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Financial
ACCOUNTING
IFRS EDITI2eN

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Chapter 2

The Recording Process

Learning Objectives

After studying this chapter, you should be able to:

[1] Explain what an account is and how it helps in the recording process.

[2] Define debits and credits and explain their use in recording business transactions.

[3] Identify the basic steps in the recording process.

[4] Explain what a journal is and how it helps in the recording process.

[5] Explain what a ledger is and how it helps in the recording process.

[6] Explain what posting is and how it helps in the recording process.

[7] Prepare a trial balance and explain its purposes.

Preview of Chapter 2

THE RECORDING PROCESS			
The Account	**Steps in the Recording Process**	**The Recording Process Illustrated**	**The Trial Balance**
• Debits and credits • Equity relationships • Summary of debit/ credit rules	• Journal • Ledger • Posting	• Summary illustration of journalizing and posting	• Limitations of a trial balance • Locating errors • Use of currency signs

Financial Accounting
IFRS Second Edition
Weygandt • Kimmel • Kieso

The Account

Account ➤ ◆ Record of increases and decreases in a specific asset, liability, equity, revenue, or expense item.

◆ Debit = "Left"

◆ Credit = "Right"

An account can be illustrated in a T-account form. ➤

Account Name

Debit / Dr.	Credit / Cr.

LO 1 Explain what an account is and how it helps in the recording process.

The Account

Debits and Credits

Double-entry system

► Each transaction must affect two or more accounts to keep the basic accounting equation in balance.

► Recording done by debiting at least one account and crediting another.

► **DEBITS must equal CREDITS**.

LO 2 Define debits and credits and explain their use in recording business transactions.

Debits and Credits

If Debit amounts are greater than Credit amounts, the account will have a debit balance.

	Account Name		
	Debit / Dr.	**Credit / Cr.**	
Transaction #1	**$10,000**	**$3,000**	**Transaction #2**
Transaction #3	**8,000**		
Balance	**$15,000**		

LO 2 Define debits and credits and explain their use in recording business transactions.

Debits and Credits

If Debit amounts are less than Credit amounts, the account will have a credit balance.

	Account Name		
	Debit / Dr.	**Credit / Cr.**	
Transaction #1	**$10,000**	**$3,000**	**Transaction #2**
		8,000	**Transaction #3**
Balance		**$1,000**	

LO 2 Define debits and credits and explain their use in recording business transactions.

Debits and Credits

Assets	
Debit / Dr.	**Credit / Cr.**
↑	↓
Normal Balance	

Chapter
3-23

Liabilities	
Debit / Dr.	**Credit / Cr.**
↓	↑
	Normal Balance

Chapter
3-24

◆ **Assets -** Debits should exceed credits.

◆ **Liabilities** – Credits should exceed debits.

◆ **Normal balance** is on the increase side.

LO 2 Define debits and credits and explain their use in recording business transactions.

Debits and Credits

Equity

Debit / Dr.	Credit / Cr.
⬇	⬆
	Normal Balance

Chapter
3-25

◆ **Issuance of share capital** and **revenues** increase equity (credit).

◆ **Dividends** and **expenses** decrease equity (debit).

Share Capital

Debit / Dr.	Credit / Cr.
⬇	⬆
	Normal Balance

Chapter
3-25

Retained Earnings

Debit / Dr.	Credit / Cr.
⬇	⬆
	Normal Balance

Chapter
3-25

Dividends

Debit / Dr.	Credit / Cr.
⬆	⬇
Normal Balance	

Chapter
3-23

LO 2

Debits and Credits

Revenue	
Debit / Dr.	**Credit / Cr.**
⬇	⬆
	Normal Balance

Chapter
3-26

Expense	
Debit / Dr.	**Credit / Cr.**
⬆	⬇
Normal Balance	

Chapter
3-27

◆ The purpose of earning **revenues** is to benefit the shareholders.

◆ The effect of debits and credits on revenue accounts is the **same as** their effect on equity.

◆ **Expenses** have the opposite effect: expenses decrease equity.

LO 2 Define debits and credits and explain their use in recording business transactions.

Debit/Credit Rules

Normal Balance **Debit**

Normal Balance **Credit**

Assets

Debit / Dr.	Credit / Cr.
↑	↓
Normal Balance	

Expense

Debit / Dr.	Credit / Cr.
↑	↓
Normal Balance	

Liabilities

Debit / Dr.	Credit / Cr.
↓	↑
	Normal Balance
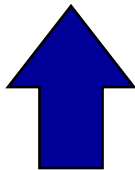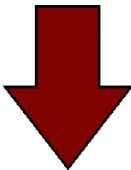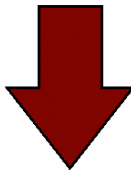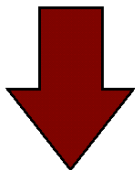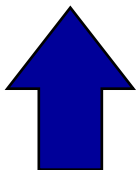
Equity

Debit / Dr.	Credit / Cr.
↓	↑
	Normal Balance

Revenue

Debit / Dr.	Credit / Cr.
↓	↑
	Normal Balance

Debit/Credit Rules

	Statement of Financial Position			Income Statement	
	Asset =	Liability +	Equity	Revenue	- Expense
Debit	↑	↓	↓	↓	↑
Credit	↓	↑	↑	↑	↓

LO 2 Define debits and credits and explain their use in recording business transactions.

Debit/Credit Rules

Question

Debits:

   a. increase both assets and liabilities.

   b. decrease both assets and liabilities.

   c. increase assets and decrease liabilities.

   d. decrease assets and increase liabilities.

LO 2 Define debits and credits and explain their use in recording business transactions.

Debit/Credit Rules

Question

Accounts that normally have debit balances are:

    a. assets, expenses, and revenues.

    b. assets, expenses, and equity.

    c. assets, liabilities, and dividends.

    d. assets, dividends, and expenses.

LO 2 Define debits and credits and explain their use in recording business transactions.

INVESTOR INSIGHT

Keeping Score

The Manchester United (GBR) football (soccer) club probably has these major revenue and expense accounts:

Revenues	Expenses
Admissions (ticket sales)	Players' salaries
Concessions	Administrative salaries
Television and radio	Travel
Advertising	Stadium maintenance

? Do you think that the Chicago Bears (USA) American football team would be likely to have the same major revenue and expense accounts as Manchester United?

Equity Relationships

Illustration 2-11

Statement of Financial Position

Assets

Liabilities

Equity
  Share capital—ordinary ← **Investments by shareholders**
  Retained earnings ← **Net income retained in the business**

Income Statement

Revenues

Less: Expenses

Net income or net loss

Retained Earnings Statement

Beginning retained earnings

Add: Net income

Less: Dividends

Ending retained earnings

LO 2
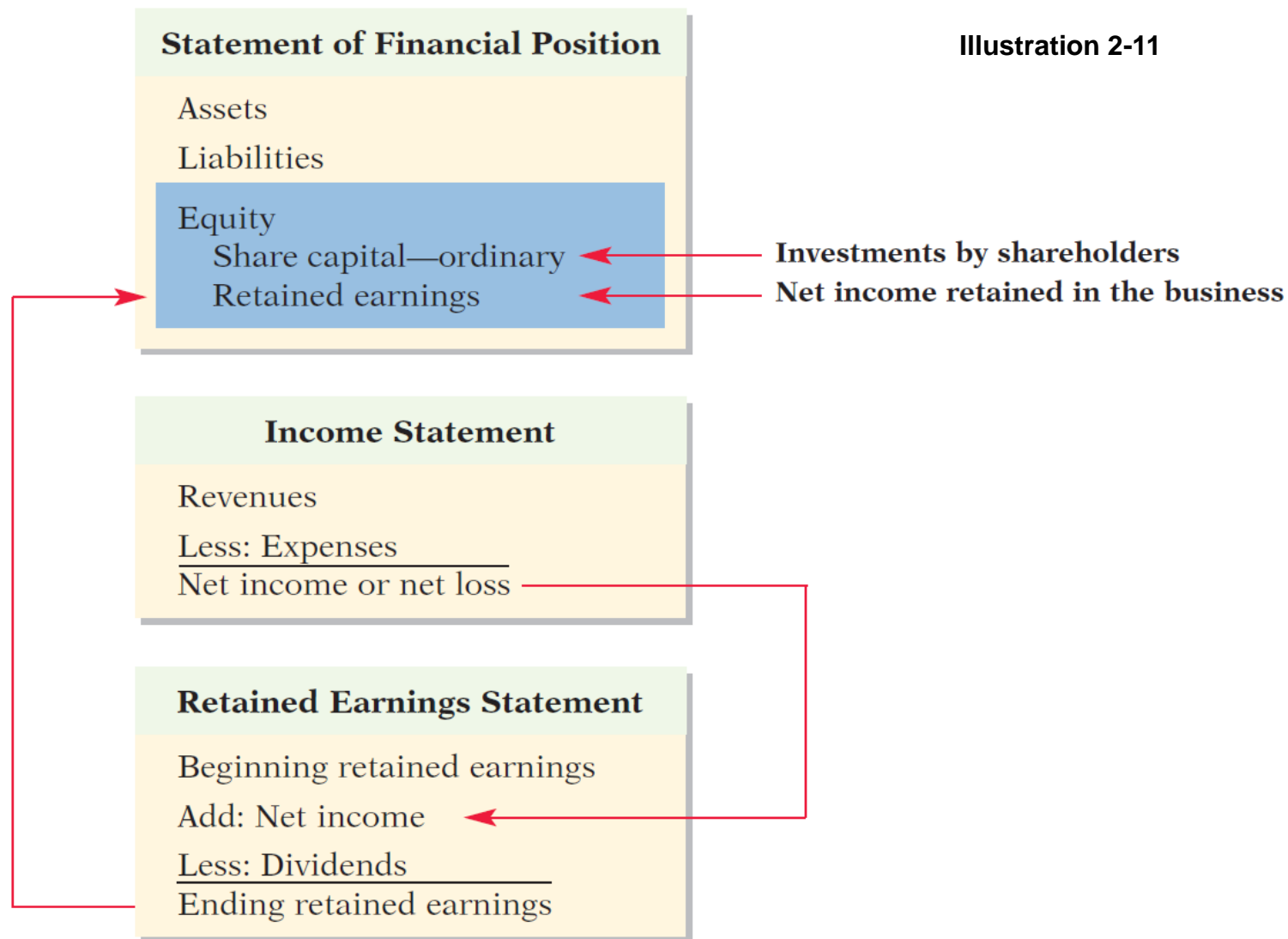
Summary of Debit/Credit Rules

Relationship among the assets, liabilities and equity of a business:

Basic Equation	Assets	=	Liabilities	+		Equity				

Expanded Equation	Assets	=	Liabilities	+	Share Capital	+	Retained Earnings	−	Dividends	+	Revenues	−	Expenses
Debit/Credit Effects	Dr. +	Cr. −		Dr. −	Cr. +		Dr. −	Cr. +		Dr. −	Cr. +		Dr. +	Cr. −		Dr. −	Cr. +		Dr. +	Cr. −

The equation must be in balance after every transaction. For every **Debit** there must be a **Credit**.

LO 2 Define debits and credits and explain their use in recording business transactions.

Kate Browne, president of Hair It Is, Inc., has just rented space in a shopping mall in which she will open and operate a beauty salon. A friend has advised Kate to set up a double-entry set of accounting records in which to record all of her business transactions. Identify the balance sheet accounts that Hair It Is, Inc., will likely need to record the transactions needed to establish and open the business. Also, indicate whether the normal balance of each account is a debit or a credit.

Assets	Liabilities	Equity
Cash (debit)	Notes payable (credit)	Share capital (credit)
Supplies (debit)	Accounts payable (credit)	
Equipment (debit)		

LO 2

Steps in the Recording Process

Illustration 2-13
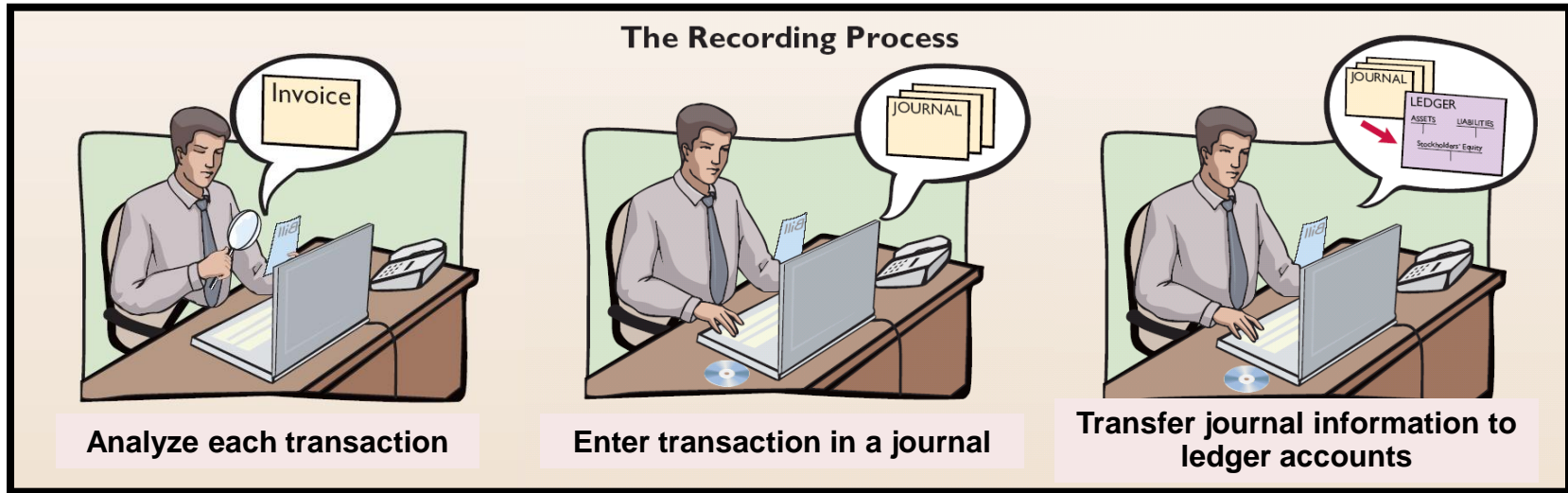
Business documents, such as a sales slip, a check, a bill, or a cash register tape, provide evidence of the transaction.

LO 3 Identify the basic steps in the recording process.

Steps in the Recording Process

The Journal

◆ Book of original entry.

◆ Transactions recorded in chronological order.

◆ Contributions to the recording process:

1. Discloses the **complete effects of a transaction**.

2. Provides a **chronological record** of transactions.

3. Helps to **prevent or locate errors** because the debit and credit amounts can be easily compared.

LO 4 Explain what a journal is and how it helps in the recording process.

Steps in the Recording Process

Journalizing - Entering transaction data in the journal.

Illustration: On September 1, shareholders' invested €15,000 cash in the corporation in exchange for share of stock, and Softbyte purchased computer equipment for €7,000 cash.

Illustration 2-14

General Journal				
Date	**Account Title**	**Ref.**	**Debit**	**Credit**
Sept. 1	Cash		15,000	
	Share capital-ordinary			15,000
	Equipment		7,000	
	Cash			7,000

LO 4 Explain what a journal is and how it helps in the recording process.

Steps in the Recording Process

Simple and Compound Entries

Illustration: On July 1, Tsai Company purchases a delivery truck costing NT$420,000. It pays NT$240,000 cash now and agrees to pay the remaining NT$180,000 on account.

Illustration 2-15

General Journal				
Date	**Account Title**	**Ref.**	**Debit**	**Credit**
July 1	Equipment		420,000	
	Cash			240,000
	Accounts payable			180,000

LO 4 Explain what a journal is and how it helps in the recording process.

Steps in the Recording Process

The Ledger

◆ **General Ledger** contains the entire group of accounts maintained by a company.

Illustration 2-16

Individual Assets	Individual Liabilities	Individual Equity
Equipment	Interest Payable	Salaries Expense
Land	Salaries Payable	Service Revenue
Supplies	Accounts Payable	Retained Earnings
Cash	Notes Payable	Share Capital—Ordinary

LO 5 Explain what a ledger is and how it helps in the recording process.
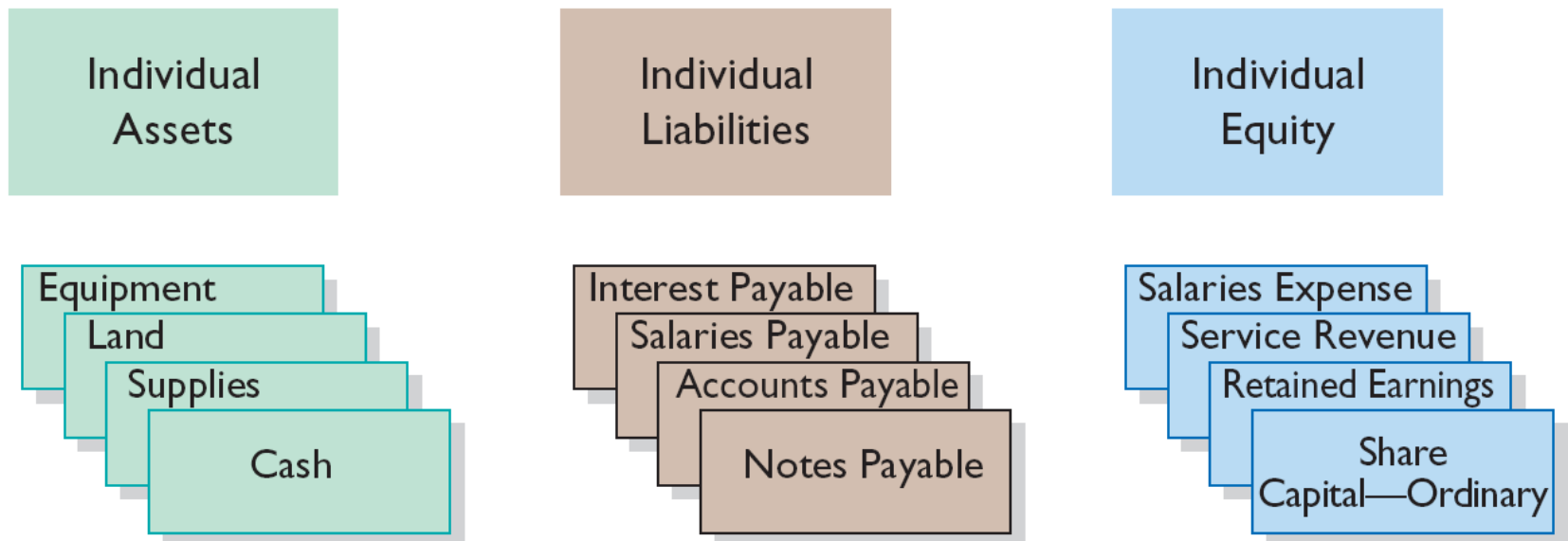
ACCOUNTING ACROSS THE ORGANIZATION

What Would Sam Do?

In his autobiography Sam Walton described the double-entry accounting system he used when Wal-Mart was just getting started: "We kept a little pigeonhole on the wall for the cash receipts and paperwork of each [Wal-Mart] store. I had a blue binder ledger book for each store. When we added a store, we added a pigeonhole. We did this at least up to twenty stores. Then once a month, the bookkeeper and I would enter the merchandise, enter the sales, enter the cash, and balance it."

Source: Sam Walton, *Made in America* (New York: Doubleday, 1992), p. 53.

? Why did Sam Walton keep separate pigeonholes and blue binders? Why bother to keep separate records for each store?

Steps in the Recording Process

Standard Form of Account

Illustration 2-17

Cash					No. 101
Date	Explanation	Ref.	Debit	Credit	Balance
2014					
June 1			25,000		25,000
2				8,000	17,000
3			4,200		21,200
9			7,500		28,700
17				11,700	17,000
20				250	16,750
30				7,300	9,450

LO 5 Explain what a ledger is and how it helps in the recording process.

Steps

Posting – process of transferring amounts from the journal to the ledger accounts.

GENERAL JOURNAL   J1

Date	Account Titles and Explanation	Ref.	Debit	Credit
2014 Sept.1	Cash	101	15,000	
	Share Capital—Ordinary	311		15,000
	(Issued shares for cash)			

GENERAL LEDGER

Cash   No.101

Date	Explanation	Ref.	Debit	Credit	Balance
2014 Sept.1		J1	15,000		15,000

Share Capital—Ordinary   No.311

Date	Explanation	Ref.	Debit	Credit	Balance
2014 Sept.1		J1		15,000	15,000
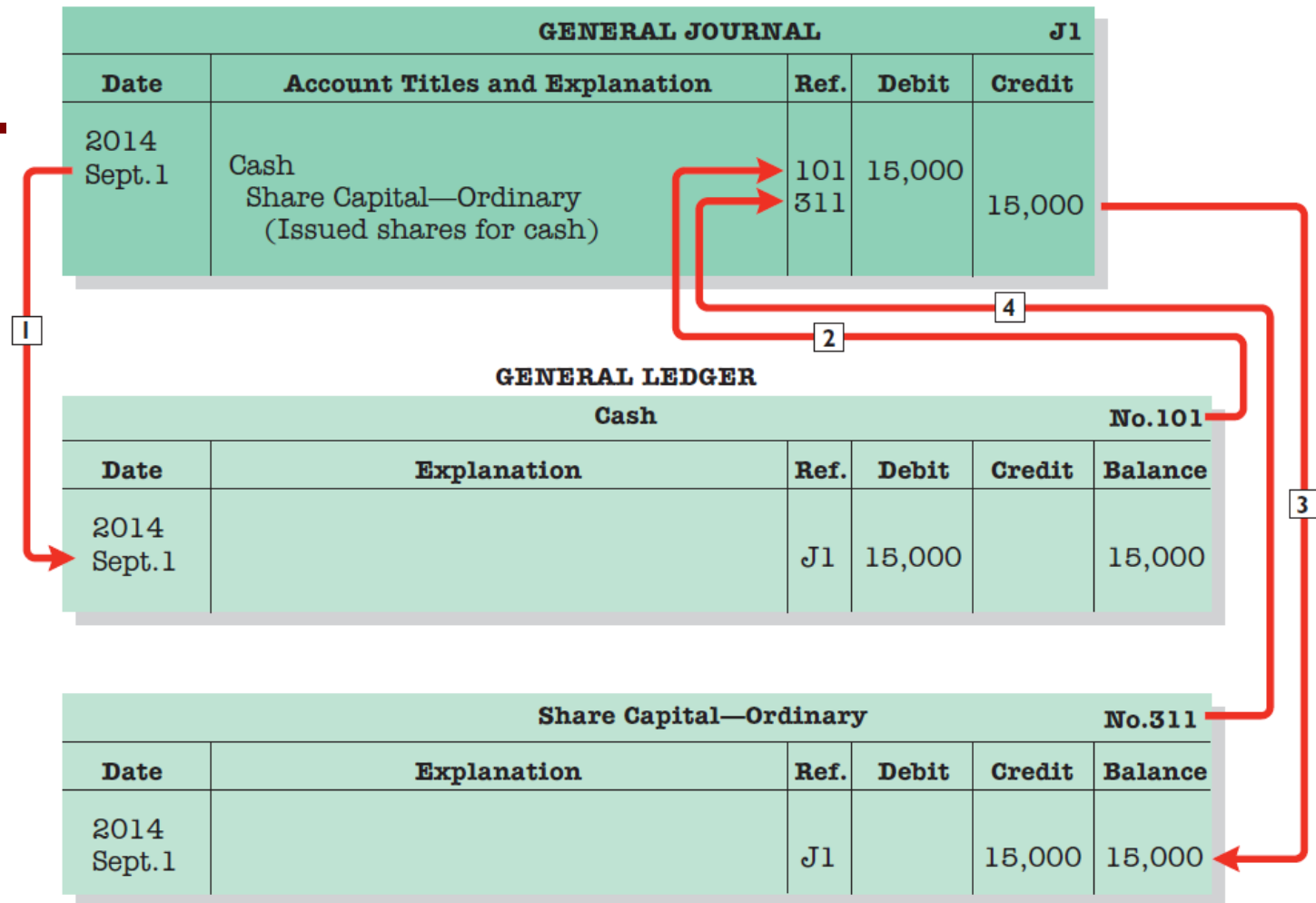
Key:
1 Post to debit account–date, journal page number, and amount.
2 Enter debit account number in journal reference column.
3 Post to credit account–date, journal page number, and amount.
4 Enter credit account number in journal reference column.

Illustration 2-18

LO 6 Explain what posting is and how it helps in the recording process.

Posting

Question

Posting:

    a.   normally occurs before journalizing.

    b.   transfers ledger transaction data to the journal.

    c.   is an optional step in the recording process.

    d.   transfers journal entries to ledger accounts.

LO 6 Explain what posting is and how it helps in the recording process.

Chart of Accounts

Accounts and account numbers arranged in sequence in which they are presented in the financial statements.

Illustration 2-19

Pioneer Advertising Agency Inc.
Chart of Accounts

Assets	Equity
101 Cash	311 Share Capital—Ordinary
112 Accounts Receivable	320 Retained Earnings
126 Supplies	332 Dividends
130 Prepaid Insurance	350 Income Summary
157 Equipment	
158 Accumulated Depreciation—Equipment	**Revenues**
	400 Service Revenue
Liabilities	**Expenses**
200 Notes Payable	631 Supplies Expense
201 Accounts Payable	711 Depreciation Expense
209 Unearned Service Revenue	722 Insurance Expense
212 Salaries and Wages Payable	726 Salaries and Wages Expense
230 Interest Payable	729 Rent Expense
	732 Utilities Expense
	905 Interest Expense

LO 6 Explain what posting is and how it helps in the recording process.

The Recording Process Illustrated

Follow these steps:

1. Determine what type of account is involved.

2. Determine what items increased or decreased and by how much.

3. Translate the increases and decreases into debits and credits.

Illustration 2-20

Transaction	On October 1, C. R. Yazici invests ₺10,000 cash in an advertising company to be known as Pioneer Advertising Agency Inc.
Basic Analysis	The asset Cash increases ₺10,000, and equity (specifically, Share Capital—Ordinary) increases ₺10,000.

Equation Analysis

Assets	=	Liabilities	+	Equity
Cash	=			Share Capital
+10,000				+10,000 Issued Shares

Debit–Credit Analysis

Debits increase assets: debit Cash ₺10,000.
Credits increase equity: credit Share Capital—Ordinary ₺10,000.

Journal Entry

Oct. 1	Cash	101	10,000	
	Share Capital—Ordinary (Issued shares for cash)	311		10,000

Posting

Cash	101		Share Capital—Ordinary	311
Oct. 1 10,000				Oct. 1 10,000

The Recording Process Illustrated

Illustration 2-21

Transaction	On October 1, Pioneer purchases office equipment costing ₺5,000 by signing a 3-month, 12%, ₺5,000 note payable.
Basic Analysis	The asset Equipment increases ₺5,000, and the liability Notes Payable increases ₺5,000.

Equation Analysis

Assets	=	Liabilities	+	Equity
Equipment	=	Notes Payable		
+5,000		+5,000		

Debit–Credit Analysis

Debits increase assets: debit Equipment ₺5,000.
Credits increase liabilities: credit Notes Payable ₺5,000.

Journal Entry

Oct. 1	Equipment	157	5,000	
	Notes Payable	200		5,000
	(Issued 3-month, 12% note for office equipment)			

Posting

Equipment	157		Notes Payable	200
Oct. 1 5,000				Oct. 1 5,000

The Recording Process Illustrated

Illustration 2-22

Transaction

On October 2, Pioneer receives a ₺1,200 cash advance from R. Knox, a client, for advertising services that are expected to be completed by December 31.

Basic Analysis

The asset Cash increases ₺1,200; the liability Unearned Service Revenue increases ₺1,200 because the service has not been provided yet. That is, when Pioneer receives an advance payment, it should record an unearned revenue (a liability) in order to recognize the obligation that exists. Note also that although many liabilities have the word "payable" in their title, unearned revenue is considered a liability even though the word payable is not used.

Equation Analysis

Assets	=	Liabilities	+	Equity
Cash	=	Unearned Service Revenue		
+1,200		+1,200		

Debit–Credit Analysis

Debits increase assets: debit Cash ₺1,200.
Credits increase liabilities: credit Unearned Service Revenue ₺1,200.

Journal Entry

Oct. 2	Cash	101	1,200	
	Unearned Service Revenue	209		1,200
	(Received cash from R. Knox for future service)			

Posting

Cash	101
Oct. 1 10,000	
2 1,200	

Unearned Service Revenue	209
	Oct. 2 1,200

The Recording Process Illustrated

Illustration 2-23

Transaction

On October 3, Pioneer pays office rent for October in cash, ₺900.

Basic Analysis

Rent Expense increases ₺900 because the payment pertains only to the current month; the asset Cash decreases ₺900.

Equation Analysis

Assets	=	Liabilities	+	Equity	
Cash	=			Expenses	
−900				−900	Rent Expense

Debit−Credit Analysis

Debits increase expenses: debit Rent Expense ₺900.
Credits decrease assets: credit Cash ₺900.

Journal Entry

Oct. 3	Rent Expense	729	900	
	Cash	101		900
	(Paid October rent)			

Posting

Cash		101
Oct. 1 10,000	Oct. 3	900
2 1,200		

Rent Expense		729
Oct. 3	900	

The Recording Process Illustrated

Illustration 2-24

The Recording Process Illustrated

Illustration 2-25

Transaction	On October 5, Pioneer purchases an estimated 3-month supply of advertising materials on account from Aero Supply for ₺2,500.
Basic Analysis	The asset Supplies increases ₺2,500; the liability Accounts Payable increases ₺2,500.

Equation Analysis

Assets	=	Liabilities	+	Equity
Supplies	=	Accounts Payable		
+2,500		+2,500		

Debit – Credit Analysis

Debits increase assets: debit Supplies ₺2,500.
Credits increase liabilities: credit Accounts Payable ₺2,500.

Journal Entry

Oct. 5	Supplies	126	2,500	
	Accounts Payable	201		2,500
	(Purchased supplies on account from Aero Supply)			

Posting

Supplies	126
Oct. 5 2,500	

Accounts Payable	201
	Oct. 5 2,500

The Recording Process Illustrated

Event	On October 9, Pioneer hires 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.
Basic Analysis	A business transaction has not occurred. There is only an agreement between the employer and the employees to enter into a business transaction beginning on October 15. Thus, a debit–credit analysis is not needed because there is no accounting entry. (See transaction of October 26 for first entry.)

LO 6

The Recording Process Illustrated

Illustration 2-27

Transaction

On October 20, Pioneer's board of directors declares and pays a ₺500 cash dividend to shareholders.

Basic Analysis

The Dividends account increases ₺500; the asset Cash decreases ₺500.

Equation Analysis

Assets	=	Liabilities	+	Equity
Cash	=			Dividends
−500				−500

Debit−Credit Analysis

Debits increase dividends: debit Dividends ₺500.
Credits decrease assets: credit Cash ₺500.

Journal Entry

Oct. 20	Dividends	332	500	
	Cash	101		500
	(Declared and paid a cash dividend)			

Posting

Cash		101
Oct. 1 10,000	Oct. 3	900
2 1,200	4	600
	20	500

Dividends	332
Oct. 20 500	

The Recording Process Illustrated

Illustration 2-28

Transaction — On October 26, Pioneer owes employee salaries of ₺4,000 and pays them in cash. (See October 9 transaction.)

Basic Analysis — Salaries and Wages Expense increases ₺4,000; the asset Cash decreases ₺4,000.

Equation Analysis

Assets	=	Liabilities	+	Equity	
Cash	=			Expenses	
−4,000				−4,000	Salaries and Wages Expense

Debit–Credit Analysis — Debits increase expenses: debit Salaries and Wages Expense ₺4,000.
Credits decrease assets: credit Cash ₺4,000.

Journal Entry

Oct. 26	Salaries and Wages Expense	726	4,000	
	Cash	101		4,000
	(Paid salaries to date)			

Posting

Cash			101
Oct. 1	10,000	Oct. 3	900
2	1,200	4	600
		20	500
		26	4,000

Salaries and Wages Expense	726
Oct. 26 4,000	

2-37

LO 6

The Recording Process Illustrated

Illustration 2-29

Transaction	On October 31, Pioneer receives ₺10,000 in cash from Copa Company for advertising services provided in October.
Basic Analysis	The asset Cash increases ₺10,000; the revenue account Service Revenue increases ₺10,000.

Equation Analysis

Assets	=	Liabilities	+	Equity
Cash	=			Revenues
+10,000				+10,000 Service Revenue

Debit–Credit Analysis

Debits increase assets: debit Cash ₺10,000.
Credits increase revenues: credit Service Revenue ₺10,000.

Journal Entry

Oct. 31	Cash		101	10,000	
	Service Revenue		400		10,000
	(Received cash for services provided)				

Posting

Cash		101		Service Revenue		400
Oct. 1 10,000	Oct. 3	900			Oct. 31 10,000	
2 1,200	4	600				
31 10,000	20	500				
	26	4,000				

Basel Company recorded the following transactions in a general journal during the month of March. Post these entries to the Cash account.

Mar. 4	Cash	2,280	
	Service Revenue		2,280
Mar. 15	Salaries and Wages Expense	400	
	Cash		400
Mar. 19	Utilities Expense	92	
	Cash		92

Cash

3/1	600		

General Ledger

Cash — No. 101

Date	Explanation	Ref.	Debit	Credit	Balance
2014					
Oct. 1		J1	10,000		10,000
2		J1	1,200		11,200
3		J1		900	10,300
4		J1		600	9,700
20		J1		500	9,200
26		J1		4,000	5,200
31		J1	10,000		15,200

Supplies — No. 126

Date	Explanation	Ref.	Debit	Credit	Balance
2014					
Oct. 5		J1	2,500		2,500

Prepaid Insurance — No. 130

Date	Explanation	Ref.	Debit	Credit	Balance
2014					
Oct. 4		J1	600		600

Equipment — No. 157

Date	Explanation	Ref.	Debit	Credit	Balance
2014					
Oct. 1		J1	5,000		5,000

Notes Payable — No. 200

Date	Explanation	Ref.	Debit	Credit	Balance
2014					
Oct. 1		J1		5,000	5,000

Accounts Payable — No. 201

Date	Explanation	Ref.	Debit	Credit	Balance
2014					
Oct. 5		J1		2,500	2,500

Unearned Service Revenue — No. 209

Date	Explanation	Ref.	Debit	Credit	Balance
2014					
Oct. 2		J1		1,200	1,200

Share Capital—Ordinary — No. 311

Date	Explanation	Ref.	Debit	Credit	Balance
2014					
Oct. 1		J1		10,000	10,000

Dividends — No. 332

Date	Explanation	Ref.	Debit	Credit	Balance
2014					
Oct. 20		J1	500		500

Service Revenue — No. 400

Date	Explanation	Ref.	Debit	Credit	Balance
2014					
Oct. 31		J1		10,000	10,000

Salaries and Wages Expense — No. 726

Date	Explanation	Ref.	Debit	Credit	Balance
2014					
Oct. 26		J1	4,000		4,000

Rent Expense — No. 729

Date	Explanation	Ref.	Debit	Credit	Balance
2014					
Oct. 3		J1	900		900

Illustration 2-31

Trial Balance

Pioneer Advertising Agency Inc.		Illustration 2-32

Pioneer Advertising Agency Inc.
Trial Balance
October 31, 2014

	Debit	Credit
Cash	₺ 15,200	
Supplies	2,500	
Prepaid Insurance	600	
Equipment	5,000	
Notes Payable		₺ 5,000
Accounts Payable		2,500
Unearned Service Revenue		1,200
Share Capital—Ordinary		10,000
Dividends	500	
Service Revenue		10,000
Salaries and Wages Expense	4,000	
Rent Expense	900	
	₺28,700	₺28,700

LO 7 Prepare a trial balance and explain its purposes.

Trial Balance

Limitations of a Trial Balance

The trial balance may balance even when

1. a transaction is not journalized,

2. a correct journal entry is not posted,

3. a journal entry is posted twice,

4. incorrect accounts are used in journalizing or posting, or

5. offsetting errors are made in recording the amount of a transaction.

LO 7 Prepare a trial balance and explain its purposes.

INVESTOR INSIGHT

Why Accuracy Matters

While most companies record transactions very carefully, the reality is that mistakes still happen. For example, bank regulators fined Bank One Corporation (now Chase) (USA) $1.8 million because they felt that the unreliability of the bank's accounting system caused it to violate regulatory requirements.

Recently, the German Finance minister, Wolfgang Schauble, said that "statistical and communication problems" were to blame for a €55.5 billion error in the accounts of nationalized property lender Hypo Real Estate Holding (DEU). Mr. Schauble referred to the error as "an annoying mistake." This seems to be a considerable understatement considering that the error represented 2.6% of the German gross domestic product. Since the bank had been previously taken over by the German government, the error had resulted in an overstatement of the federal debt of €55.5 billion.

? In order for these companies to prepare and issue financial statements, their accounting equations (debits and credits) must have been in balance at year-end. How could these errors or misstatements have occurred?

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