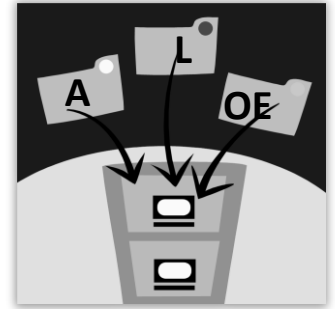


## Sorting Out Business Transactions



In order to keep track of how well a business is doing, you need to record all its business transactions. What's a business transaction? Well, paying a monthly telephone bill affects a business's financial condition because it now has less cash on hand. Selling something to a customer using a credit card is also a business transaction. These economic events that directly change an entity's financial condition or directly affect its results of operations are called **business transactions**.

All business transactions can be stated in terms of changes in the elements of the accounting equation. You will see how business transactions affect the accounting equation by studying some typical transactions. The examples in this packet represent the business transactions that we will be working with in this class.

When recording business transactions, the first method that we will examine is the Accounting Equation Chart. This chart writes out the accounting equation along the top, with a few sub-categories under each element. The level of detail (and account names) will vary depending on the business, but here is an example:

		ASSETS					LIABILITIES	OWNER'S EQUITY	
		Cash	Accounts Receivable	Supplies	Equipment	Land	Accounts Payable	Capital	Description
<i>Beginning</i>		\$0	\$0	\$0	\$0	\$0	\$0	\$0	
09/01		+1000						+1000	Investment
09/05		+5000						+5000	Fees Earned
09/07			+400					+400	Fees Earned
09/09		-800		+800					
09/12					+1200		+1200		
09/18		-900						-900	Rent Expense
09/22				-500				-500	Supplies Expense
09/29		+200	-200						
09/29		-800					-800		
09/30		-300						-300	Withdrawal
<i>Ending</i>		\$3400	\$200	\$300	\$1200	\$0	\$400	\$4700	
		\$5100					\$5100		

It may look a little confusing, but we'll go through each of the 10 business transactions shown in the table in detail. Once you learn how to do these 10 types of transactions, you can do 90% of all business transactions.

### **Owner Making An Investment**

*Example 1: Owner invested \$1000 cash in the business on 09/01.*

These transactions record when the owner makes an investment in their own business. You will always increase "cash" (because the amount of cash in the business increases) and increase "capital" (because the owner's equity increases from the investment). Notice that you write a description next to every change in the capital column. In this case, you just write "investment".

### **Receiving Fees Earned**

*Example 2: Customers paid cash for (whatever services your business offers), totaling \$5000 on 09/05.*

*Example 3: Customers purchased (whatever services your business offers) on account, totaling \$400 on 09/07.*

These transactions record when your business makes money. There are two types of fees earned transactions: when customers pay you cash (example 2) and when customers pay you on credit, or on account as we call it in accounting (example 3). In the cash example, you increase "cash" and increase capital by the amount of the fees earned. In the credit example, you increase "accounts receivable" (money that you're expecting to receive from customers) and capital. Make sure to write your descriptions.

### **Making Purchases of Supplies, Equipment, Land**

*Example 4: Purchased \$800 of supplies with cash on 09/09.*

*Example 5: Purchased \$1200 of equipment on account (on credit) on 09/12.*

These transactions are pretty straightforward. For the cash transactions, you decrease “cash” and increase whatever you purchased. In example 4, you decrease “cash” and increase “supplies”. For the credit example (example 5), you increase “equipment” and increase “accounts payable” (because the amount you owe to your creditors goes up). Don’t confuse these with expense transactions (like paying rent, utilities, wages) – we’ll cover these next.

### **Paying Expenses** (excluding supplies expense)

*Example 6: Paid rent expense of \$900 in cash on 09/18.*

For most normal expenses, you will reduce “cash” and reduce “capital” by the amount of the expense. Sometimes, you will see expenses being paid on account (using credit). In those situations, you just increase “accounts payable” and decrease “capital”.

### **Supplies Expense**

*Example 7: Completed inventory and found that the amount of supplies on hand at the end of the month was \$300, meaning that \$500 in supplies had been used during the period.*

Supplies expense is handled a little differently. You purchased supplies earlier in the month, but you also have been using them throughout the month. When you complete inventory, you can tell how much you’ve used ... and then you have to expense this amount. What you do is reduce “supplies” by the amount that has been used and reduce “capital” by the amount as supplies expense. These are always the same.

### **Paying Off Accounts Receivable/Payable**

*Example 8: Received \$200 cash from customers paying on their accounts (accounts receivable) on 09/29.*

*Example 9: Made a payment to creditors (accounts payable) of \$800 on 09/29.*

Eventually, people have to pay off their creditors. Customers pay you cash on their accounts receivable, and you pay your accounts payable. For example 8, you would increase “cash” and decrease “accounts receivable” by the amount of the payment from your customers, in this case \$200. For example 9, you reduce “cash” and reduce “accounts payable” by the amount of your payment, in this case \$800.

### **Owner Making A Withdrawal**

*Example 10: Owner withdrew \$300 for personal use on 09/30.*

Owners will often withdraw money from their business for personal uses. They need to record these withdrawals, or else the books won’t balance at the end of the month. In the example, you would reduce cash and reduce capital by the amount of the withdrawal.

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**CHECK YOUR WORK:** Add up each of the columns, including the beginning balances, and write the totals at the bottom of the chart. Then, total up the assets ... this amount should equal liabilities + owner’s equity.

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And that’s it! If you learn these 10 examples, then you can handle just about any business transactions ... and these will be the only types of transactions that we will cover in class this quarter (we’ll get a little more fancy next quarter).

We will learn a couple other ways to record transactions over the next couple weeks (T-Accounts and Journals/Ledgers), but the types of transactions will remain the same.