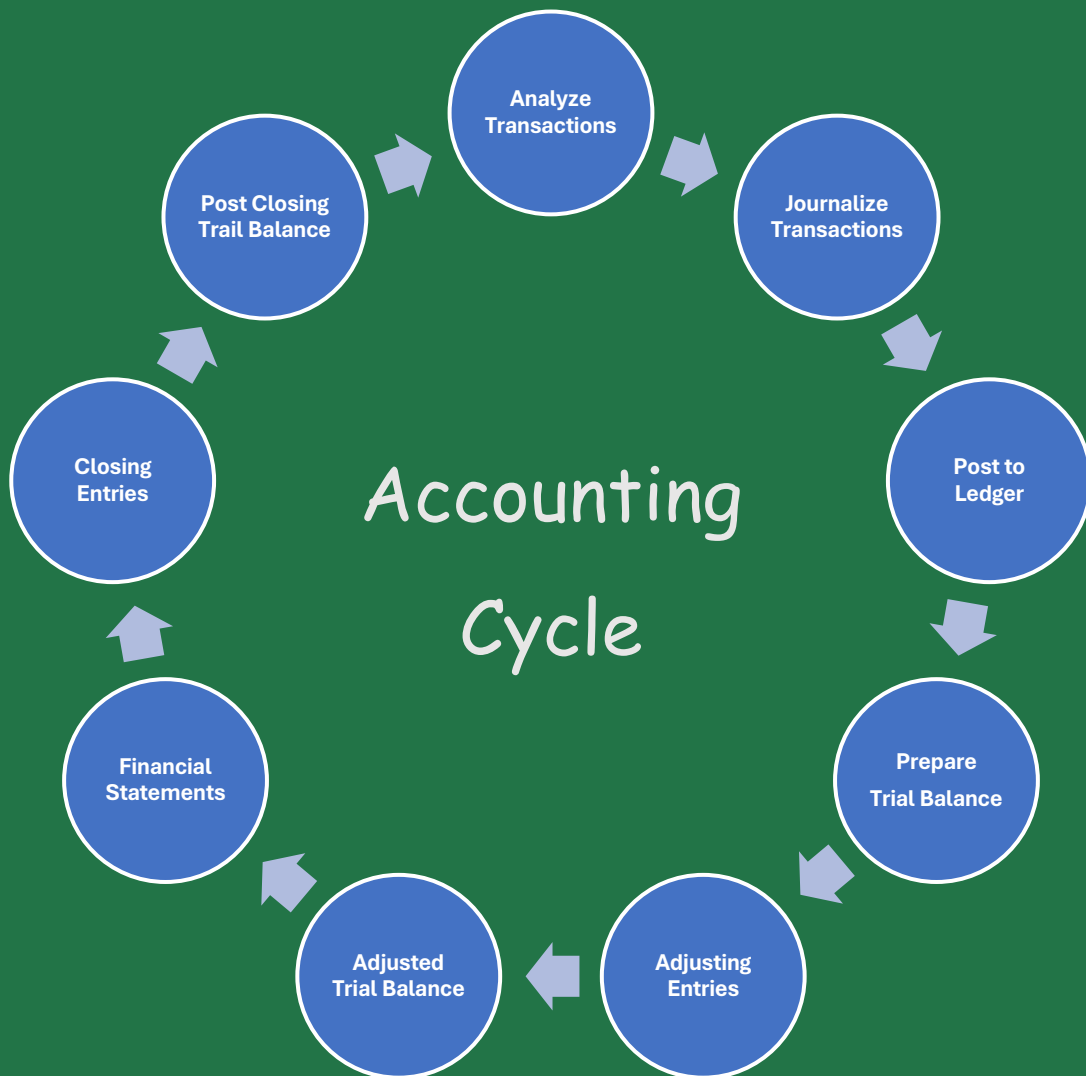


# CHAPTER 2

## The Recording Process



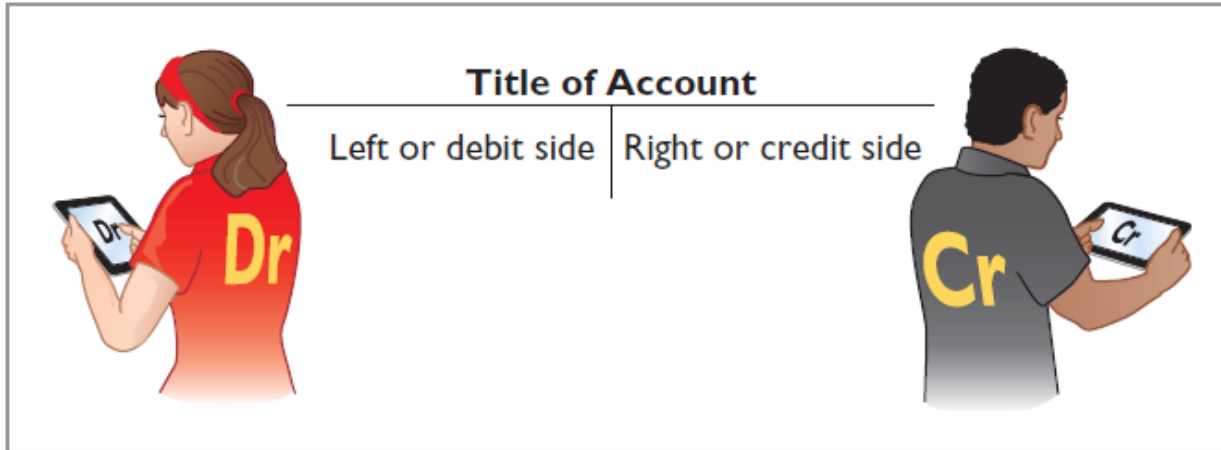
*Prepared by: Md. Nazmul Haque, BBA & MBA, AIS, DU*

## ACCOUNT

An account is **an individual accounting record** of increases and decreases in a specific asset, liability, or owner's equity item.

an account consists of three parts:

1. a title,
2. a left side (debit side)
3. a right side (credit side)



| Account Name |              |
|--------------|--------------|
| Debit / Dr.  | Credit / Cr. |
|              |              |
|              |              |
|              |              |

## DEBITS AND CREDITS

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### Debits and Credits

The term **debit** indicates the left side of an account, and **credit** indicates the right side. They are commonly abbreviated as **Dr.** for debit and **Cr.** for credit. They **do not** mean increase or decrease, as is commonly thought. We use the terms **debit** and **credit** repeatedly in the recording process to describe **where** entries are made in accounts. For example, the act of **entering an amount on the left side of an account is called debiting** the account. **Making an entry on the right side is crediting** the account.

### Debit Balance and Credit Balance

If the total of the debit amounts exceeds the credits, there will be a debit balance.

If the credit amounts exceed the debits, there will be a credit balance.

### Account Form

| Cash     |        |           |       |
|----------|--------|-----------|-------|
| (Debits) | 15,000 | (Credits) | 7,000 |
|          | 1,200  |           | 1,700 |
|          | 1,500  |           | 250   |
|          | 600    |           | 1,300 |
| Balance  | 8,050  |           |       |
| (Debit)  |        |           |       |



## DEBIT AND CREDIT PROCEDURE

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### Dr./Cr. Procedures for Assets and Liabilities



#### Assets

**Asset accounts normally show debit balances.** That is, debits to a specific asset account should exceed credits to that account.

| Assets  |   |
|---|---|
| Debit / Dr.   | Credit / Cr.  |
|  |  |
| Normal Balance  |   |

#### Liabilities



Likewise, **liability accounts normally show credit balances.** That is, credits to a liability account should exceed debits to that account.

| Liabilities   |   |
|---|---|
| Debit / Dr.   | Credit / Cr.  |
|  |  |
|   | Normal Balance  |

## Dr./cr. Procedures for Owner's Equity



### Owner's Capital

Investments by owners are credited to the Owner's Capital account. Credits increase this account, and debits decrease it. When an owner invests cash in the business, the company debits (increases) Cash and credits (increases) Owner's Capital. When the owner's investment in the business is reduced, Owner's Capital is debited (decreased).

| Owner's Capital   |   |
|---|---|
| Debit / Dr.   | Credit / Cr.  |
|  |  |
|   | Normal Balance  |



### Owner's Drawings

An owner may withdraw cash or other assets for personal use. Withdrawals could be debited directly to Owner's Capital to indicate a decrease in owner's equity. However, it is preferable to use a separate account, called Owner's Drawings. This separate account makes it easier to determine total withdrawals for each accounting period. Owner's Drawings is increased by debits and decreased by credits. Normally, the drawings account will have a debit balance.

| Owner's Drawing   |   |
|---|---|
| Debit / Dr.   | Credit / Cr.  |
|  |  |
| Normal Balance  |   |



## Revenues

The purpose of earning revenues is to benefit the owner(s) of the business. When a company recognizes revenues, owner's equity increases. Therefore, **the effect of debits and credits on revenue accounts is the same as their effect on Owner's Capital**. That is, revenue accounts are increased by credits and decreased by debits.

| Revenue   |   |
|---|---|
| Debit / Dr.   | Credit / Cr.  |
|  |  |
|   | Normal Balance  |



## Expenses



Expenses have the opposite effect. Expenses decrease owner's equity. Since expenses decrease net income and revenues increase it, it is logical that the increase and decrease sides of expense accounts should be the opposite of revenue accounts. Thus, expense accounts are increased by debits and decreased by credits.

| Expense   |   |
|---|---|
| Debit / Dr.   | Credit / Cr.  |
|  |  |
| Normal Balance  |   |

## Summary of Debit/Credit Rules:

Normal  
Balance  
**Debit**



| Assets  |   |
|---|---|
| Debit / Dr.   | Credit / Cr.  |
|  |  |
| Normal Balance  |   |

| Expense  |  |
|--|--|
| Debit / Dr.  | Credit / Cr.   |
|  |  |
| Normal Balance   |  |

Normal  
Balance  
**Credit**

| Owner's Capital   |   |
|---|---|
| Debit / Dr.   | Credit / Cr.  |
|  |  |
|   | Normal Balance  |

| Liabilities   |   |
|---|---|
| Debit / Dr.   | Credit / Cr.  |
|  |  |
|   | Normal Balance  |

| Revenue   |   |
|---|---|
| Debit / Dr.   | Credit / Cr.  |
|  |  |
|   | Normal Balance  |

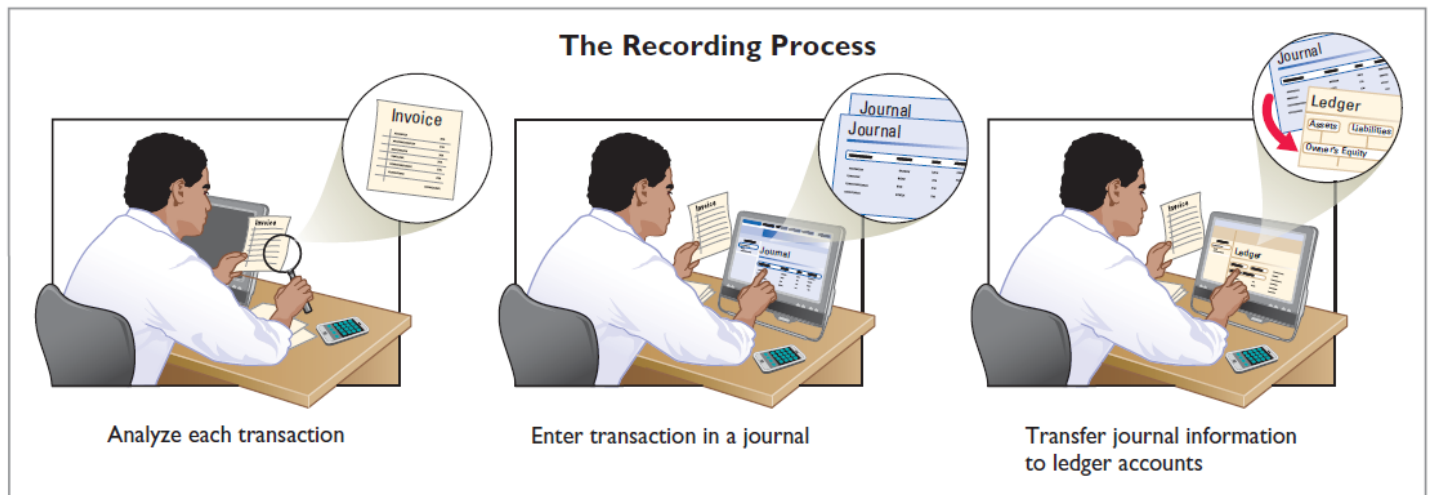
## STEPS IN THE RECORDING PROCESS

### Steps in the Recording Process

Although it is possible to enter transaction information directly into the accounts without using a journal, few businesses do so. Practically every business uses three basic steps in the recording process:

1. **Analyze each transaction** for its effects on the accounts. (Chapter 1)
2. Enter the transaction information in a **journal**.
3. Transfer the journal information to the appropriate accounts in the **ledger**.

**The purpose of transaction analysis** is first to identify the type of account involved, and then to determine whether to make a debit or a credit to the account. You should always perform this type of analysis before preparing a journal entry. Doing so will help you understand the journal entries.



### The Journal

Companies initially record transactions in chronological order (the order in which they occur). Thus, the **journal** is referred to as **the book of original entry**. For each transaction, the journal shows the debit and credit effects on specific accounts. Companies may use various kinds of journals, but every company has the most basic form of journal, a **general journal**. Typically, a general journal has spaces for **dates, account titles and explanations, references, and two amount columns**. *Whenever we use the term "journal" in this textbook, we mean the general journal unless we specify otherwise.* The journal makes several significant contributions to the recording process:

1. It discloses in one place the **complete effects of a transaction**.
2. It provides a **chronological record** of transactions.
3. It helps to **prevent or locate errors** because the debit and credit amounts for each entry can be easily compared.



## Journalizing

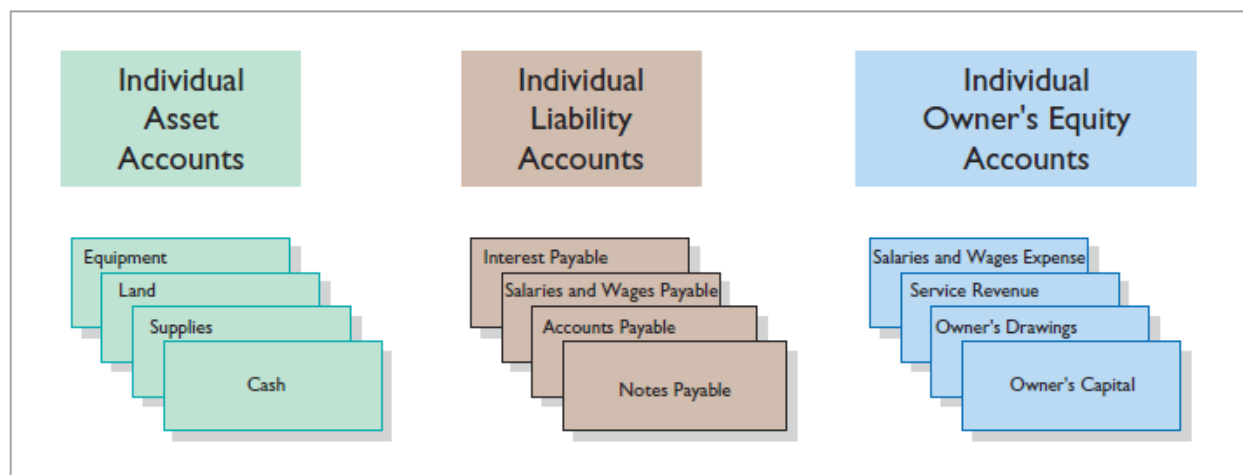
Entering transaction data in the journal is known as **journalizing**. Companies make separate journal entries for each transaction.

Standard Format of Journal

| Date | Account Titles and Explanation | Ref. | Debit | Credit |
|------|--------------------------------|------|-------|--------|
|      |                                |      |       |        |

## The Ledger

The entire group of accounts maintained by a company is the **ledger**. The ledger provides the **balance** in each of the accounts as well as keeps track of **changes** in these balances. Companies may use various kinds of ledgers, but every company has a general ledger. A **general ledger** contains all the asset, liability, and owner's equity accounts. *Whenever we use the term "ledger" in this textbook, we are referring to the general ledger unless we specify otherwise.*



Companies arrange the ledger in the **sequence** in which they present the accounts in the financial statements, beginning with the balance sheet accounts. First in order are the **asset accounts**, followed by **liability accounts**, **owner's capital**, **owner's drawings**, **revenues**, and **expenses**. Each account is numbered for easier identification. The ledger provides the balance in each of the accounts. For example, the Cash account shows the amount of cash available to meet current obligations. The Accounts Receivable account shows amount due from customers. Accounts Payable shows amounts owed to creditors.

### Standard Form of Ledger:

| Account's Name |             |      |       |        |         |        |
|----------------|-------------|------|-------|--------|---------|--------|
| Date           | Explanation | Ref. | Debit | Credit | Balance |        |
|                |             |      |       |        | Debit   | Credit |
|                |             |      |       |        |         |        |

## PREPARATION OF TRIAL BALANCE

A **trial balance** is a list of accounts and their balances at a given time. Customarily, companies prepare a trial balance at the end of an accounting period. They list accounts in the order in which they appear in the ledger. Debit balances appear in the left column and credit balances in the right column.

**The trial balance proves the mathematical equality of debits and credits after posting.** Under the double-entry system, this equality occurs when the sum of the debit account balances equals the sum of the credit account balances. **A trial balance may also uncover errors in journalizing and posting. In addition, a trial balance is useful in the preparation of financial statements.**

The steps for preparing a trial balance are:

- List the account titles and their balances in the appropriate debit or credit column.
- Total the debit and credit columns.
- Prove the equality of the two columns.

### Illustration – 1

Alex Cloud Service Center, Inc. engaged in the following transactions during the March, 2014:

- March 1** Alex began the business with an investment of \$26,000 in cash and a land worth \$50,000. The business issued common stocks in return to the Alex.
- 2** Borrowed \$45,000 from the bank and signed a note payable in the name of the business.
- 3** Paid cash of \$40,000 to acquire another land.
- 5** Performed service for a customer and received cash of \$5,000.
- 7** Purchased supplies on account \$2300.
- 10** Performed customer service and earned **revenue on** account \$3,600.
- 15** Paid \$1,200 **on account**.
- 24** Paid the following cash expenses: salaries \$3,000; rent \$1,500; and interest \$400.
- 25** Received \$3,100 **on account**.
- 28** Received a \$200 **utility bill** that will be paid next week.
- 31** Paid cash dividends of \$1,800.

#### Requirements:

- a) Journalize the transactions
- b) Post to the ledger accounts
- c) Prepare a trial balance at March 31, 2014.

### Solution

a) The journal entries of the transaction of March, 2014, are given below:

| Date    | Account Titles and Explanation  | Ref. | Debit                 | Credit |
|---------|---|------|-----------------------|--------|
| March 1 | <b>Cash</b><br><b>Land</b><br>Common Stock<br><i>(Cash and land invested by owner)</i>                      |      | 26,000<br>50,000      | 76,000 |
| 2       | <b>Cash</b><br>Notes Payable<br><i>(Borrowed cash on notes payable)</i>                                     |      | 45,000                | 45,000 |
| 3       | <b>Land</b><br><b>Cash</b><br><i>(Purchased land in cash)</i>   |      | 40,000                | 40,000 |
| 5       | <b>Cash</b><br>Service Revenue<br><i>(Performed service and received cash)</i>                              |      | 5,000                 | 5,000  |
| 7       | Supplies<br>Accounts Payable<br><i>(Purchased supplies on account)</i>                                      |      | 2,300                 | 2,300  |
| 10      | Accounts Receivable<br>Service Revenue<br><i>(Performed service on account)</i>                             |      | 3,600                 | 3,600  |
| 15      | Accounts Payable<br><b>Cash</b><br><i>(Paid on account)</i>   |      | 1,200                 | 1,200  |
| 24      | Salary Expense<br>Rent Expense<br>Interest Expense<br><b>Cash</b><br><i>(Paid expenses in cash)</i>         |      | 3,000<br>1,500<br>400 | 4,900  |
| 25      | <b>Cash</b><br>Accounts Receivable<br><i>(Received cash on account)</i>                                     |      | 3,100                 | 3,100  |
| 28      | Utilities Expense<br>Utilities <b>Payable</b><br><i>(Received utility bill but didn't pay the bill yet)</i> |      | 200                   | 200    |
| 31      | Dividends<br><b>Cash</b><br><i>(Paid dividends in cash)</i>   |      | 1,800                 | 1,800  |

b) Posting to the ledger accounts are shown below:

**Cash**

| Date    | Explanation         | Ref. | Debit  | Credit | Balance |        |
|---------|---------------------|------|--------|--------|---------|--------|
|         |                     |      |        |        | Debit   | Credit |
| March 1 | Common Stock        |      | 26,000 |        | 26,000  |        |
| 2       | Notes Payable       |      | 45,000 |        | 71,000  |        |
| 3       | Land                |      |        | 40,000 | 31,000  |        |
| 5       | Service Revenue     |      | 5,000  |        | 36,000  |        |
| 15      | Accounts Payable    |      |        | 1,200  | 34,800  |        |
| 24      | Salary Expense      |      |        | 3,000  | 31,800  |        |
| 24      | Rent Expense        |      |        | 1,500  | 30,300  |        |
| 24      | Interest Expense    |      |        | 400    | 29,900  |        |
| 25      | Accounts Receivable |      | 3,100  |        | 33,000  |        |
| 31      | Dividends           |      |        | 1,800  | 31,200  |        |

Land

| Date    | Explanation  | Ref. | Debit  | Credit | Balance |        |
|---------|--------------|------|--------|--------|---------|--------|
|         |              |      |        |        | Debit   | Credit |
| March 1 | Common Stock |      | 50,000 |        | 50,000  |        |
| 3       | Cash         |      | 40,000 |        | 90,000  |        |

Common Stock

| Date    | Explanation | Ref. | Debit | Credit | Balance |        |
|---------|-------------|------|-------|--------|---------|--------|
|         |             |      |       |        | Debit   | Credit |
| March 1 | Cash        |      |       | 26,000 |         | 26,000 |
|         | Land        |      |       | 50,000 |         | 76,000 |

Notes Payable

| Date    | Explanation | Ref. | Debit | Credit | Balance |        |
|---------|-------------|------|-------|--------|---------|--------|
|         |             |      |       |        | Debit   | Credit |
| March 2 | Cash        |      |       | 45,000 |         | 45,000 |

Service Revenue

| Date    | Explanation         | Ref. | Debit | Credit | Balance |        |
|---------|---------------------|------|-------|--------|---------|--------|
|         |                     |      |       |        | Debit   | Credit |
| March 5 | Cash                |      |       | 5,000  |         | 5,000  |
| 10      | Accounts Receivable |      |       | 3,600  |         | 8,600  |

Supplies

| Date    | Explanation      | Ref. | Debit | Credit | Balance |        |
|---------|------------------|------|-------|--------|---------|--------|
|         |                  |      |       |        | Debit   | Credit |
| March 7 | Accounts Payable |      | 2,300 |        | 2,300   |        |

Accounts Payable

| Date   | Explanation | Ref. | Debit | Credit | Balance |        |
|--------|-------------|------|-------|--------|---------|--------|
|        |             |      |       |        | Debit   | Credit |
| Mach 7 | Supplies    |      |       | 2,300  |         | 2,300  |
| 15     | Cash        |      | 1,200 |        |         | 1,100  |

### Accounts Receivable

| Date    | Explanation     | Ref. | Debit | Credit | Balance |        |
|---------|-----------------|------|-------|--------|---------|--------|
|         |                 |      |       |        | Debit   | Credit |
| Mach 10 | Service Revenue |      | 3,600 |        | 3,600   |        |
| 25      | Cash            |      |       | 3,100  | 500     |        |

### Salary Expense

| Date     | Explanation | Ref. | Debit | Credit | Balance |        |
|----------|-------------|------|-------|--------|---------|--------|
|          |             |      |       |        | Debit   | Credit |
| March 24 | Cash        |      | 3,000 |        | 3,000   |        |

### Rent Expense

| Date     | Explanation | Ref. | Debit | Credit | Balance |        |
|----------|-------------|------|-------|--------|---------|--------|
|          |             |      |       |        | Debit   | Credit |
| March 24 | Cash        |      | 1,500 |        | 1,500   |        |

### Interest Expense

| Date     | Explanation | Ref. | Debit | Credit | Balance |        |
|----------|-------------|------|-------|--------|---------|--------|
|          |             |      |       |        | Debit   | Credit |
| March 24 | Cash        |      | 400   |        | 400     |        |

### Utilities Expense

| Date     | Explanation       | Ref. | Debit | Credit | Balance |        |
|----------|-------------------|------|-------|--------|---------|--------|
|          |                   |      |       |        | Debit   | Credit |
| March 28 | Utilities Payable |      | 200   |        | 200     |        |

### Utilities Payable

| Date     | Explanation       | Ref. | Debit | Credit | Balance |        |
|----------|-------------------|------|-------|--------|---------|--------|
|          |                   |      |       |        | Debit   | Credit |
| March 28 | Utilities Expense |      |       | 400    |         | 400    |

### Dividends

| Date     | Explanation | Ref. | Debit | Credit | Balance |        |
|----------|-------------|------|-------|--------|---------|--------|
|          |             |      |       |        | Debit   | Credit |
| March 31 | Cash        |      | 1,800 |        | 1,800   |        |

## **Illustration – 2**

During the month of October, 2017, the following transactions occurred for the Pioneer Advertising Company.

**October 1** C. R. Byrd invests \$10,000 cash in an advertising company called Pioneer Advertising.

- 1 Pioneer purchased office equipment costing \$5,000 by signing a 3-month, 12%, \$5,000 note payable.
- 2 Received a \$1,200 cash advance from R. Knox, a client, for advertising services that are expected to be completed by December 31.
- 3 Paid office rent for October in cash, \$900.
- 4 Paid \$600 for a one-year insurance policy that will expire next year on September 30.
- 5 Purchased an estimated 3-month supply of advertising materials on account from Aero Supply for \$2,500.
- 9 Hired four employees to begin work on October 15. Each employee is to receive a weekly salary of \$500 for a 5-day work week, payable every 2 weeks—first payment made on October 26.
- 20 C. R. Byrd withdrew \$500 cash for personal use.
- 26 Pioneer owed employee salaries of \$4,000 and paid them in cash (October 9 event).
- 31 Received \$10,000 in cash from Copa Company for advertising services performed in October.

### **Requirements:**

- a) Journalize the transactions
- b) Post to the ledger accounts
- c) Prepare a trial balance at October 31, 2017.



**Solution:**

a) The journal entries of the transaction are given below:

| Date           | Account Titles and Explanation   | Ref. | Debit | Credit |
|----------------|--|------|-------|--------|
| 2017<br>Oct. 1 | Cash<br>Owner's Capital<br><i>(Owner's investment of cash in business)</i>                 |      | 1000  | 1000   |
| 1              | Equipment<br>Notes Payable<br><i>(Issued 3-month, 12% note for office equipment)</i>       |      | 5000  | 5000   |
| 2              | Cash<br>Unearned Service Revenue<br><i>(Received cash from R. Knox for future service)</i> |      | 1200  | 1200   |
| 3              | Rent Expense<br>Cash<br><i>(Paid October rent)</i>   |      | 900   | 900    |
| 4              | Prepaid Insurance<br>Cash<br><i>(Paid one-year policy; effective date October 1)</i>       |      | 600   | 600    |
| 5              | Supplies<br>Accounts Payable<br><i>(Purchased supplies on account from Aero Supply)</i>    |      | 2500  | 2500   |
| 20             | Owner's Drawings<br>Cash<br><i>(Withdrew cash for personal use)</i>                        |      | 500   | 500    |
| 26             | Salaries and Wages Expense<br>Cash<br><i>(Paid salaries to date)</i>                       |      | 4000  | 4000   |
| 31             | Cash<br>Service Revenue<br><i>(Received cash for services performed)</i>                   |      | 1000  | 1000   |

b) Posting to the ledger accounts are shown below:

Cash

| Date   | Explanation                | Ref. | Debit | Credit | Balance      |        |
|--------|----------------------------|------|-------|--------|--------------|--------|
|        |                            |      |       |        | Debit        | Credit |
| Oct. 1 | Owner's Capital            |      | 10000 |        | 10000        |        |
| 2      | Unearned Service Revenue   |      | 1200  |        | 11200        |        |
| 3      | Rent Expense               |      |       | 900    | 10300        |        |
| 4      | Prepaid Insurance          |      |       | 600    | 9700         |        |
| 20     | Owner's Drawings           |      |       | 500    | 9200         |        |
| 26     | Salaries and Wages Expense |      |       | 4000   | 5200         |        |
| 31     | Service Revenue            |      | 10000 |        | <b>15200</b> |        |

Supplies

| Date   | Explanation      | Ref. | Debit | Credit | Balance |        |
|--------|------------------|------|-------|--------|---------|--------|
|        |                  |      |       |        | Debit   | Credit |
| Oct. 5 | Accounts Payable |      | 2500  |        | 2500    |        |

Prepaid Insurance

| Date   | Explanation | Ref. | Debit | Credit | Balance |        |
|--------|-------------|------|-------|--------|---------|--------|
|        |             |      |       |        | Debit   | Credit |
| Oct. 4 | Cash        |      | 600   |        | 600     |        |

Equipment

| Date   | Explanation | Ref. | Debit | Credit | Balance |        |
|--------|-------------|------|-------|--------|---------|--------|
|        |             |      |       |        | Debit   | Credit |
| Oct. 1 |             |      | 5000  |        | 5000    |        |

Notes Payable

| Date   | Explanation   | Ref. | Debit | Credit | Balance |        |
|--------|---------------|------|-------|--------|---------|--------|
|        |               |      |       |        | Debit   | Credit |
| Oct. 1 | Notes Payable |      |       | 5000   |         | 5000   |

### Accounts Payable

| Date   | Explanation | Ref. | Debit | Credit | Balance |        |
|--------|-------------|------|-------|--------|---------|--------|
|        |             |      |       |        | Debit   | Credit |
| Oct. 5 |             |      |       | 2500   |         | 2500   |

### Unearned Service Revenue

| Date   | Explanation | Ref. | Debit | Credit | Balance |        |
|--------|-------------|------|-------|--------|---------|--------|
|        |             |      |       |        | Debit   | Credit |
| Oct. 2 | Supplies    |      |       | 1200   |         | 1200   |

### Owner's Capital

| Date   | Explanation | Ref. | Debit | Credit | Balance |        |
|--------|-------------|------|-------|--------|---------|--------|
|        |             |      |       |        | Debit   | Credit |
| Oct. 1 | Cash        |      |       | 10000  |         | 10000  |

### Owner's Drawings

| Date    | Explanation | Ref. | Debit | Credit | Balance |        |
|---------|-------------|------|-------|--------|---------|--------|
|         |             |      |       |        | Debit   | Credit |
| Oct. 20 | Cash        |      | 500   |        | 500     |        |

### Service Revenue

| Date    | Explanation | Ref. | Debit | Credit | Balance |        |
|---------|-------------|------|-------|--------|---------|--------|
|         |             |      |       |        | Debit   | Credit |
| Oct. 31 | Cash        |      |       | 10000  |         | 10000  |

### Salaries and Wages Expense

| Date    | Explanation | Ref. | Debit | Credit | Balance |        |
|---------|-------------|------|-------|--------|---------|--------|
|         |             |      |       |        | Debit   | Credit |
| Oct. 26 | Cash        |      | 4000  |        | 4000    |        |

### Rent Expense

| Date   | Explanation | Ref. | Debit | Credit | Balance |        |
|--------|-------------|------|-------|--------|---------|--------|
|        |             |      |       |        | Debit   | Credit |
| Oct. 3 | Cash        |      | 900   |        | 900     |        |

c) The trial balance of Pioneer Engineering is prepared below:

**Pioneer Advertising**

**Trial Balance**

**October 31, 2017**

| <b>Serial No.</b> | <b>Accounts Name</b>       | <b>L.F</b> | <b>Debit (\$)</b>   | <b>Credit (\$)</b>  |
|-------------------|----------------------------|------------|---------------------|---------------------|
| 1                 | Cash                       |            | 15200               |                     |
| 2                 | Supplies                   |            | 2500                |                     |
| 3                 | Prepaid Insurance          |            | 600                 |                     |
| 4                 | Equipment                  |            | 5000                |                     |
| 5                 | Notes Payable              |            |                     | 5000                |
| 6                 | Accounts Payable           |            |                     | 2500                |
| 7                 | Unearned Service Revenue   |            |                     | 1200                |
| 8                 | Owner's Capital            |            |                     | 10000               |
| 9                 | Owner's Drawings           |            | 500                 |                     |
| 10                | Service Revenue            |            |                     | 10000               |
| 11                | Salaries and Wages Expense |            | 4000                |                     |
| 12                | Rent Expense               |            | 900                 |                     |
|                   |                            |            | <b><u>28700</u></b> | <b><u>28700</u></b> |

### **Practice Problem:**

Bob Sample opened the Campus Laundromat on September 1, 2017. During the first month of operations, the following transactions occurred.

- Sept. 1. Bob invested \$20,000 cash in the business.
- 2. The company paid \$1,000 cash for store rent for September.
- 3. Purchased washers and dryers for \$25,000, paying \$10,000 in cash and signing a \$15,000, 6-month, 12% note payable.
- 4. Paid \$1,200 for a one-year accident insurance policy.
- 10. Received a bill from the *Daily News* for online advertising of the opening of the laundromat \$200.
- 20. Bob withdrew \$700 cash for personal use.
- 30. The company determined that cash receipts for laundry services for the month were \$6,200.

### **Instructions**

- a) Journalize the September transactions.
- b) Open ledger accounts and post the September transactions.
- c) Prepare a trial balance at September 30, 2017.