Analyzing Transactions

Use this presentation to help you learn how to analyze business transactions.

Source Documents

Most business transactions are evidenced by source documents. Examples of source documents include invoices, bills, checks, and bank deposit slips.

Foundation

The prerequisite for this tutorial is a thorough understanding of account types.

See Help Lesson #1 – Understanding Accounts

Business Transaction

A business transaction is any event that affects the financial condition of a company and can be reliably measured in a dollar amount.

When you are working an accounting problem, the information about a transaction found in the source document has already been interpreted and is presented to you in written form.

For instance, the transaction supported by this purchase invoice might read:

Purchased office supplies for cash, $51.40.
The Business
For this tutorial, we will use the transactions of Jones Career Consulting. This is a consulting services business owned and operated by Karen Jones.

Analyzing a Transaction
Most transactions contain clues that help you identify the accounts involved in the transaction.

Double-Entry Accounting
In financial accounting, we use a system known as double-entry accounting. This means that each transaction will affect at least two different accounts.

Analyzing a Transaction
The first transaction for Jones Career Consulting occurred on May 1 and was as follows:
Karen Jones invested $7,500 cash in her new business.

Analyzing a Transaction
When analyzing transactions, it is helpful to answer the following three questions:

1. What accounts are involved in the transaction?
2. What is the classification of each account?
3. What is happening to each account—is it increasing or decreasing?

The following slides will help clarify these questions.

Analyzing a Transaction
Recall that most transactions contain clues that help you identify the accounts involved in the transaction.

Further recall that each transaction will involve at least two different accounts.
Karen Jones invested $7,500 cash in her new business.

When you see the word invested in a transaction description, it points to an investment in the owner’s capital account. Recall from Lesson 1 that the account name for capital is the owner’s name followed by the word Capital. In this case, the account would be Karen Jones, Capital.

When you see the word cash in a transaction description, it indicates the Cash account.

In the first transaction for Jones Career Consulting, two accounts were identified:

Cash
Karen Jones, Capital
Analyzing a Transaction

When classifying these accounts, Cash falls into the category of Asset and Karen Jones, Capital falls into the category of Owner’s Equity.

<table>
<thead>
<tr>
<th>Chart of Accounts</th>
</tr>
</thead>
<tbody>
<tr>
<td>Assets</td>
</tr>
<tr>
<td>Cash</td>
</tr>
<tr>
<td>Accounts Receivable</td>
</tr>
<tr>
<td>Office Supplies</td>
</tr>
<tr>
<td>Office Equipment</td>
</tr>
<tr>
<td>Building</td>
</tr>
<tr>
<td>Liabilities</td>
</tr>
<tr>
<td>Accounts Payable</td>
</tr>
<tr>
<td>Mortgage Payable</td>
</tr>
<tr>
<td></td>
</tr>
</tbody>
</table>

Effect on the Account

The next step is to determine what is happening to each account in the transaction or what is the effect on the transaction. An account may either be increasing or decreasing.

What Happens to the Cash Account?

When a business receives cash from any source, the Cash account will increase.

Stumbling Block

It is important that you understand that you must analyze each account separately when answering the questions what classification and what effect.

In any given transaction, there may be two accounts increasing, two accounts decreasing, or one increasing and one decreasing.

Karen Jones invested $7,500 cash in her new business.

The two accounts involved in this transaction are Karen Jones, Capital and Cash.

Stumbling Block

When an owner invests an asset in the company, the owner’s equity will increase. In this transaction, Karen Jones, Capital is increasing.

Karen Jones, Capital
Another Transaction

The next transaction for Jones Career Consulting occurred on May 3 and was as follows:

*The business purchased $300 in supplies on account.*

Analyzing a Transaction

*The business purchased $300 in supplies from Office Mix on account.*

The words on account in a transaction description indicate that a transaction occurred without payment. Payment will be made at a later date.

Analyzing a Transaction

Recall that the first step in analyzing a transaction is to determine the accounts involved. In this transaction the two clues that stand out are

*The business purchased $300 in supplies from Office Mix on account.*

More About “On Account”

Remember on account means that payment will be made at a later date.

A company may either make purchases on account or provide goods or services on account.

When a purchase is made on account, the company owes an amount to a creditor. The account used to keep up with amounts owed by a company is Accounts Payable.

Analyzing a Transaction

*The business purchased $300 in supplies from Office Mix on account.*

The word supplies in this transaction description indicates the use of the supplies account.

If we refer to the Chart of Accounts for Jones Consulting Services, we find that this company specifically calls this account Office Supplies.

More About “On Account”

When a service or product is provided on account, the company will receive payment from a customer at a later date. The account used to keep up with amounts owed to a company is Accounts Receivable.
Analyzing a Transaction

*The business purchased $300 in supplies from Office Mix on account.*

In this transaction, Jones Career Consulting has made a purchase on account and will pay for the supplies at a later date. Therefore, Accounts Payable is the account that is indicated in this transaction.

Effect on the Account

The next step is to determine what is happening to each account in the transaction or what is the effect on the transaction.

An account may either be increasing or decreasing.

Review the Second Transaction

*The business purchased $300 in supplies on account.*

The two accounts involved in this transaction are Office Supplies and Accounts Payable.

What Happens to the Office Supplies Account?

When additional supplies are purchased, the amount of the Office Supplies account increases.

Office Supplies
What Happens to Accounts Payable?

Accounts Payable is used to keep up with amounts owed by a company. When a business receives goods or services but does not pay for them, the amount the company owes increases.

Transaction Analysis Sheet

1. Jones Career Consulting provided services for a customer receiving a cash payment of $500.

<table>
<thead>
<tr>
<th>What Accounts?</th>
<th>What Classification?</th>
<th>What Effect?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>Asset</td>
<td>Increasing</td>
</tr>
<tr>
<td>Consulting Income</td>
<td>Revenue</td>
<td>Increasing</td>
</tr>
</tbody>
</table>

Remember that each account is analyzed separately.

Transaction Analysis Sheet

2. Jones Career Consulting pays the utilities bill of $175.

<table>
<thead>
<tr>
<th>What Accounts?</th>
<th>What Classification?</th>
<th>What Effect?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>Asset</td>
<td>Decreasing</td>
</tr>
<tr>
<td>Consulting Income</td>
<td>Revenue</td>
<td>Increasing</td>
</tr>
<tr>
<td>Utilities Expense</td>
<td>Expense</td>
<td>Increasing</td>
</tr>
</tbody>
</table>

Transaction Analysis Sheet

Use the Transaction Analysis Sheet to analyze the following transactions.

Next Step

We have now added to the foundation we are building for analyzing business transactions. The next step is to learn about Debits and Credits.

Choose Help Lesson #3 – Debits and Credits
Keep Practicing
You now have a firm foundation built for analyzing business transactions. It takes time and practice to learn how to effectively analyze transactions, but if you keep at it, you will be very accomplished at this in no time!