636.S6315 2014

657'.044—dc23

2014040768

10 9 8 7 6 5 4 3 2 1

PEARSON

www.pearsonhighered.com

ISBN 10: 0-13-379100-9
ISBN 13: 978-0-13-379100-6

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Preface

NEW TO THIS EDITION

All Chapters:

- Found after each Learning Unit, Try It! Interactive questions give students the opportunity to apply the concept they just learned. Linking in the eText will allow students to practice in MyAccountingLab without interrupting their interaction with the eText. Students' performance on the questions creates a precise adaptive study plan in MyAccountingLab for additional practice.
- New discussions of modern accounting techniques and tools bring accounting practice into the 21st century, while still focusing on building basic skills and background knowledge so students can critically understand their practice.
- Updated end-of-chapter problem material gives a fresh opportunity for students and instructors to apply the concepts they have learned.
- New Demonstration Summary Problems for Chapters 6–25 walk students through a sample problem as if they were getting one-on-one help from their instructor.
- New Computer Workshops for QuickBooks and Sage 50 (formerly Peachtree) give students an opportunity to practice in real-world applications.
- New Learning Objectives align with Learning Units for easy class organization and topic coverage.

SAMPLING OF CHAPTER-SPECIFIC UPDATES

Chapter 1: Accounting Concepts and Procedures

- New discussion in Learning Unit 1-3 of Cash Basis versus Accrual Accounting. This new section reinforces the matching principle as students begin recording transactions into the expanded accounting equation. This discussion sets the framework for the text's use of the Accrual Basis of Accounting.
- New chapter-wide continuing demonstration problem.

Chapter 4: The Accounting Cycle Continued

- New learning unit added to Chapter 4. This new unit focuses on adjustments and how to record them on the worksheet. A step-by-step approach is used to place adjustments on the worksheet. The remainder of the chapter focuses on completion of the worksheet and preparing the financial statements.

Chapter 6: Banking Procedure and Control of Cash

- This chapter provides a fresh look at how technology is changing the banking process. A new focus is on the latest trends in banking and how banking apps provide easy smartphone access to banking. Mobile banking has been completely updated to provide students with the latest technology updates like computerized bank deposits and virtual checks.

Chapter 7: Calculating Pay and Recording Payroll Taxes: The Beginning of the Payroll Process

- This chapter takes a new approach to simplifying concepts. All tables, figures and rates have been updated to use the 2014 rates. The chapter also features a new presentation of the payroll register in a much more concise format to enhance student learning.

Chapter 8: Paying the Payroll, Depositing Payroll Taxes, and Filing the Required Quarterly and Annual Tax Forms: The Conclusion of the Payroll Process

- New forms are included in this chapter, along with a simplified presentation of tax deposits and new information about FUTA—its new rate and form. This chapter has also been streamlined from the previous edition. Students can more clearly see the relationship of the employee to the employer.

Chapter 16: Accounting for Property, Plant, Equipment, and Intangible Assets

- Updated material introduced for depreciation for tax purpose. References are now made to GDS (General Depreciation System) and ADS (Alternative Depreciation Systems). Emphasis is placed on tax reporting versus financial reporting.

Visual Walkthrough

COACHING SUCCESS WITH IN-CHAPTER LEARNING TOOLS



TRY IT!

Learning Unit 1-1

Record the following transactions into the basic accounting equation:

$$\text{Cash} + \text{Salon Equipment} = \text{Accounts Payable} + \text{B. Rey, Capital}$$

1. Bernie Rey invests \$20,000 to open a hair salon company.
2. The hair salon company buys new salon equipment for \$10,000, paying \$4,000 down and charging the balance.

Calculate the ending balances.

• Try It! Interactive Questions

NEW! Found at the end of each Learning Unit, these questions provide students a chance to check their understanding of key concepts in the unit. Linking in the eText will allow students to practice in MyAccountingLab without interrupting their interaction with the eText. Students' performance on the questions creates a precise adaptive study plan for additional practice.

• Video Solutions

NEW! Found in the eText and MyAccountingLab, the video solutions feature the author walking through the Try It! questions on a white board. Designed to give students detailed help when they need it.

• Coaching Tips

These kernels of advice are short, sweet, and to the point. These tips have been placed strategically throughout the text, where students are known to need a hint or reminder.



COACHING TIP

In accounting, capital does not mean cash. Capital is the owner's current investment, or equity, in the assets of the business.

ACCOUNTING COACH

CHAPTER

1

The following Coaching Tips are from Learning Units 1-1 through 1-4. Take the Pre-Game Checkup and use the Check Your Score at the bottom of the page to see how you are doing. The Accounting Coach provides tips before each Checkup to help you avoid common accounting errors.

LU 1-1 Accounting, Business, and the Accounting Equation

Pre-Game Tips: After a transaction is recorded in the accounting equation, the sum of all the assets must equal the total of all the liabilities and owner's equity.

Pre-Game Checkup: Answer true or false to the following statements.

1. Capital is cash.
2. Accounts Payable is a liability.
3. A shift in assets means liabilities will increase.
4. Assets - Liabilities = Owner's Equity.
5. Assets represent what is owned by the business.

LU 1-2 The Balance Sheet

LU 1-3 The Accounting Equation Expanded: Revenue, Expenses, and Withdrawals

Pre-Game Tips: Revenue is recorded when earned even if cash is not received. Expenses are recorded when they happen (incurred) whether they are paid or to be paid later.

Pre-Game Checkup: Answer true or false to the following statements.

1. Revenue is an asset.
2. Withdrawals increase owner's equity.
3. As expenses go down, owner's equity goes down.
4. An advertising bill incurred but unpaid is recorded as an increase in Advertising Expense and a decrease in a liability.
5. Revenue inflows can only be in the form of cash.

LU 1-4 The Three Financial Statements

Pre-Game Tips: Net income from the income statement is

• Accounting Coach

Each Learning Unit of the chapter is summarized as a "Pre-Game Tip," for students to review before taking the "Pre-Game Checkup." These True/False questions, created by Jeffrey Slater, the author, challenge the student to apply what's learned in each section and help students focus on the key topics in each chapter.

END-OF-CHAPTER PRACTICE MATERIAL

• Chapter Summary

Organized by Learning Objective, the Chapter Summary breaks down the key elements of each objective, and provides easy reference to the key terms.

Chapter Summary

Here are all the key terms and equations to help you understand the concepts of this chapter and prepare you for your exam. After completing this review, go to [MyAccountingLab](#) for more practice opportunities.

	Concepts You Should Know	Key Terms
L01	Explain Accounting, Business, and the Accounting Equation 1. The functions of accounting involve analyzing, recording, classifying, summarizing, reporting, and interpreting financial information. 2. Forms of business organization: <ol style="list-style-type: none"> A sole proprietorship is a business owned by one person. A partnership is a business owned by two or more persons. A corporation is a business owned by stockholders. An LLC is owned by a limited number of members. 3. The Sarbanes-Oxley Act helps prevent fraud at publicly-held companies. 4. GAAP and IFRS are guidelines established by U.S. (GAAP) and international (IFRS) accounting standard boards.	Accounting (p. 2) Accounts payable (p. 7) Assets (p. 4) $Assets = Liabilities + Owner's Equity$ (p. 5) Basic accounting equation (p. 5) Bookkeeping (p. 4) Capital (p. 5) Corporation (p. 3) Creditor (p. 5) Equities (p. 5) Generally accepted accounting principles (GAAP) (p. 4) International Financial Reporting Standards (IFRS) (p. 4) Liabilities (p. 5) Limited Liability Company (p. 3) Manufacturer (p. 3) Merchandise company (p. 3) Owner's equity (p. 5) Partnership (p. 2) Service company (p. 3) Shift in assets (p. 6) Supplies (p. 6) Sole proprietorship (p. 2)
L02	Prepare a Balance Sheet 1. $Assets = Liabilities + Owner's Equity$ is the basic accounting equation. 2. Liabilities represent amounts owed to creditors. 3. Capital does not mean cash. 4. In a shift of assets the composition of assets changes but the total of assets does not change.	Balance sheet (p. 7) Statement of financial position (p. 7)

Discussion Questions and Critical Thinking/Ethical Case

1. What are the functions of accounting?
2. Define, compare, and contrast sole proprietorships, partnerships, and corporations.
3. How are businesses classified?
4. How has technology affected the role of the bookkeeper?
5. List the three elements of the basic accounting equation.
6. Define capital.
7. The total of the left-hand side of the accounting equation must equal the total of the right-hand side. True or false? Please explain.
8. A balance sheet tells a company where it is going and how well it performs. True or false? Please explain.
9. Revenue is an asset. True or false? Please explain.
10. Owner's equity is subdivided into what categories?
11. A withdrawal is a business expense. True or false? Please explain.

• Discussion Questions and Critical Thinking/Ethical Cases

The first set of end-of-chapter questions asks students to think critically about what they have just learned. They can be used in class to generate discussion or can be assigned as homework, requiring short essay answers.

Selected end-of-chapter problems are designed to be completed with Sage 50 or QuickBooks. All questions are available in MyAccountingLab.

• **Concept Checks**

These short exercises can be assigned as homework or discussed in class for difficult topics.

Exercises
MyAccountingLab

Set A

16A-1. Blue Company incurred the following expenditures to buy a new machine: ◀ **L01** (15 min)

- Invoice, \$28,000 less 9% cash discount.
- Freight charges, \$490.
- Assembly charges, \$1,100.
- Special base to support machine, \$508.
- Machine dropped and repaired, \$350.

What is the actual cost of the machine?

16A-2. From the following, prepare depreciation schedules for the first 2 years for (a) straight-line, (b) units-of-production, and (c) double declining-balance at twice the straight-line rate methods. ▶ **L02** (30 min)

- Machine purchased on January 1, \$1,470.
- Residual value, \$290.
- Estimated useful life, 5 years.
- Total estimated output, 590 units.
- Output year 1, 50 units.
- Output year 2, 200 units.

16A-3. August Co., whose accounting period ends on machine for \$6,780 on January 1 with an estimated useful life of 4 years. Prepare the current as well as the following year using double declining-balance at twice the straight-

16A-4. A machine that cost \$9,080 with \$3,920 of accumulated depreciation was traded in for a similar machine having a \$5,850 cash value. The trade-in allowance in was offered by the seller.

CHAPTER 16 Accounting for Property, Plant, Equipment, and Intangible Assets **603**

Problems

Set A

16A-1. Record the following transactions (all paid in cash except on March 24) in the general journal of Orange Company: ◀ **L01,3** (30 min)

S50 / QB

201X		Check Figure:
Feb.	5 Purchased land for \$92,000. The \$92,000 included attorney's fees of \$5,900.	
	18 Orange Company decided to pave the parking lot for \$5,300.	
Mar.	24 Purchased a building for \$86,000, putting down 26% and mortgaging the remainder.	Feb. 18
	29 Bought equipment for \$36,000. Freight and assembly were an additional \$4,400.	Dr. Land Improvement \$5,300
May	10 Added a new wing for \$175,000 to building that was purchased on March 24.	Cr. Cash \$5,300
June	15 Performed ordinary repair work on equipment purchased March 29, \$850, to maintain its normal operations.	
July	1 Bought a truck for \$13,500.	
Oct.	15 Added a hydraulic loader to truck, \$2,500.	

• **Exercises and Problems (Sets A and B)**

Each question has been updated in this new edition. Short exercises can be assigned or used in class to focus on building skills. The longer problems give students a chance to do one learning unit at a time or combine many units in one problem. These problems help put the pieces together. They're a great reinforcement of the accounting principles.

• **Financial Report Problem**

Students use the 2013 annual financial report of the Kellogg’s Company to apply theory and applications completed in the chapter.

• **On the Job Continuing Problem**

Students follow the activities of a fictional company, *The Smith Computer Center*, and then are asked to apply concepts to solve specific accounting problems for the company. Problems can be found in Chapters 1–15 and can be solved manually or by using Sage 50 or QuickBooks.

Financial Report Problem

Reading the Kellogg’s Annual Report
 Go to <http://investor.kelloggs.com/investor-relations/annual-reports/> to access the Kellogg’s 2013 Annual Report and find the balance sheet of Kellogg’s. Did Kellogg’s Accounts Payable go up or down from 2012 to 2013? What does this change mean? Into what category does Accounts Payable fall by rules of debit and credit? Which side of the T account would make Accounts Payable increase?

ON THE JOB SMITH COMPUTER CENTER

The Smith Computer Center created its chart of accounts as follows:

Assets		Revenue	
1000	Cash	4000	Service Revenue
1020	Accounts Receivable	Expenses	
1030	Supplies	5010	Advertising Expense
1080	Computer Shop Equipment	5020	Rent Expense
1090	Office Equipment	5030	Utilities Expense
Liabilities		5040	Phone Expense
2000	Accounts Payable	5050	Supplies Expense
Owner’s Equity		5060	Insurance Expense
3000	Feldman, Capital	5070	Postage Expense
3010	Feldman, Withdrawals		

You will use this chart of accounts to complete the Continuing Problem. The following problem continues from Chapter 1.

Assignment

- Set up T accounts in a ledger and post the ending balances from Chapter 1.
- Record transactions k through s in the appropriate T accounts.
- Foot and take the balances of the T accounts where appropriate.
- Prepare a trial balance at the end of August.
- From the trial balance, prepare an income statement, statement of owner’s

Mini Practice Set

Sousa Realty

Est. Time: 5 hours

Reviewing the Accounting Cycle Twice

This comprehensive review problem requires you to complete the accounting cycle for Sousa Realty twice. This practice set allows you to review Chapters 1–5 while reinforcing the relationships between all parts of the accounting cycle. By completing two cycles, you will see how the ending September balances in the ledger are used to accumulate data in October.

First, look at the chart of accounts for Sousa Realty.

Assets		Revenue	
111	Cash	411	Commissions Earned
112	Accounts Receivable	Expenses	
114	Prepaid Rent	511	Rent Expense
115	Office Supplies	512	Salaries Expense
121	Office Equipment	513	Gas Expense

• **Mini Practice Sets**

The in-text Sousa Realty Practice Set (Chapter 5) includes actual source documents for each transaction and The Elegant Dress Shop Practice Set (Chapter 12) enable students to complete two cycles of transactions (either manually, with Sage 50 or with QuickBooks).

• Computer Workshops

This book contains seven computer workshops to be completed with Sage 50 and QuickBooks. Detailed step-by-step instructions are available on the Student Download site, and in MyAccountingLab showing students how to take any manual problem from the end of the chapter and solve it using both types of software.

SAGE 50 COMPUTER WORKSHOP

S50

Computerized Accounting Application for Chapter 5

Refresher on using Sage 50 Complete Accounting

Before starting this assignment, you may want to refresh your memory by reading the following PDF documents in the multimedia library of the MyAccountingLab Web site. Remember to choose the PDF document for your version of Sage 50.

1. An Introduction to Sage 50
2. Correcting Sage 50 Transactions
3. How to Repeat or Restart a Sage 50 Assignment
4. Backing Up and Restoring Your Work in Sage 50

You also should have completed the following workshops:

1. Workshop 1 Atlas Company from Chapter 3
2. Workshop 2 Zell Company from Chapter 4

Workshop 3:

Accounting Cycle Mini Practice Set

In this workshop, you will complete the September and October accounting cycles for Sousa Realty using Sage 50. Tasks include posting journal entries and adjusting journal entries, printing reports and financial statements, and closing the accounting period.

Instructions and the data file for completing this assignment are in the multimedia library of the MyAccountingLab Web site. Open the *Workshop 3 Sousa Realty* PDF document for your version of Sage 50 and download the *Sousa Realty* data file for your version of Sage 50.

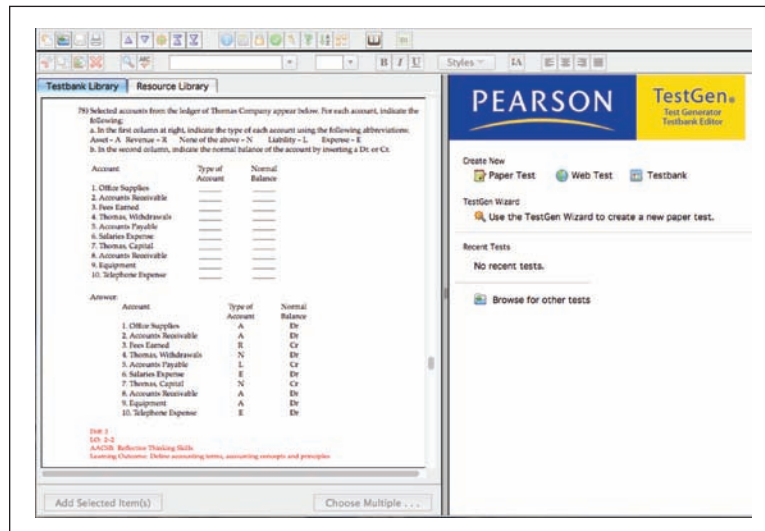
QUICKBOOKS COMPUTER WORKSHOP

QB

Computerized Accounting Application for Chapter 5

Refresher on using QuickBooks Accountant

SUPPLEMENTS FOR INSTRUCTORS AND STUDENTS



• Test Bank

NEW! The Test Bank now includes algorithmic questions. Both objective-based questions and computational problems are available throughout the over 3,000 questions in the Test Bank.

• Study Guide and Working Papers

These guides include templates to answer questions that appear in the text, including: Demonstration Summary Problems, Set A and B Exercises, Set A and B Problems, On the Job Continuing Problems, and Mini Practice Sets.


Each chapter also includes a Self-Practice Test with solutions. The Working Papers are also available in Excel Format.

• Solutions Manual

Contains solutions to all end-of-chapter questions.

CHAPTERS 1-20

13TH EDITION
COLLEGE ACCOUNTING
A PRACTICAL APPROACH



SLATER

ALWAYS LEARNING

Chapter 2

DEBITS AND CREDITS:
ANALYZING AND RECORDING
BUSINESS
TRANSACTIONS

Standard Account

Figure 2.1 The Standard Account Form Is the Source of the T Account's Shape

Account Title				Account No.			
Date	Item	PR	Debit	Date	Item	PR	Credit
Debit				Credit			

- All T accounts have this structure
- Left side is called debit side
- Right side is called credit side
- Debit and Credit indicates position only

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• PowerPoint Presentations

The lecture notes provided take students through the learning objectives of the chapter, using art from the text as a guide.

- Instructor PowerPoint Presentations—complete with lecture notes
- Student PowerPoint Presentations

• Instructor's Resource Manual

Each chapter of the manual is organized by Learning Objective, and offers the following resources to instructors:

- Chapter Overview
- Assignment Grid
- Summary
- Key Concepts
- Lecture Outlines

Student and Instructor Resources

FOR STUDENTS

MyAccountingLab

myaccountinglab.com online Homework and Assessment Manager includes:

- Pearson eText
- Student PowerPoint® Presentations
- Data Files
- Accounting Cycle Tutorial
- New! Try It! Videos
- Flash Cards
- Working Papers
- New! Learning Catalytics
- New! Dynamic Study Modules

Student Resource Web site: pearsonhighered.com/slater

The Book's Web site contains the following:

- **Data Files:** Computer Workshop files and Solutions to end-of-chapter QuickBooks and Sage 50 exercises and problems from the text, in the most recent version of each software
- **Working Papers:** In Excel Format

Students can also purchase a printed **Study Guide with Working Papers** to accompany the text.

FOR INSTRUCTORS

MyAccountingLab

myaccountinglab.com online Homework and Assessment Manager

For the instructor's convenience, the instructor resources can be downloaded from the textbook's catalog page (pearsonhighered.com/slater) and MyAccountingLab.

Available resources include the following:

- **Instructor's Resource Manual**
- **Solutions Manual**
- **Test Bank**
- **PowerPoint Presentations**
- **Working Papers**

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Jeff Slater teaches at the North Shore Community College in Danver, Massachusetts, where he was voted Teacher of the Year. Additionally, he has acted as a consultant for the federal office of personnel management, training personnel in government book-keeping and accounting. Jeff has traveled the country speaking about class retention in Accounting courses.

He has been author or co-author of over ten college textbooks, including the following Pearson titles:

- Basic College Mathematics
- Beginning Algebra
- College Accounting
- Intermediate Algebra
- Prealgebra

Jeff lives with his wife: Shelley, and Golden Doodle: Bernie. He has two children: Abby and Russell, and four grandchildren: Matt, Mia, Sam, and Hope. In his spare time, he enjoys collecting vintage toys and vintage auto parts.

IN HIS OWN WORDS

“Talk to your students, not at them.” In my 45 years of teaching I’ve learned that you need to show students you care about them. I love to take complicated material and break it down into simple steps to enhance learning. I believe in repetition: “Say it once, say it again.” Talking about real world examples and how it relates to accounting theory makes the class come alive.

I WANT TO HEAR FROM YOU

Students know that I love what I do . . . They are my customers and they need to be served in a professional manner. Please e-mail me at jeffslater@aol.com, and I promise to get back to you within 24 hours or less.

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College Accounting

A Practical Approach

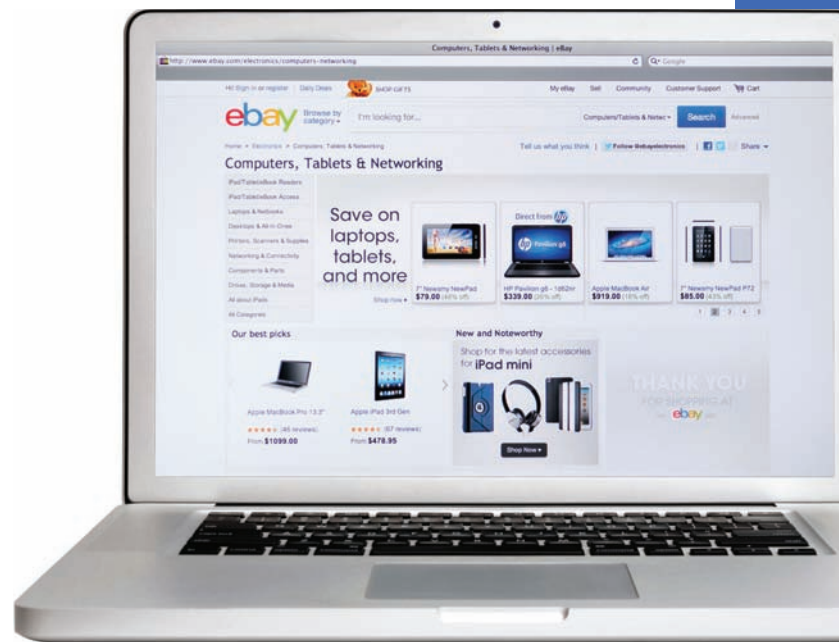
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Accounting Concepts and Procedures

CHAPTER 1

CHAPTER PREVIEW: THE BIG PICTURE

Pam Sullivan has been searching the Web for the best deal on a Microsoft Surface Pro tablet. She decided the best deal for her was on eBay. She found a manufacturer-refurbished tablet that had an original price of \$695 marked down to \$499. Payment could be made via PayPal using a major credit card or with an electronic check. Pam wondered how eBay could keep track of all of the millions of sales transactions each day. Her accounting professor told her that eBay tracks the sale in its version of a PayPal account called the Revenue account. In this chapter we will see how a company records transactions and communicates its sales to the business world. In 2015 eBay and PayPal will become independent companies.



Learning Objectives

- L01** Explain Accounting, Business, and the Accounting Equation
- L02** Prepare a Balance Sheet
- L03** Record Transactions into the Expanded Accounting Equation
- L04** Prepare the Three Financial Statements

LEARNING UNIT 1-1

L01 

Accounting, Business, and the Accounting Equation

Accounting A system that measures the business's activities in financial terms, provides written reports and financial statements about those activities, and communicates these reports to decision makers and others.

Companies like eBay have to comply with many federal statutes. The Sarbanes-Oxley Act is a federal statute passed to prevent fraud at publicly-held companies. This act requires a closer look at the internal controls and the accuracy of the financial results of a company.

Accounting is the language of business; it provides information to managers, owners, investors, government agencies, and others inside and outside the organization. Accounting provides answers and insights to questions like these:

- Which computer software will best fit our company?
- Should I invest in Facebook or Apple stock?
- How will increasing fuel costs affect Jet Blue?
- Can Boeing pay its debt obligations?
- What percentage of the Walmart marketing budget is allocated to e-business? How does that percentage compare with that of the competition? What is the overall financial condition of Walmart?

Smaller businesses also need answers to their financial questions:

- At a local Subway, did business increase enough over the last year to warrant hiring a new Sandwich Artist?
- Should a local real estate agency spend more money to design, produce, and send out new brochures in an effort to generate more home listings and sales?
- What role should social media play in the future of business spending?

Accounting is as important to individuals as it is to businesses; it answers questions like these:

- Should I take out a loan to buy a new computer or wait until I can afford to pay cash for it?
- With interest rates fluctuating, would my money work better in a money market or in the stock market?

The accounting process analyzes, records, classifies, summarizes, reports, and interprets financial information for decision makers—whether individuals, small businesses, large corporations, or governmental agencies—in a timely fashion. It is important that students understand the “whys” of this accounting process. Just knowing the mechanics is not enough.

Types of Business Organizations

The four main categories of business organizations are (1) sole proprietorships, (2) partnerships, (3) corporations, and (4) limited liability companies. Let's define each of them and look at their advantages and disadvantages. This information also appears in Table 1.1, page 3.

Sole proprietorship A type of business organization that has one owner. The owner is personally liable for paying the business's debts.

Sole Proprietorship. A **sole proprietorship**, such as Jill's Nail Care, is a business that has one owner. That person is both the owner and the manager of the business. An advantage of a sole proprietorship is that the owner makes all the decisions for the business. A disadvantage is that if the business cannot pay its obligations, the business owner must pay them, which means that the owner could lose some or all of his or her personal assets (e.g., house or savings).

Sole proprietorships are easy to form. They end if the business closes or when the owner dies.

Partnership A form of business organization that has at least two owners. The partners usually are personally liable for the partnership's debts.

Partnership. A **partnership**, such as Hope and Sam, is a form of business ownership that has at least two owners (partners). Each partner acts as an owner of the company, which is an advantage because the partners can share the decision making and the risks of the business usually outlined in a partnership agreement. A disadvantage

TABLE 1.1 Types of Business Organizations

	Sole Proprietorship (Jill's Nail Care)	Partnerships (Hope and Sam)	Corporation (Facebook)	Limited Liability Companies (LLC)
Ownership	Business owned by one person.	Business owned by more than one person.	Business owned by stockholders.	Business owned by a limited number of members.
Formation	No formal filing or agreement necessary to form.	Requires a partnership agreement to define the terms of partnership.	Requires filing with the state to be recognized.	Requires filing with the state a document called articles of incorporation.
Liability	Owner could lose personal assets to meet obligations of business.	Partners could lose personal assets to meet obligations of partnership.	Limited personal risk. Stockholders' loss is limited to their investment in the company.	Limited personal risk. Members loss is limited to their investment.
Closing	Ends with death of owner or closing of business.	Ends with death of partner or closing of business.	Can continue indefinitely.	May end with death of member.

is that, as in a sole proprietorship, the partners' personal assets could be lost if the partnership cannot meet its obligations.

Partnerships are easy to form. They end when a partner dies or leaves the partnership, or when the partners decide to close the business.

Corporation. A **corporation**, such as Facebook, is a business owned by stockholders. The corporation may have only a few stockholders, or it may have many. The stockholders are not personally liable for the corporation's debts, and they usually do not have input into the business's decisions.

Corporations are more difficult to form than sole proprietorships or partnerships, as the corporation must file with the state in order to gain the protections provided by this form of business. Corporations can exist indefinitely.

Limited Liability Company (LLC). A **limited liability company**, such as the law firm of Battista, Tucker and Sam, LLC, is a business owned by a few members. The members are liable only to the extent of their investment in the firm and, unlike a corporation, have input into the business's decisions. Like corporations, the LLC must file with the state in which it does business in order to gain the liability protection of this form of business.

Classifying Business Organizations

Whether we are looking at a sole proprietorship, a partnership, or a corporation, the business can be classified by what it does to earn money. Companies are categorized as service, merchandise, or manufacturing businesses.

A limo service is a good example of a **service company** because it provides a service. The first part of this book focuses on service businesses.

Gap and Pottery Barn sell products. They are called merchandise companies. **Merchandise companies** can either make their own products or sell products that are made by another supplier. Companies such as Levi Strauss and Company and Ford Motor Company that make their own products are called **manufacturers**. (See Table 1.2, page 4.)

Definition of Accounting

Accounting (also called the accounting process) is a system that measures the activities of a business in financial terms. It provides reports and financial statements that show how the various transactions the business undertook (e.g., buying and selling goods) affected the business. This accounting process performs the following functions:

- **Analyzing:** Looking at what happened and how the business was affected.
- **Recording:** Putting the information into the accounting system.

Corporation A type of business organization that is owned by stockholders. Stockholders usually are not personally liable for the corporation's debts.

Limited Liability Company A type of business organization that is owned by a few members. Members are only liable to the extent of their investment.

Service company Business that provides a service.

Merchandise company Business that makes its own products or buys a product from a manufacturing company to sell to its customers.

Manufacturer Business that makes a product and sells it to its customers.

TABLE 1.2 Examples of Service, Merchandise, and Manufacturing Businesses

Service Businesses	Merchandise Businesses	Manufacturing Businesses
Jill's Nail Care	Pottery Barn	Hershey's
Facebook	Best Buy	Ford Motor Company
Dr. Wheeler, M.D.	Amazon.com	Toro
Accountemps	Home Depot	Levi Strauss and Company
Langley Landscaping	Gap	Brunswick

- **Classifying:** Grouping all the same activities (e.g., all purchases) together.
- **Summarizing:** Totaling the results.
- **Reporting:** Issuing the statements that tell the results of the previous functions.
- **Interpreting:** Examining the statements to determine how the various pieces of information they contain relate to each other.
- **Communication:** Providing the reports and financial statements to people who are interested in the information, such as the business's decision makers, investors, creditors, and government agencies (e.g., the Internal Revenue Service).

As you can see, a lot of people use these reports. A set of procedures and guidelines was developed to make sure that everyone prepares and interprets them the same way. These guidelines are known as **generally accepted accounting principles (GAAP)**. **International Financial Reporting Standards (IFRS)** are a group of guidelines developed by the International Accounting Standards Board. The United States is considering some changes from GAAP to IFRS. No final decisions will be made until 2017.

Now let's look at the difference between bookkeeping and accounting. Keep in mind that we use the terms *accounting* and the *accounting process* interchangeably.

Generally accepted accounting principles (GAAP) The procedures and guidelines that must be followed during the accounting process.

International Financial Reporting Standards (IFRS) A group of accounting standards and procedures that if adopted by the U.S., could replace GAAP.

Bookkeeping The recording function of the accounting process.

Computer Software and the Bookkeeper

Bookkeeping is the recording (record keeping) function of the accounting process. Today, computers are used for routine bookkeeping operations that formerly took weeks or months to complete. This book explains the processes and logical steps behind those operations, giving the reader the hands-on knowledge that a bookkeeper needs even though computers perform many tasks. Bookkeepers today need to be trained to use the latest computer software that is available, including QuickBooks, Excel, and Sage 50.

An accountant takes the bookkeeping records and prepares the financial statements that are used to analyze the company's financial position. Accounting involves many complex activities. Often, it includes the preparation of tax and financial reports, budgeting, and analyses of financial information.

The Accounting Equation: Assets, Liabilities, and Equities

Let's begin our study of accounting concepts and procedures by looking at a small business: Mia Wong's law practice. Mia decided to open her practice at the end of August. She consulted her accountant before she made her decision, and he gave her some important information. First, he told her the new business would be considered a separate business entity whose finances had to be kept separate and distinct from Mia's personal finances. The accountant went on to say that all transactions can be analyzed using the basic accounting equation: $\text{Assets} = \text{Liabilities} + \text{Owner's Equity}$.

Mia had never heard of the basic accounting equation. She listened carefully as the accountant explained the terms used in the equation and how the equation works.

Assets. Cash, land, supplies, office equipment, buildings, and other properties of value *owned* by a firm are called **assets**.

Assets Properties (resources) of value owned by a business (cash, supplies, equipment, land).

Equities. The rights or financial claims to the assets are called **equities**. Equities belong to those who supply the assets. If you are the only person to supply assets to the firm, you have the sole rights or financial claims to them. For example, if you supply the law firm with \$6,000 in cash and \$8,000 in office equipment, your equity in the firm is \$14,000.

Relationship between Assets and Equities. The relationship between assets and equities is

$$\begin{array}{ccc} \text{Assets} & = & \text{Equities} \\ \text{(Total value of items owned by business)} & & \text{(Total claims against the assets)} \end{array}$$

The total dollar value of the assets of your law firm will be equal to the total dollar value of the financial claims to those assets, that is, equal to the total dollar value of the equities.

The total dollar value is broken down on the left-hand side of the equation to show the specific items of value owned by the business and on the right-hand side to show the types of claims against the assets owned.

Liabilities. A firm may have to borrow money to buy more assets; when it does, it *buys assets on account* (buy now, pay later). Suppose the law firm purchases a new computer for \$3,000 on account from Dell, and the company is willing to wait 10 days for payment. The law firm has created a **liability**: an obligation to pay that comes due in the future. Dell is called the **creditor**. This liability—the amount owed to Dell—gives the company the right, or the financial claim, to \$3,000 of the law firm’s assets. When Dell is paid, the company’s rights to the assets of the law firm will end because the obligation has been paid off.

Basic Accounting Equation. To best understand the various claims to a business’s assets, accountants divide equities into two parts. The claims of creditors—outside persons or businesses—are labeled *liabilities*. The claim of the business’s owner is labeled **owner’s equity**. Let’s see how the accounting equation looks now.

$$\begin{array}{ccc} \text{Assets} = & \underbrace{\hspace{10em}} & \text{Equities} \\ & \begin{array}{l} 1. \text{Liabilities: rights of creditors} \\ 2. \text{Owner's equity: rights of owner} \end{array} & \\ \text{Assets} = & \text{Liabilities} + & \text{Owner's Equity} \end{array}$$

The total value of all the assets of a firm equals the combined total value of the financial claims of the creditors (liabilities) and the claims of the owners (owner’s equity). This calculation is known as the **basic accounting equation**. The basic accounting equation provides a basis for understanding the conventional accounting system of a business. The equation records business transactions in a logical and orderly way that shows their impact on the company’s assets, liabilities, and owner’s equity.

Importance of Creditors. Another way of presenting the basic accounting equation is

$$\text{Assets} - \text{Liabilities} = \text{Owner's Equity}$$

This form of the equation stresses the importance of creditors. The owner’s rights to the business’s assets are determined after the rights of the creditors are subtracted. In other words, creditors have first claim to assets. If a firm has no liabilities—therefore no creditors—the owner has the total rights to assets. Another term for the owner’s current investment, or equity, in the business’s assets is **capital**.

As Mia Wong’s law firm engages in business transactions (paying bills, serving customers, and so on), changes will take place in the assets, liabilities, and owner’s equity (capital). Let’s analyze some of these transactions.

Equities The rights or financial claims of creditors (liabilities) and owners (owner’s equity) who supply the assets to a firm.

Liabilities Obligations that come due in the future. Liabilities are the financial rights or claims of creditors to assets.

Creditor Someone who has a claim to assets.

Owner’s equity Rights or financial claims to the assets of a business (in the accounting equation, assets minus liabilities).

Basic accounting equation

Assets = Liabilities + Owner’s Equity.

Capital The owner’s investment of equity in the company.

**COACHING TIP**

In accounting, capital does not mean cash. Capital is the owner's current investment, or equity, in the assets of the business.

Transaction A Aug. 28: Mia invests \$6,000 in cash and \$200 of office equipment into the business.

On August 28, Mia withdraws \$6,000 from her personal bank account and deposits the money in the law firm's newly opened bank account. She also invests \$200 of office equipment in the business. She plans to be open for business on September 1. With the help of her accountant, Mia begins to prepare the accounting records for the business. We put this information into the basic accounting equation as follows:

		Assets		=	Liabilities	+	Owner's Equity
	Cash	+	Office Equipment	=			Mia Wong, Capital
Transaction	+\$6,000	+	+\$200	=			+\$6,200
					<u>\$6,200 = \$6,200</u>		

Note that the total value of the assets, cash, and office equipment—\$6,200—is equal to the combined total value of liabilities (none, so far) and owner's equity (\$6,200). Remember, Mia has supplied all the cash and office equipment, so she has the sole financial claim to the assets. Note how the heading “Mia Wong, Capital” is written under the owner's equity heading. The \$6,200 is Mia's investment, or equity, in the firm's assets.

Transaction B Aug. 29: Law practice buys office equipment for cash, \$500.

From the initial investment of \$6,000 cash, the law firm buys \$500 worth of office equipment (such as a computer desk), which lasts a long time, whereas **supplies** (such as pens) tend to be used up relatively quickly.

Supplies One type of asset acquired by a firm; it has a much shorter life than equipment.

		Assets		=	Liabilities	+	Owner's Equity
	Cash	+	Office Equipment	=			Mia Wong, Capital
Beginning Balance	\$6,000	+	\$200	=			\$6,200
Transaction	-500		+500				
Ending Balance	\$5,500	+	\$700	=			\$6,200
					<u>\$6,200 = \$6,200</u>		

Shift in assets A shift that occurs when the composition of the assets has changed but the total of the assets remains the same.

Shift in Assets. As a result of the last transaction, the law office has less cash but has increased its amount of office equipment. This **shift in assets** indicates that the makeup of the assets has changed, but the total of the assets remains the same.

Suppose you go food shopping at Walmart with \$100 and spend \$60. Now you have two assets, food and money. The composition of your assets has *shifted*—you have more food and less money than you did—but the *total* of the assets has not increased or decreased. The total value of the food, \$60, plus the cash, \$40, is still \$100. When you borrow money from the bank, on the other hand, you increase cash (an asset) and increase liabilities at the same time. This action results in an increase in assets, not just a shift.

An accounting equation can remain in balance even if only one side is updated. The key point to remember is that the left-hand-side total of assets must always equal the right-hand-side total of liabilities and owner's equity.

Transaction C Aug. 30: Law firm buys additional office equipment on account, \$300.

The law firm purchases an additional \$300 worth of chairs and desks from Wilmington Company. Instead of demanding cash right away, Wilmington agrees to deliver the equipment and to allow up to 60 days for the law practice to pay the invoice (bill).

This liability, or obligation to pay in the future, has some interesting effects on the basic accounting equation. Wilmington Company accepts as payment a partial claim against the assets of the law practice. This claim exists until the law firm pays off the bill. This unwritten promise to pay the creditor is a liability called **accounts payable**.

Accounts payable Amounts owed to creditors that result from the purchase of goods or services on account—a liability.

Assets		=	Liabilities	+	Owner's Equity
Cash	+ Office Equipment	=	Accounts Payable	+	Mia Wong, Capital
\$5,500	+ \$700	=			\$6,200
	+300		+300		
\$5,500	+ \$1,000	=	\$300	+	\$6,200
			<u>\$6,500 = \$6,500</u>		

Beginning Balance
Transaction
Ending Balance

When this information is analyzed, we can see that the law practice increased what it owes (accounts payable) as well as what it owns (office equipment) by \$300. The law practice gains \$300 in an asset but also takes on an obligation to pay Wilmington Company at a future date.

The owner's equity remains unchanged. This transaction results in an increase of total assets from \$6,200 to \$6,500.

Finally, note that after each transaction the basic accounting equation remains in balance. Now it's your turn to see if you understood what we have covered. This TRY IT! feature will be found after each learning unit. The solutions are at end of the chapter following the blueprint.



TRY IT!

Learning Unit 1-1

Record the following transactions into the basic accounting equation:

$$\text{Cash} + \text{Salon Equipment} = \text{Accounts Payable} + \text{B. Rey, Capital}$$

- Bernie Rey invests \$20,000 to open a hair salon company.
- The hair salon company buys new salon equipment for \$10,000, paying \$4,000 down and charging the balance.

Calculate the ending balances.

The Balance Sheet

LEARNING UNIT 1-2

In the first learning unit, the transactions for Mia Wong's law firm were recorded in the accounting equation. The transactions we recorded occurred before the law firm opened for business. A statement called a **balance sheet** or **statement of financial position** can show the financial position of a company before it opened. The balance sheet is a formal statement that presents the information from the ending balances of both sides of the accounting equation. Think of the balance sheet as a snapshot of the business's financial position as of a particular date.



Balance sheet A statement, as of a particular date, that shows the amount of assets owned by a business as well as the amount of claims (liabilities and owner's equity) against these assets. Also known as **statement of financial position**.

Let's look at the balance sheet of Mia Wong's law practice for August 31, 201X, shown in Figure 1.1, page 8. The figures in the balance sheet come from the ending balances of the accounting equation for the law practice as shown in Learning Unit 1-1.

Note in Figure 1.1 that the assets owned by the law practice appear on the left-hand side and that the liabilities and owner's equity appear on the right-hand side. Both sides equal \$6,500. This *balance* between left and right gives the balance sheet its name. In later chapters we look at other ways to set up a balance sheet.

FIGURE 1.1
The Balance Sheet

	ASSETS Cash + Office Equipment ENDING BALANCES \$5,500 + \$1,000	= LIABILITIES = Accounts Payable = \$300	+ OWNER'S EQUITY + Mia Wong, Capital + \$6,200
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MIA WONG, ATTORNEY-AT-LAW BALANCE SHEET AUGUST 31, 201X			
	Assets	Liabilities and Owner's Equity	
	Cash	Liabilities	
	Office Equipment	Accounts Payable	
		Owner's Equity	
		Mia Wong, Capital	
	Total Assets	Total Liabilities and Owner's Equity	



COACHING TIP
The balance sheet shows the company's financial position as of a particular date. (In our example, that date is at the end of August.)

Points to Remember in Preparing a Balance Sheet

The Heading. The heading of the balance sheet provides the following information:

- The company name: Mia Wong, Attorney-at-Law
- The name of the statement: Balance Sheet
- The date for which the report is prepared: August 31, 201X

Use of the Dollar Sign. Note that the dollar sign is not repeated each time a figure appears. As shown in Figure 1.2, the balance sheet for Mia Wong's law practice, it usually is placed to the left of each column's top figure and to the left of the column's total.

FIGURE 1.2 Partial Balance Sheet

MIA WONG, ATTORNEY-AT-LAW BALANCE SHEET AUGUST 31, 201X			
	Assets		
	Cash		
	Office Equipment		
	Total Assets		

A single line means the numbers above it have been added or subtracted.

A double line indicates a total.

Distinguishing the Total. If you are using a paper ledger, when adding numbers down a column, use a single line above the total and a double line beneath it. A single line means that the numbers above it have been added or subtracted. A double line indicates a total. These rules are the same for all accounting reports. With computer software today, the dollar sign and total are just a click away as the balance sheet's layout is pre-programmed.

The balance sheet gives Mia the information she needs to see the law firm's financial position before it opens for business. This information does not tell her, however, whether the firm made a profit.

**TRY IT!****Learning Unit 1-2**

From the following prepare a balance sheet in proper form:

Flynn Company; November 30, 201X; iPads \$4,000; Accounts Payable \$3,000; Pete Flynn, Capital \$9,000; Cash \$8,000

The Accounting Equation Expanded: Revenue, Expenses, and Withdrawals

As soon as Mia Wong's office opened on September 1, she began performing legal services for her clients and earning revenue for the business. At the same time, as a part of doing business, she incurred various expenses such as rent. Mia's accountant explained there are two types of accounting systems to record business transactions: the **cash basis** system and the **accrual basis** system. In the cash basis system, revenues are recorded when cash is received, and expenses are recorded when cash is paid. Some small businesses use this method, and individuals use the cash basis to do their personal income taxes. In the accrual basis system, revenue transactions are recorded when they are earned (not when money is received), and expenses are recorded when they are incurred (or happen) whether paid in cash or not. The accountant told Mia that she would be using the accrual basis system of accounting because this system matches revenues and expenses in the same time period (not just when cash is paid). Now let's look at how the revenue transaction is recorded for Mia's business.

Revenue

A service company earns **revenue** when it provides services to its clients. Mia's law firm earned revenue when she provided legal services to her clients for legal fees. When revenue is earned, owner's equity is increased. In effect, revenue is a subdivision of owner's equity.

Assets are increased. The increase is in the form of cash if the client pays right away. If the client promises to pay in the future, the increase is called **accounts receivable**. When revenue is earned, the transaction is recorded as an increase in revenue and an increase in assets (either as cash or as accounts receivable, depending on whether it was paid right away or will be paid in the future).

Expenses

A business's **expenses** are the costs the company incurs in carrying on operations in its effort to create revenue. Expenses are also a subdivision of owner's equity; when expenses are incurred, they *decrease* owner's equity. Expenses can be paid for in cash or they can be charged.

Net Income/Net Loss

When revenue totals more than expenses, **net income** is the result; when expenses total more than revenue, **net loss** is the result.

Withdrawals

At some point Mia Wong may need to withdraw cash or other assets from the business to pay living or other personal expenses that do not relate to the business. We will record these transactions in an account called **withdrawals**. Sometimes this account is called the *owner's drawing account*. Withdrawals is a subdivision of owner's equity that records personal expenses not related to the business. Withdrawals decrease owner's equity (see Figure 1.3, page 10).

LEARNING UNIT 1-3



L03

Cash basis An accounting system that records revenue when cash is received and expenses when paid. This system does not match revenues and expenses like in the accrual basis of accounting.

Accrual basis An accounting system that matches revenues when earned with expenses that are incurred.

Revenue An amount earned by performing services for customers or selling goods to customers; it can be in the form of cash or accounts receivable. A subdivision of owner's equity: As revenue increases, owner's equity increases.

Accounts receivable An asset that indicates amounts owed by customers.

Expense A cost incurred in running a business by consuming goods or services in producing revenue. A subdivision of owner's equity.

Net income When revenue totals more than expenses, the result is net income.

Net loss When expenses total more than revenue, the result is net loss.

Withdrawals A subdivision of owner's equity that records money or other assets an owner withdraws from a business for personal use.