STUDY GUIDE/WORKING PAPERS, CHAPTERS 1-15

HEINTZ
& PARRY

COLLEGE ACCOUNTING

16TH EDITION

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College Accounting

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James A. Heintz

University of Kansas

Robert W. Parry, Jr.

Indiana University

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STUDY GUIDE

CONTENTS

STUDY GUIDE

WORKING PAPERS

CHAPTER 1
INTRODUCTION TO ACCOUNTING

LEARNING OBJECTIVES

Chapter 1 is designed to introduce you to accounting—its purpose, process, and career opportunities. Businesses that keep good accounting records benefit in many ways. Users of accounting information are able to make sound decisions which will affect the business's future. There are many career opportunities in various fields of accounting, some of which are entry-level and task-oriented and others that involve decision making and planning.

Objective 1. Describe the purpose of accounting.

Accounting is the process by which businesses keep track of daily transactions and determine how the business is doing. Accounting provides needed information for its many users, from owners to government agencies and others.

Objective 2. Describe the accounting process.

Accounting contains six major steps. The first step is getting started—looking at information available and figuring out what to do with it. This first step usually occurs when the business receives some type of information such as a bill that needs to be properly entered into the business's records. Analyzing is the process of deciding what the piece of information means to the business—should it result in an accounting entry or not? The second step is entering the information in the accounting system; the third step is classifying or grouping like things together. Summarizing, the fourth step, brings together those information items to determine a result—such as profit or loss. Reporting communicates those results; the final step is examining and interpreting the financial statements to evaluate the financial health of the business.

Objective 3. Define three types of business ownership structures.

Businesses can be classified according to the number of owners. A sole proprietorship is owned by one person who assumes all risks for the business and makes all business decisions. A partnership is owned by two or more persons who share the risks and decision making. Corporations have many owners (shareholders) whose risk is limited to their investment and who have little influence in business decisions.

Objective 4. Classify different types of businesses by activities.

Businesses can also be classified by the type of service or product they provide. A service business provides a service, a merchandising business purchases a product from another business to sell, and a manufacturing business makes a product to sell.

Objective 5. Identify career opportunities in accounting.

Accounting has varied and diverse opportunities, depending on the education and experience of the worker, the type of business, and the accounting processes used within the business.

Accounting clerks record, sort and file accounting information. Bookkeepers supervise clerks, help with daily accounting work and summarize information.

Public accountants offer services such as auditing, tax advice, and management consulting. Managerial accountants offer services to private businesses, such as designing accounting information systems, general accounting, cost accounting, budgeting, tax accounting, and internal auditing. Government and not-for-profit organizations also employ accountants.

Accounting is a professional field which includes organizations and certifications for those who pass examinations and have relevant work experience.

REVIEW QUESTIONS

Instructions: Analyze each of the following items carefully before writing your answer in the column at the right.

Question	Answer
1. The purpose of accounting is to provide current information to users. For each user below, briefly describe what type of information is needed.	
a. Owners (present and future).	____________________ ____________________
b. Managers who make decisions for the business.	____________________ ____________________
c. Creditors (present and future).	____________________ ____________________
d. Government agencies (state, local, and national).	____________________ ____________________
2. A travel agency is an example of this type of business	____________________
3. The ownership structure where owners share risks and decision making is called a(n) ________	____________________
4. A(n) ________ business makes a product to sell	____________________
5. A business that purchases a product from another business to sell to customers is called a(n) ________ business	____________________
6. Under the ________ ownership structure, the owner's personal assets can be taken to pay creditors	____________________
7. The Financial Accounting Standards Board develops procedures and guidelines called ________ to be followed in the accounting process	____________________
8. The owners' risk is usually limited to their initial investment in this type of ownership structure	____________________
9. By meeting education and experience requirements, and passing an examination, a public accountant can achieve recognition as a(n) ________	____________________

10. The six major steps of the accounting process are listed at the right. In front of each term, write the letter that identifies the correct description provided in the column on the left.

a. The process of entering financial information about events affecting the business.

b. The process of bringing together various items of information to determine a result.

c. The process of sorting or grouping like things together, rather than merely keeping a simple, diary-like narrative record of numerous and varied transactions.

d. The process of determining the effect of various events on the business.

e. The process of deciding the importance of the information in various reports.

f. The process of communicating the results of operations.

_______ Analyzing
_______ Recording
_______ Classifying
_______ Summarizing
_______ Reporting
_______ Interpreting

CHAPTER 2
ANALYZING TRANSACTIONS: THE ACCOUNTING EQUATION

LEARNING OBJECTIVES

Chapter 2 continues the introductory discussion of accounting—its elements, equation, and transactions. The accounting equation provides a structure for analyzing transactions. After all transactions have been analyzed, the financial statements—income statement, statement of owner's equity, and balance sheet—are prepared. Let's look at each of these learning objectives in detail.

Objective 1. Define the accounting elements.

Accounting elements are the parts that make up the accounting equation: assets, liabilities, and owner's equity. **Assets** are items *owned* by the business that will provide future benefits. **Liabilities** are debts *owed* by the business and will require a future outflow of assets. **Owner's equity** (also called net worth or capital) is the difference between assets and liabilities. **Revenues** represent the amount a business charges customers for products sold or services provided. Revenues create an inflow of assets. **Expenses** represent an outflow of assets (or increase in liabilities) as a result of the efforts made to generate revenues.

Objective 2. Construct the accounting equation.

The accounting equation shows the relationship among assets, liabilities, and owner's equity (the accounting elements):

Assets = Liabilities + Owner's Equity

When given two of the numbers for the equation above, you can calculate the missing number by adding or subtracting. The accounting equation may be expanded to include revenues, expenses, and drawing. Although drawing is not considered a major element in the accounting equation, it is a very special type of owner's equity account. It represents the withdrawal of assets from the business by the owner.

Assets Items Owned			=	Liabilities Amounts Owed	+	Owner's Equity Owner's Investment + Equity						
Cash	+	Delivery Equipment	=	Accounts Payable	+	Jessica Jane, Capital	−	Jessica Jane, Drawing	+	Revenues	−	Expenses

Objective 3. Analyze business transactions.

Analyzing is the first step in the accounting process. Three questions must be answered: (1) What happened? (2) Which accounts are affected, and what kind of accounts are they (asset, liability, owner's equity)? (3) How is the accounting equation affected? (Accounts will increase or decrease, but the equation always remains in balance.)

Objective 4. Show the effects of business transactions on the accounting equation.

Each transaction will affect asset, liability, owner's equity, revenue, or expense accounts. For example, when an owner invests cash in the business, the asset account called *Cash* increases, and the owner's equity account *Capital* also increases.

For each transaction, you must decide what accounts are affected and whether the accounts increase or decrease. After each transaction, the equation must still be in balance.

Objective 5. Prepare an income statement, statement of owner's equity, and balance sheet.

After the transactions are completed, the financial statements are prepared to show the results of those transactions. All financial statements have a heading that indicates the name of the firm, title of the statement, and time period or date covered by the statement. The income statement reports revenues, expenses, and the net income for the period. The statement of owner's equity shows the beginning balance of the owner's capital account, plus investments and net income, less withdrawals to compute the ending capital balance. The balance sheet reports all assets, liabilities, and the owner's capital on a certain date.

Objective 6. Define the three basic phases of the accounting process.

The three basic phases of the accounting process are input, processing, and output. The inputs to the accounting process are the business transactions. These transactions are processed to recognize their effects on the assets, liabilities, owner's equity, revenues, and expenses of the business. The results of these events are then reported as outputs of the accounting process in the financial statements.

REVIEW QUESTIONS

Instructions: Analyze each of the following items carefully before writing your answer in the column at the right.

Question	Answer
1. The entire accounting process is based on one simple equation called the ________	____________
2. An individual, association, or organization that engages in business activities.	____________
3. An item owned by a business that will provide future benefits is a(n) ________	____________
4. Something owed to another business entity is a(n) ________	____________
5. A(n) ________ is an unwritten promise to pay a supplier for assets purchased or a service rendered	____________
6. The amount by which assets exceed the liabilities of a business. . . .	____________
7. According to the ________ concept, nonbusiness assets and liabilities are not included in the business entity's records	____________
8. Assets – liabilities = ________.	____________
9. Assets – owner's equity = ________	____________
10. Assets = liabilities + ________.	____________
11. The outflow of assets (or increase in liabilities) as the result of efforts to produce revenue is called a(n) ________	____________
12. When total revenues exceed total expenses, the difference is called ________	____________
13. When expenses are greater than revenues, the difference is called ________	____________
14. Any accounting period of twelve months' duration is called a(n) ________	____________
15. Withdrawals, or ________, represent a reduction in owner's equity because the owner takes cash or other assets for personal use.	____________
16. The financial statement that reports the profitability of the business for a period of time.	____________
17. The financial statement that shows investments and withdrawals by the owner, as well as profit or loss generated by the business	____________
18. The financial statement that reports the assets, liabilities, and owner's equity on a specific date.	____________
19. On the balance sheet, assets are listed in order of ________ , or the ease with which they can be converted to cash	____________

EXERCISES AND PROBLEMS

Exercise 1

Using the accounting equation provided below, compute the missing amounts.

	ASSETS	=	LIABILITIES	+	OWNER'S EQUITY
(a)	______	=	$4,000	+	$20,000
(b)	$25,000	=	$8,000	+	______
(c)	$50,000	=	______	+	$10,000

Exercise 2

Using the accounting equation provided below, compute the missing amounts.

					OWNER'S EQUITY						
	ASSETS	=	LIABILITIES	+	CAPITAL	–	DRAWING	+	REVENUE	–	EXPENSES
(a)	______	=	$60,000	+	$20,000	–	$10,000	+	$80,000	–	$60,000
(b)	$80,000	=	______	+	$35,000	–	$ 5,000	+	$70,000	–	$55,000
(c)	$90,000	=	$25,000	+	______	–	$ 2,000	+	$57,000	–	$50,000
(d)	$60,000	=	$20,000	+	$30,000	–	$ 5,000	+	______	–	$40,000
(e)	$40,000	=	$25,000	+	$40,000	–	$ 5,000	+	$30,000	–	______
(f)	$75,000	=	$20,000	+	$50,000	–	______	+	$40,000	–	$25,000

Exercise 3

If owner's equity was $38,000 at the beginning of the period and $45,000 at the end of the period, compute the net income or loss for the period. (There were no investments or withdrawals during the period.)

____

____

Exercise 4

If Irma Elkton, a dentist, owns office equipment amounting to $3,500, laboratory equipment amounting to $10,000, and other property that is used in the business amounting to $4,620, and owes business suppliers a total of $5,000, the owner's equity in the business is:

____

Exercise 5

One year later, the amount of Dr. Elkton's business assets has increased to a total of $22,000, and the amount of business liabilities has increased to a total of $6,000. Assuming that Dr. Elkton has not made any additional investments or withdrawals, compute:

(a) Owner's equity at year end. . . . . $ ______________

(b) Net income or loss for the year. . . . . $ ______________

Exercise 6

Rich Brite has started his own business. During the first month, the following transactions occurred.

(a) He invested $15,000 cash in the business, and the money was used to open a bank account.
(b) Purchased office equipment for cash, $4,000.
(c) Purchased a computer on account for $9,000.
(d) Paid $2,000 on account for the office equipment.

Using the lines provided below, show the effect of each transaction on the basic elements of the accounting equation: assets, liabilities, and owner's equity. Compute the new amounts for each element after each transaction to satisfy yourself that the accounting equation has remained in balance.

	ASSETS	=	LIABILITIES	+	OWNER'S EQUITY
(a)	________		________		________
Bal.	________		________		________
(b)	________		________		________
Bal.	________		________		________
(c)	________		________		________
Bal.	________		________		________
(d)	________		________		________
Bal.	________		________		________

Exercise 7

In late May, Glen Ross opened a business by investing $20,000 cash and purchasing office equipment on account for $8,000. These events were properly entered in the accounting records. In June, the following transactions took place.

(a) Ross received $4,000 from a client for professional services rendered.
(b) Ross paid $1,200 office rent for the month.
(c) Ross paid $200 to the power company for the month's utility bill.
(d) Ross withdrew $600 cash for personal use.

Exercise 7 (concluded)

On the first Balance (Bal.) line provided below, record the amount of assets, liabilities, and owner's equity as the result of Ross's investment and purchase of office equipment in May. Then, record the effect of transactions (a) to (d) on the expanded accounting equation: Assets = Liabilities + Owner's Equity [Capital – Drawing + Revenues – Expenses]. Compute the new balances for each category after each transaction to satisfy yourself that the accounting equation has remained in balance.

				OWNER'S EQUITY									
	ASSETS	=	LIABILITIES	+	GLEN ROSS, CAPITAL	–	GLEN ROSS, DRAWING	+	REVENUES	–	EXPENSES		DESCRIPTION
Bal.													
(a)													
Bal.													
(b)													
Bal.													
(c)													
Bal.													
(d)													
Bal.													

Exercise 8

Judith Moore started her own business. During the month of July, the following transactions occurred.

(a) Invested $10,000 cash in the business.
(b) Purchased office equipment for $5,500 on account.
(c) Received $900 cash from a client for services rendered.
(d) Purchased computer equipment for cash, $6,000.
(e) Received $1,500 cash from a client for services rendered.
(f) Paid $800 office rent for the month.
(g) Paid the telephone bill for the month, $75.
(h) Paid $100 on account, for office equipment previously purchased.
(i) Moore withdrew $500 for personal use.

Required:

1. Record the effect of each of the above transactions on the accounting equation provided in the chart on the next page. Compute the new balances for the accounts after each transaction to satisfy yourself that the equation has remained in balance.

Exercise 8 (concluded)

	ASSETS		=	LIABILITIES		+	OWNER'S EQUITY				
	Cash	+ Office Equipment	=	Accounts Payable	+ J. Moore, Capital		– J. Moore, Drawing	+ Revenues	– Expenses		Description
(a)											
Bal.											
(b)											
Bal.											
(c)											
Bal.											
(d)											
Bal.											
(e)											
Bal.											
(f)											
Bal.											
(g)											
Bal.											
(h)											
Bal.											
(i)											
Bal.											

2. After recording the above transactions, compute the following.

Total assets . . . . $ ____________

Total liabilities . . . . $ ____________

Owner's equity . . . . $ ____________

Owner's equity in excess of original investment . . . . $ ____________

Total revenues . . . . $ ____________

Total expenses . . . . $ ____________

Net income . . . . $ ____________

Exercise 9

Based on the transactions reported in Exercise 8, prepare an income statement for Judith Moore Enterprises for the month ended July 31, 20--, in the form provided below.

Exercise 10

Based on the transactions reported in Exercise 8, prepare a statement of owner's equity for Judith Moore Enterprises for the month ended July 31, 20--, in the form provided below.