In Chapter 2, you learned how to calculate the financial position of a company and to present it using a balance sheet. You found that assets, liabilities, and equity were constantly changing. In this chapter, you will begin a process to track these changes.

3.1 ▶ Business Transactions

On any given day, many events occur that cause the financial position of a business to change. Each of these events is called a **business transaction** which may be defined as a financial event that causes a change in financial position.

For example, suppose the business buys a truck for which it pays $20 000 cash. This event is a transaction because it causes the financial position of the business to change. There would be an increase in assets of $20 000 in the item Trucks. There would also be a decrease of $20 000 in the asset Cash.

Suppose that the business owes $7000 to City Finance and makes a payment of $1000 against the debt. This event is also a transaction that causes the financial position to change. The amount in liabilities owed to City Finance would be reduced by $1000. In assets, the cash on hand would be reduced by $1000.

On the other hand, suppose that the city plumbing inspector inspects the building and leaves a letter suggesting some improvements. This is not a business transaction because no assets or liabilities have changed as a result of the activity.

Source Documents

When an asset, liability, or equity item is recorded for accounting purposes, a business paper or document is required to verify the dollar amount. The business paper is called a **source document**. It is the original record of the transaction—which is why it is called the source—and it provides accounting personnel with the information they need to process the transaction properly.

Examples of source documents include hydro bills, telephone bills, cheque copies, store receipts, cash register summaries, and credit card slips. They provide proof of payment, proof of purchase, and reference. Depending on the size of the business, source documents may move from person to person and from department to department. They are eventually filed because owners, managers, auditors, and others may want to ask questions. In Chapter 6, a full discussion is devoted to source documents, with illustrations. For now, remember

1. accounting entries are made from business papers known as source documents
2. source documents are kept on file for reference purposes and are proof of transactions

Accounting Standards—The Objectivity Principle

Objectivity is a long-standing accounting principle related to source documents. The **objectivity principle** requires that a business's accounting be recorded on the basis of clear, verifiable evidence. This principle means that different people looking at the evidence will arrive at the same values for the transaction. Simply put, this means that transactions will be recorded on fact, not on personal opinion or feelings.

Objectivity Principle: accounting data should be verifiable.

All accounting transactions must be supported by business papers called source documents.

Source Documents: business forms (papers) that give evidence of business transactions on a certain date.

The source document for a transaction is almost always the best objective evidence available. For example, the best objective evidence for the purchase of a new desk used in the business is the bill received from the retailer. The source document shows the amount agreed to by the buyer and the seller, who are usually independent of each other.

Five common source documents are:

1.) the opening balance sheet

2.) invoice

3.) cheque record

4.) remittance slip

5.) Bank deposit slip

THE FIRST BALANCE SHEET

- when a business is established the details of assets, liabilities and owner's equity are presented in the first balance sheet.
- this becomes a source document as at the date when the owner begins his or her business

T-accounts would need to be opened to record each asset, liabilities and owner's capital account as at the opening balance sheet date.

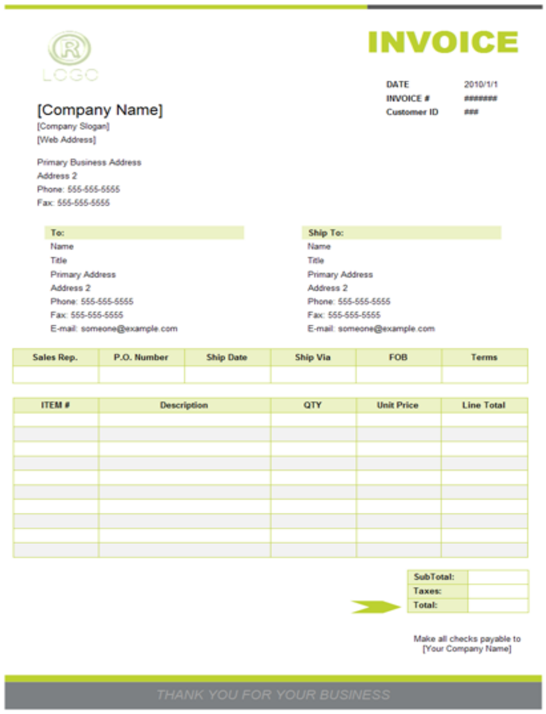
THE INVOICE

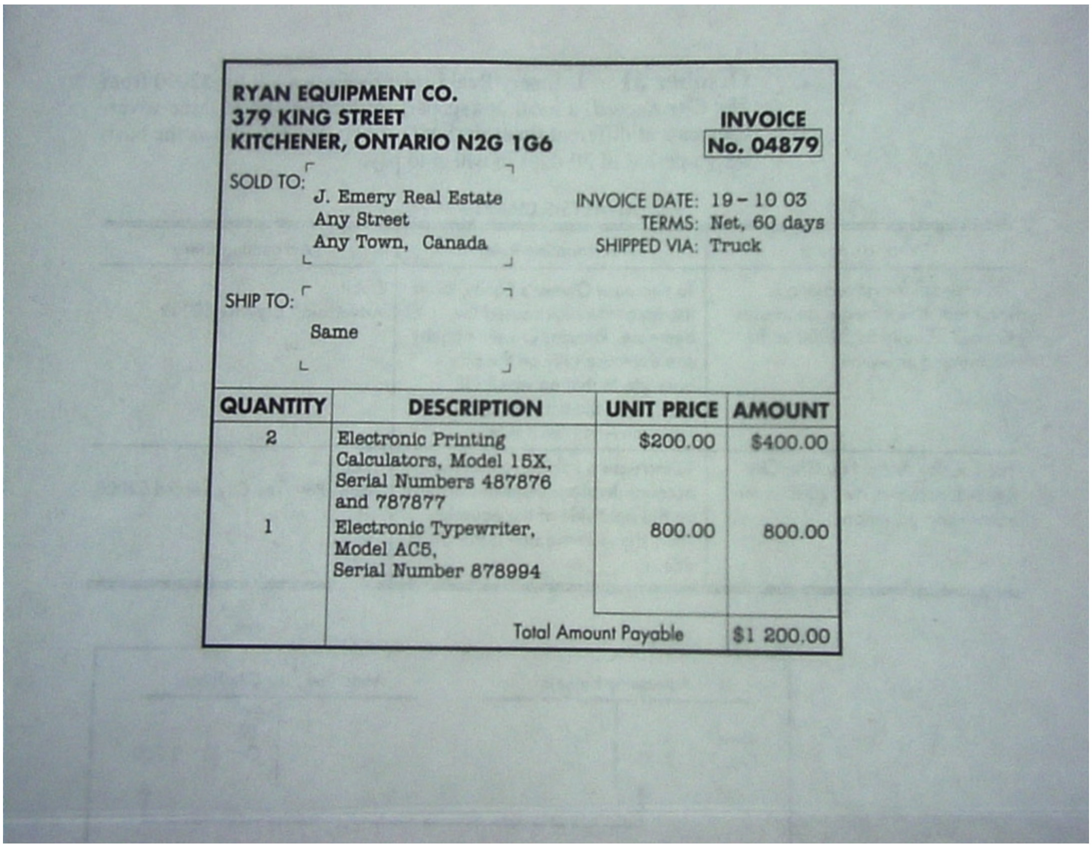
- when a business buys an asset with cash or on credit, the seller completes a bill of sale often called the sales invoice or just the invoice.

The name of the document my vary

invoice
sales slip
sales ticket
cash register tape

- the buyer will receive the original, which becomes the source document for the transaction





RYAN EQUIPMENT CO.
379 KING STREET
KITCHENER, ONTARIO N2G 1G6

INVOICE
No. 04879

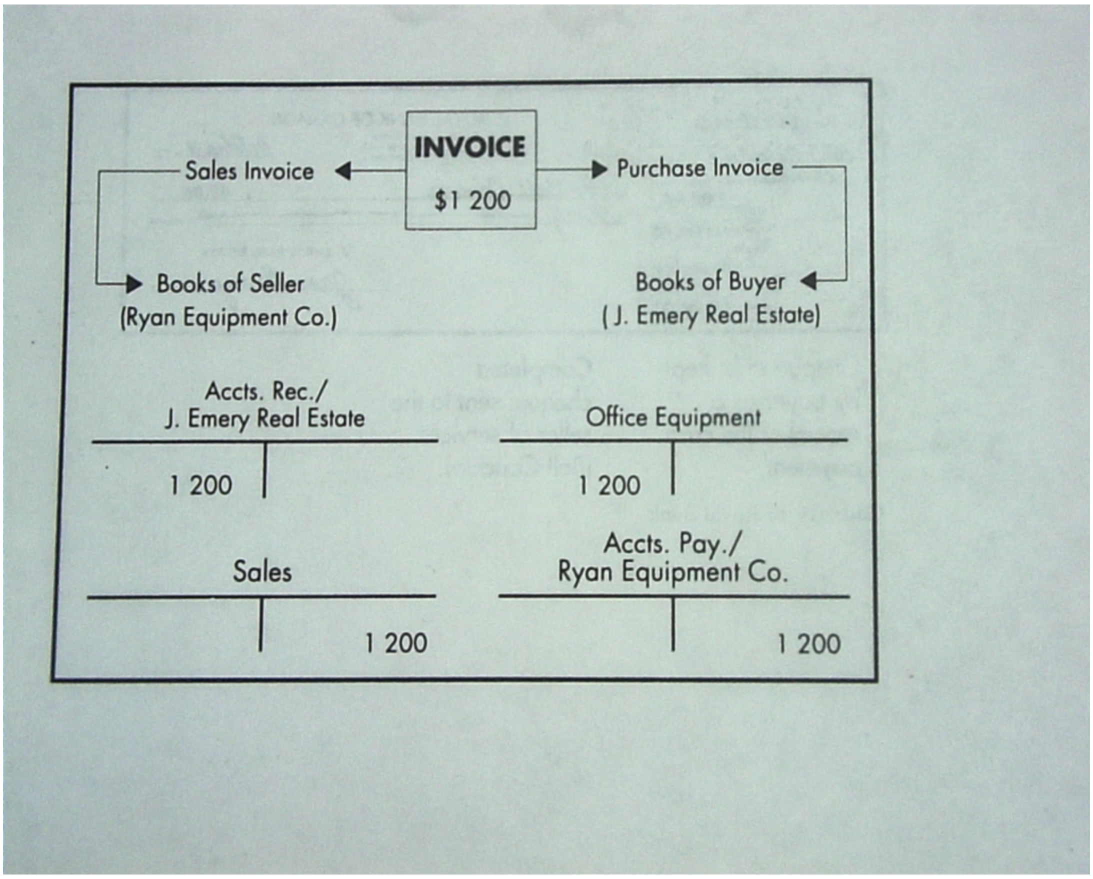
SOLD TO: J. Emery Real Estate
Any Street
Any Town, Canada

INVOICE DATE: 19 – 10 03
TERMS: Net, 60 days
SHIPPED VIA: Truck

SHIP TO: Same

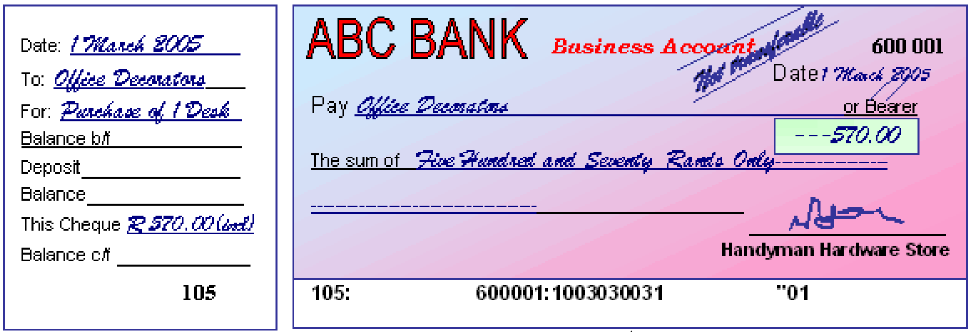
QUANTITY	DESCRIPTION	UNIT PRICE	AMOUNT
2	Electronic Printing Calculators, Model 15X, Serial Numbers 487876 and 787877	$200.00	$400.00
1	Electronic Typewriter, Model AC5, Serial Number 878994	800.00	800.00
	Total Amount Payable		$1 200.00

-This is called the purchase invoice by the buyer (J. Emery Real Estate), because he/she receives the original for buying the asset.
- The seller retains a copy of the invoice and it becomes the source document for the sales or the sales invoice - it is proof that the sale occurred.


INVOICE
$1 200
Sales Invoice
Purchase Invoice
Books of Seller
(Ryan Equipment Co.)
Books of Buyer
(J. Emery Real Estate)
Accts. Rec./
J. Emery Real Estate
1 200
Office Equipment
1 200
Sales
1 200
Accts. Pay./
Ryan Equipment Co.
1 200

THE CHEQUE RECORD

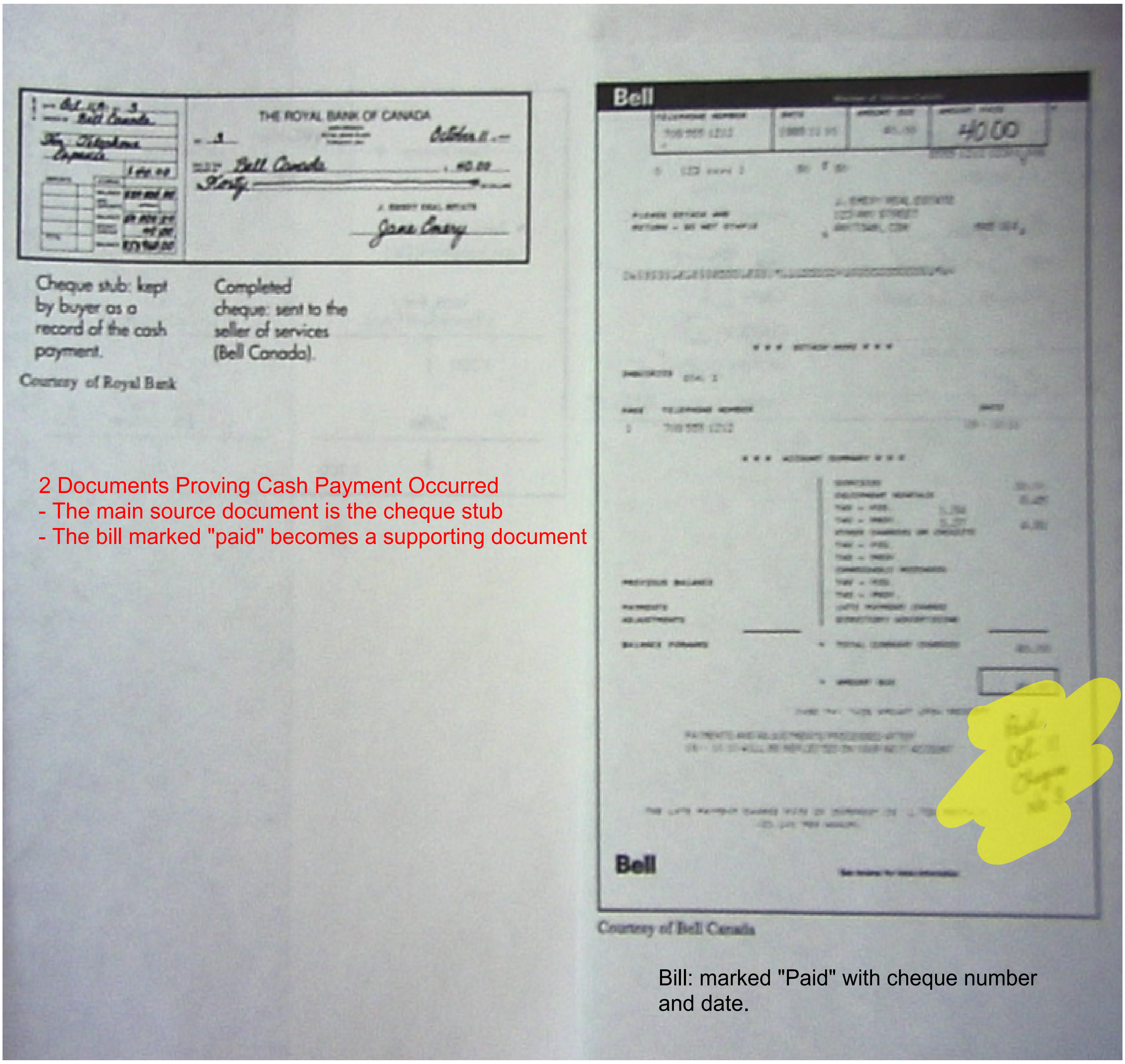
- used as evidence of each cash payment
- it may take many forms: one is the cheque stub


Date: 1 March 2005
To: Office Decorators
For: Purchase of 1 Desk
Balance b/f
Deposit
Balance
This Cheque R 570.00 (incl)
Balance c/f
105

ABC BANK Business Account
Not transferable
600 001
Date 1 March 2005
Pay Office Decorators or Bearer
---570.00
The sum of Five Hundred and Seventy Rands Only-----------
Handyman Hardware Store
105: 600001:1003030031 "01

Cheque stub: kept by the buyer as a record of payment

Completed cheque: sent to the seller of the services (Office Decorators)



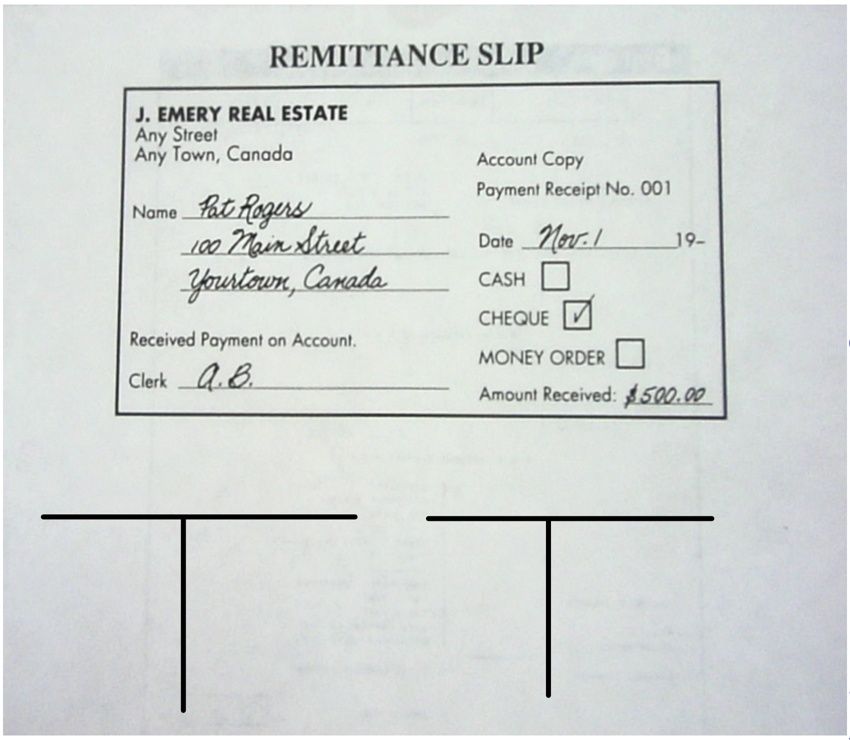
2 Documents Proving Cash Payment Occurred
- The main source document is the cheque stub
- The bill marked "paid" becomes a supporting document

Bill: marked "Paid" with cheque number and date.

THE REMITTANCE SLIP

- When a customer pays a debt by cheque, many businesses prepare a business form called the remittance slip. It becomes the source document for the record of the dollar amount received. It may also be called a receipt.

Remittance Slip - a source document proving the receipt of a customer's cheque.


REMITTANCE SLIP

J. EMERY REAL ESTATE
Any Street
Any Town, Canada

Account Copy
Payment Receipt No. 001

Name Pat Rogers
100 Main Street
Yourtown, Canada

Date Nov. 1 19-
CASH ☐
CHEQUE ☑
MONEY ORDER ☐

Received Payment on Account.
Clerk A. B.
Amount Received: $500.00

This remittance slip would be prepared _before_ the customer's cheque is deposited into to J. Emery
Real Estate's bank account.
- this is important because accounting requires evidence that a cheque has been received.
-once prepared the remittance slip becomes the source document for ???

Homework

Section 3.1

Review Questions #1-7

Exercises 1-5

SECTION 3.1 REVIEW QUESTIONS (page 59)

1. *A business transaction is a financial event that causes a change in financial position.*
2. *Answers will vary. An example of a transaction could be a new office desk that is purchased and paid for in cash.*
3. *Answers will vary. An example of an event that is not a transaction could be the owner examining some new computer equipment that is demonstrated by a salesperson.*
4. *A source document is the original record of a transaction that provides the accounting department with the information it needs related to the transaction.*
5. *Examples of source documents include hydro bills, telephone bills, cheque copies, store receipts, cash register tapes, and credit card slips.*
6. *After the accounting entries have been completed, the source documents are filed for future reference.*
7. *The objectivity principle states that accounting will be recorded on the basis of objective evidence. This means that transactions will be recorded based on facts not on personal opinions or feelings. For example, the best objective evidence for the cost of cellphone use is the bill from the cellphone company.*

SECTION 3.1 EXERCISES (page 59)

Exercise 1, p. 59

A. *transaction*
B. *transaction*
C. *not a transaction*
D. *transaction*
E. *transaction*
F. *not a transaction*
G. *transaction*
H. *not a transaction*

Exercise 2, p. 59

A. *transaction*
B. *not a transaction*
C. *not a transaction*
D. *transaction*
E. *not a transaction*
F. *transaction*
G. *transaction*
H. *not a transaction*

Exercise 3, p. 60

A. *Campbell & Associates issued the bill.*
B. *Smokey Valley Ski Club received the bill.*
C. *The bill was issued July 22, 20–.*
D. *Campbell and Associates issued the bill because they audited the records of Smokey Valley Ski Club and also prepared financial statements for them.*
E. *Yes, the bill represents good objective evidence because it originates from a source independent of the business.*

Exercise 4, p. 60

A. *The Davey Company issued the bill.*

B. *Smokey Valley Ski Club received the bill.*

C. *The bill was issued December 5, 20–.*

D. *The goods were delivered December 5, 20–. They were delivered by CPX.*

E. *The bill is due for payment 30 days from December 5, 20–, which would be the following January 4.*

F. *The bill was issued as evidence of the transaction to be used in the accounting records of both the purchaser and the vendor.*

G. *No, this was not a cash sale transaction. It is a sale on credit.*

H. *The bill represents good objective evidence because it comes from an independent source.*

Exercise 5, p. 61

A. *The memorandum is not good objective evidence because it does not come from an independent source.*

B. *The best objective evidence for this transaction would be the bill from the supplier.*

Topic 1 Problems

P 4-1 - Do together

a) J. Emery Real Estate (Seller)

b) Pat Rogers (Buyer)

c) J. Emery Real Estate

d) Terms: Net 30 days

e) Real Estate services

f) Invoice #'s help identify the source document

g) 5% of 120000
$0.05 \times 120000 = \boxed{\$6000}$

h) Nov 30th

i) 2% per month will be charged on overdue accounts.

j) A/R Pat Rogers increases \$6000 (Debit)
Commissions earned increases \$6000 (Credit)

k)

A/R Pat Rogers	
Oct 31 6000	

Commissions Earned	
	Oct 31 6000

l) Commissions Expense \$6000 (Debit)
A/P J. Emery Real Estate ↑ \$6000 (Credit)

m)

A/P J. Emery	
	Oct 31 6000

Commissions Exp.	
Oct 31 6000	