

Financial Accounting

Sixth Edition

The Accounting Cycle: During the Period

CHAPTER 2

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Functions of Financial Accounting

(1) **Measure** business activities of the company.

- Record transactions

(2) **Communicate** measurements to external parties for decision making.

- Prepare financial statements



PART A

MEASURING BUSINESS ACTIVITIES

Learning Objective 1

LO2-1 Identify the basic steps in measuring external transactions.

Key Point

- External transactions are transactions between the company and a separate company or individual.
- Internal transactions do not include an exchange with a separate economic entity.

Illustration 2-1

Six Steps in Measuring External Transactions

- Step 1** • Use source documents to identify **accounts** affected by an external transaction.
- Step 2** • Analyze the impact of the transaction on the **accounting equation**.
- Step 3** • Assess whether the transaction results in a **debit** or **credit** to account balances.
- Step 4** • Record the transaction in a **journal** using debits and credits.
- Step 5** • Post the transaction to the **general ledger**.
- Step 6** • Prepare a **trial balance**.

Capturing Transactions in Accounts

- **Account:** Record of all transactions related to a particular item over a period of time.
 - Asset accounts:
Examples: Cash, Supplies, and Equipment
 - Liability accounts:
Examples: Accounts Payable, Salaries Payable, Utilities Payable, and Taxes Payable
 - Stockholders' equity accounts:
Examples: Common Stock and Retained Earnings
- **Chart of accounts:** A list of all account names used to record transactions

Key Point

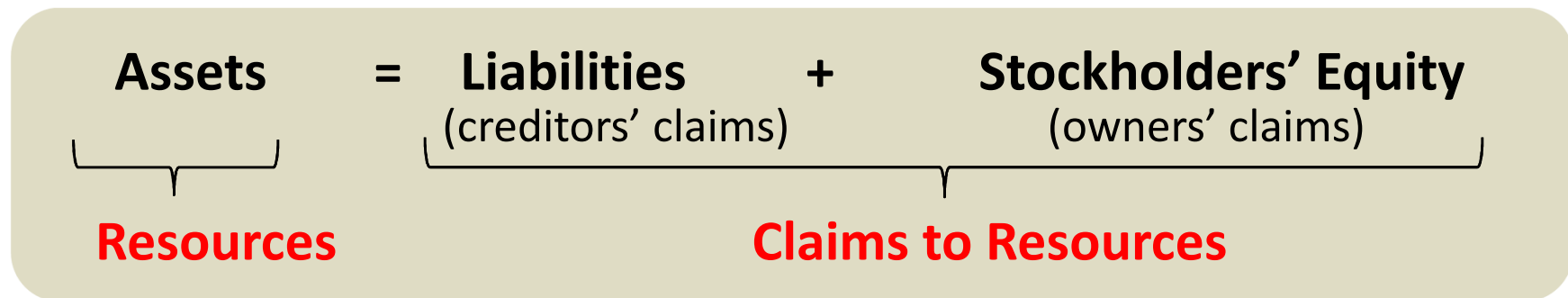
- The six-step measurement process (Illustration 2–1) is the foundation of financial accounting.
- To understand this process, it is important to realize in Step 2 that we analyze the effects of business transactions on the accounting equation (Part A of this chapter).
- Then, in Step 3 we begin the process of translating those effects into the accounting records (Part B of this chapter).

Learning Objective 2

LO2-2 Analyze the impact of external transactions on the accounting equation.

Effects of Transactions on the Basic Accounting Equation

- Each transaction will have a dual effect on the basic accounting equation



- If total assets **increase**, then liabilities or stockholders' equity **increases** by the same amount.
- If total assets **decrease**, then liabilities or stockholders' equity **decreases** by the same amount.

Understanding Effects of Transaction

- For each transaction, ask these three questions:
 - 1. What is one account affected by the transaction?**
 - Does this account increase or decrease?
 - 2. What is a second account affected by the transaction?**
 - Does this account increase or decrease?
 - 3. Do assets equal liabilities plus stockholders' equity?**
 - **THEY MUST!! EVERY TIME!!**

Illustration 2-2

External Transactions of Eagle Soccer Academy

<u>Transaction</u>	<u>Date</u>	<u>Description</u>
(1)	Dec. 1	Sell shares of common stock for \$200,000 to obtain the funds necessary to start the business.
(2)	Dec. 1	Borrow \$100,000 from the local bank and sign a note promising to repay the full amount of the debt in three years.
(3)	Dec. 1	Purchase equipment necessary for giving soccer training. \$120,000 cash.
(4)	Dec. 1	Pay one year of rent in advance, \$60,000 (\$5,000 per month).
(5)	Dec. 6	Purchase supplies on account, \$23,000.
(6)	Dec. 12	Provide soccer training to customers for cash, \$43,000.
(7)	Dec. 17	Provide soccer training to customers on account, \$20,000.
(8)	Dec. 23	Receive cash in advance for 12 soccer training sessions to be given in the future, \$6,000.
(9)	Dec. 28	Pay salaries to employees, \$28,000.
(10)	Dec. 30	Pay cash dividends of \$4,000 to shareholders.

Transaction (1): Issue Common Stock (1 of 3)

Sell shares of common stock for \$200,000 to obtain the funds necessary to start the business.



- What is one account affected by the transaction?
 - ❑ Cash
- Does that account increase or decrease?
 - ❑ Increase by \$200,000

Transaction (1): Issue Common Stock (2 of 3)

Sell shares of common stock for \$200,000 to obtain the funds necessary to start the business.



- What is a second account affected by the transaction?
 - ❑ Common Stock
- Does that account increase or decrease?
 - ❑ Increase by \$200,000

Transaction (1): Issue Common Stock (3 of 3)

Sell shares of common stock for \$200,000 to obtain the funds necessary to start the business.

<u>Assets</u>	=	<u>Liabilities</u>	+	<u>Stockholders' Equity</u>
Cash				Common Stock
(1) +\$200,000	=			+\$200,000

- **Do assets equal liabilities plus stockholders' equity?**
 - Yes, assets increase by \$200,000 and stockholders' equity increases by \$200,000

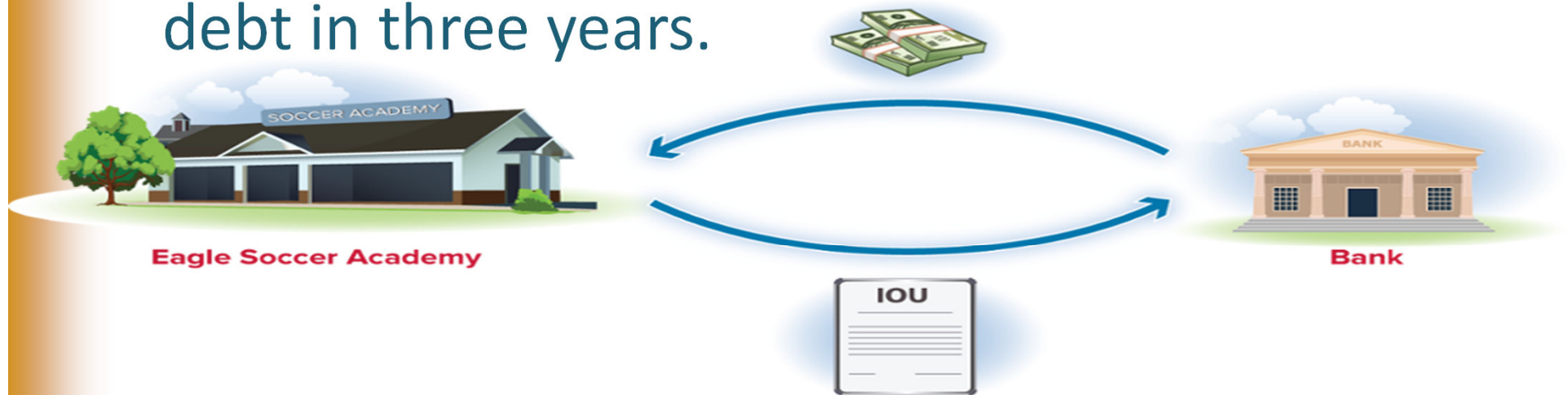
Common Mistake

It's sometimes tempting to *decrease* cash as a way of recording an investor's initial investment.

However, remember we account for the transactions *from the company's perspective*, and the company *received* cash from the stockholder—an increase in cash.

Transaction (2): Borrow Cash from the Bank

Borrow \$100,000 from the local bank and sign a note promising to repay the full amount of the debt in three years.



<u>Assets</u>	=	<u>Liabilities</u>	+	<u>Stockholders' Equity</u>
Cash		Notes Payable		Common Stock
Bal. \$200,000				\$200,000
(2) +\$100,000		+\$100,000		
Bal. \$300,000		\$100,000		\$200,000
<u>\$300,000</u>	=			<u>\$300,000</u>

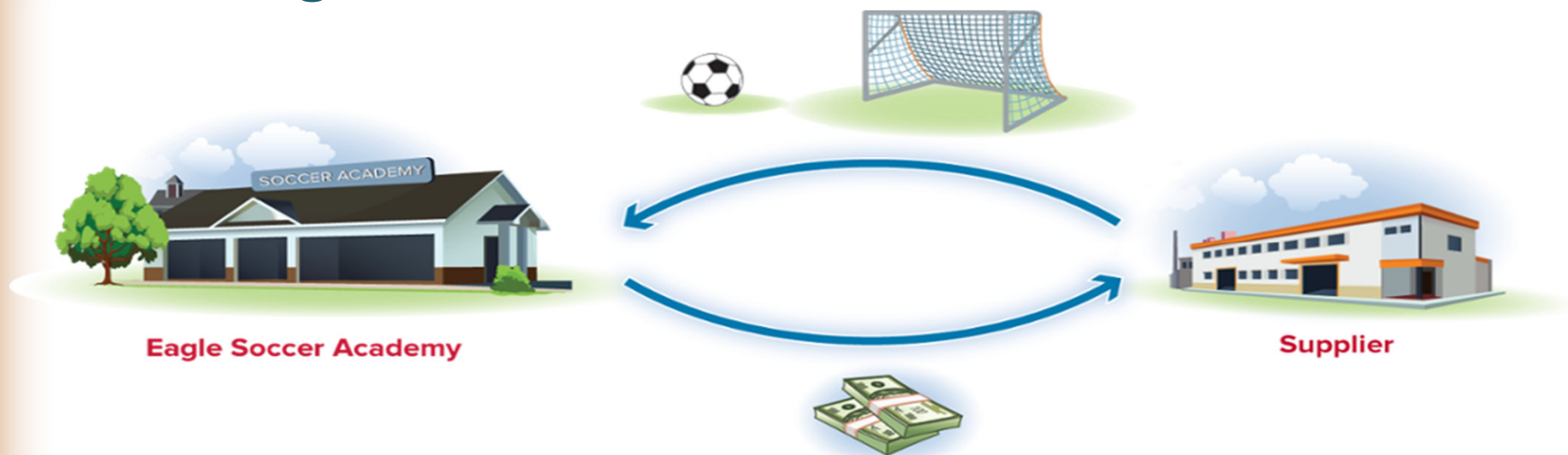
Key Point

After each transaction, *the accounting equation must always remain in balance.*

In other words, assets must always equal liabilities plus stockholders' equity.

Transaction (3): Purchase Equipment

Purchase equipment necessary for giving soccer training, \$120,000 cash.



Assets		=	Liabilities	+	Stockholders' Equity
Cash	Equipment		Notes Payable		Common Stock
Bal. \$300,000			\$100,000		\$200,000
(3) -\$120,000	+\$120,000				
Bal. \$180,000	\$120,000		\$100,000		\$200,000
\$300,000		=		\$300,000	

Concept Check 2-1

What would be the effect on total assets if a company purchased land for \$200,000 cash?

- a. Total assets would go up by \$200,000.
- b. Total assets would go down by \$200,000.
- c. There would be zero effect on total assets.

One asset (land) would go up and another asset (cash) would go down. There would be zero effect on total assets.

Transaction (4): Pay for Rent in Advance

Pay one year of rent in advance, \$60,000 (\$5,000 per month).



Assets			=	Liabilities	+	Stockholders' Equity
Cash	Prepaid Rent	Equipment		Notes Payable		Common Stock
Bal. \$180,000		\$120,000		\$100,000		\$200,000
(4) -\$ 60,000	+\$60,000					
Bal. \$120,000	\$60,000	\$120,000		\$100,000		\$200,000
\$300,000			=	\$300,000		

Transaction (5): Purchase Supplies on Account

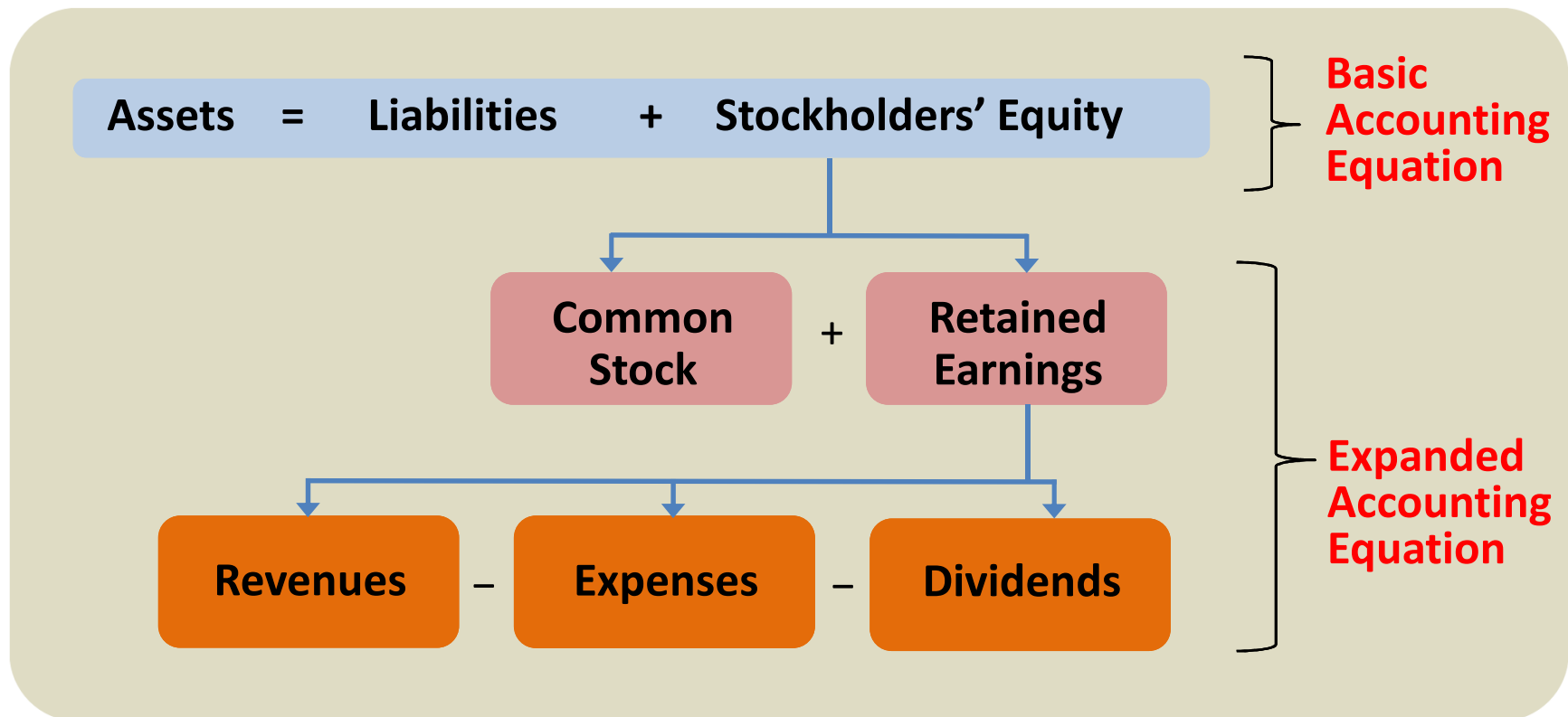
Purchase supplies on account, \$23,000.



Assets				=	Liabilities		+	Stockholders' Equity
Cash	Supplies	Prepaid Rent	Equipment		Accounts Payable	Notes Payable		Common Stock
Bal. \$120,000		\$60,000	\$120,000			\$100,000		\$200,000
(5)	<u>+\$23,000</u>				<u>+\$23,000</u>			
Bal. \$120,000	\$23,000	\$60,000	\$120,000		\$23,000	\$100,000		\$200,000
\$323,000				=	\$323,000			

Illustration 2-3

Expanded Accounting Equation



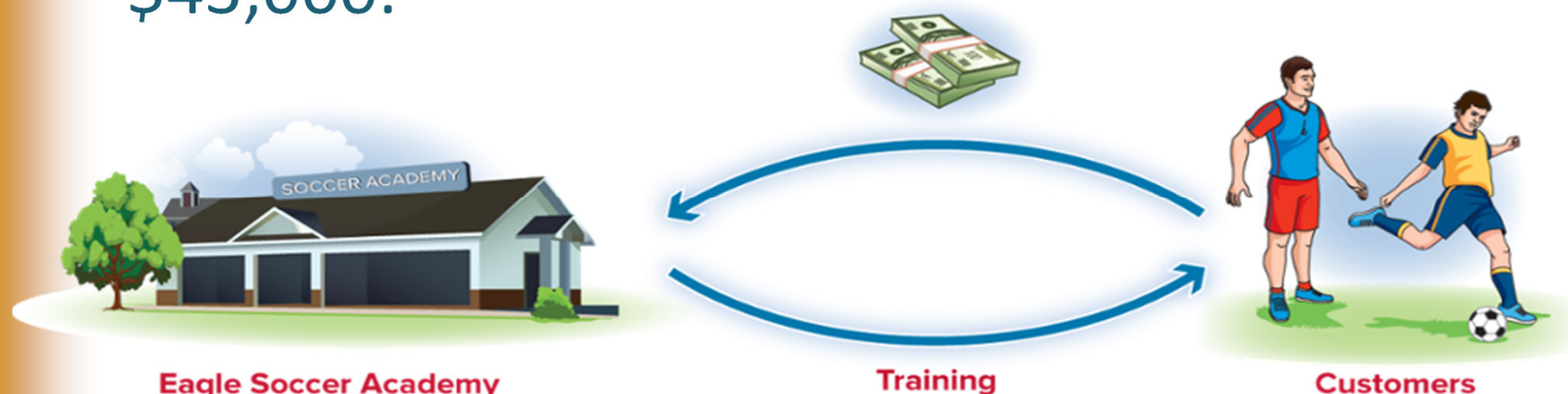
Key Point

The expanded accounting equation demonstrates that *revenues increase retained earnings* while *expenses and dividends decrease retained earnings*.

Retained earnings is a component of stockholders' equity.

Transaction (6): Provide Services for Cash

Provide soccer training to customers for cash, \$43,000.



Assets				=	Liabilities		+	Stockholders' Equity	
Cash	Supplies	Prepaid Rent	Equipment		Accounts Payable	Notes Payable		Common Stock	Retained Earnings
Bal. \$120,000	\$23,000	\$60,000	\$120,000		\$23,000	\$100,000		\$200,000	
(6) +\$43,000									+Service Revenue
Bal. \$163,000	\$23,000	\$60,000	\$120,000		\$23,000	\$100,000		\$200,000	\$43,000
\$366,000				=	\$366,000				

Transaction (7): Provide Services on Account

Provide soccer training to customers on account, \$20,000.



Assets					=	Liabilities		+ Stockholders' Equity	
Cash	Accounts Receivable	Supplies	Prepaid Rent	Equipment		Accounts Payable	Notes Payable	Common Stock	Retained Earnings
Bal. \$163,000		\$23,000	\$60,000	\$120,000		\$23,000	\$100,000	\$200,000	\$43,000
(7)	+\$20,000								+\$20,000
Bal. \$163,000	\$20,000	\$23,000	\$60,000	\$120,000		\$23,000	\$100,000	\$200,000	\$63,000
\$386,000					=	\$386,000			

Service Revenue

Transaction (8): Receive Cash in Advance from Customers

Receive cash in advance for 12 soccer training sessions to be given in the future, \$6,000.



Assets					=	Liabilities			+ Stockholders' Equity	
Cash	Accounts Receivable	Supplies	Prepaid Rent	Equipment		Accounts Payable	Deferred Revenue	Notes Payable	Common Stock	Retained Earnings
Bal. \$163,000	\$20,000	\$23,000	\$60,000	\$120,000		\$23,000		\$100,000	\$200,000	\$63,000
(8) +\$ 6,000							\$6,000			
Bal. \$169,000	\$20,000	\$23,000	\$60,000	\$120,000		\$23,000	\$6,000	\$100,000	\$200,000	\$63,000
\$392,000					=	\$392,000				

Common Mistake

Don't let the account name fool you.

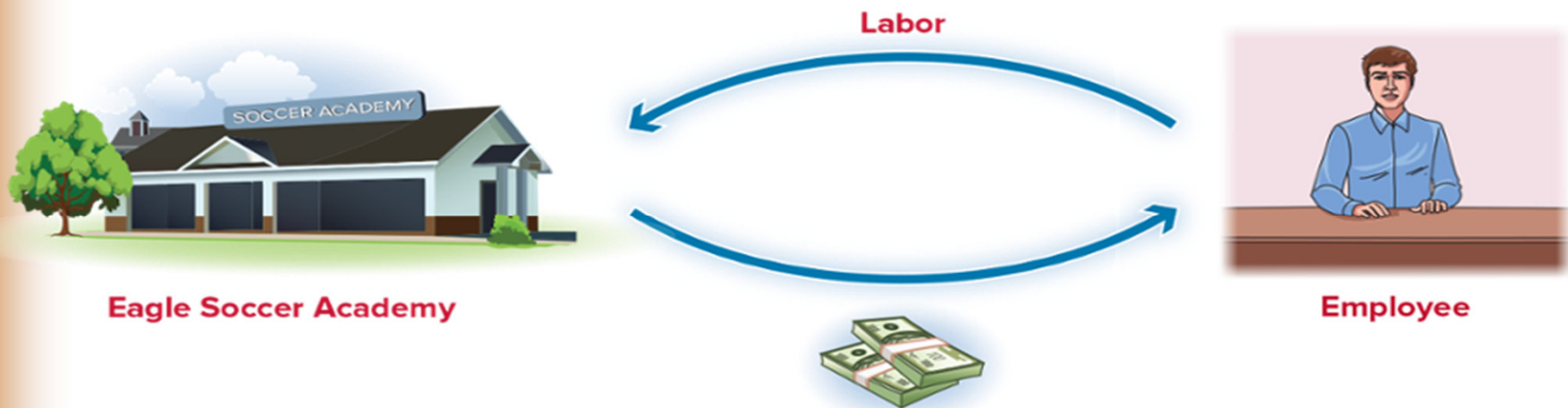
Even though the term *revenue* appears in the account title for *deferred revenue*, this is NOT a revenue account.

Deferred indicates that the company has yet to provide services even though it has collected the customer's cash.

The company owes the customer a service, which creates a *liability*.

Transaction (9): Pay Salaries to Employees

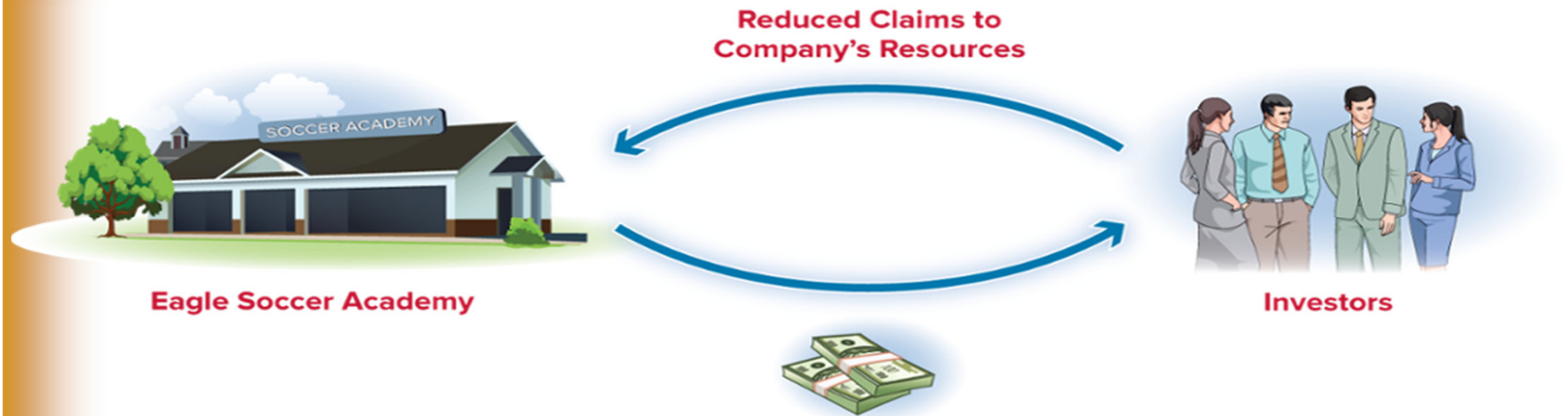
Pay salaries to employees, \$28,000.



Assets					=	Liabilities			+ Stockholders' Equity	
Cash	Accounts Receivable	Supplies	Prepaid Rent	Equipment		Accounts Payable	Deferred Revenue	Notes Payable	Common Stock	Retained Earnings
Bal. \$169,000	\$20,000	\$23,000	\$60,000	\$120,000		\$23,000	\$6,000	\$100,000	\$200,000	\$63,000
(9) -\$28,000										-\$28,000 Salaries Expense
Bal. \$141,000	\$20,000	\$23,000	\$60,000	\$120,000		\$23,000	\$6,000	\$100,000	\$200,000	\$35,000
\$364,00					=	\$364,000				

Transaction (10): Pay Cash Dividends

Pay cash dividends of \$4,000 to stockholders.



Assets					=	Liabilities			+ Stockholders' Equity	
Cash	Accounts Receivable	Supplies	Prepaid Rent	Equipment		Accounts Payable	Deferred Revenue	Notes Payable	Common Stock	Retained Earnings
Bal. \$141,000	\$20,000	\$23,000	\$60,000	\$120,000		\$23,000	\$6,000	\$100,000	\$200,000	\$35,000
(10)–\$ 4,000										–\$ 4,000 Dividends
Bal. \$137,000	\$20,000	\$23,000	\$60,000	\$120,000		\$23,000	\$6,000	\$100,000	\$200,000	\$31,000
\$360,000					=	\$360,000				

Common Mistake

- Students often believe a payment of dividends to owners increases stockholders' equity.
- Remember, you are accounting for the resources of the company.
- While stockholders have more personal cash after dividends have been paid, the company in which they own stock has fewer resources (less cash).

Illustration 2-4

Summary of All 10 External Transactions of Eagle Soccer Academy

	Assets					=	Liabilities			+	Stockholders' Equity	
	Cash	Accounts Receivables	Supplies	Prepaid Rent	Equipment		Accounts Payable	Deferred Revenue	Notes Payable		Common Stock	Retained Earnings
Dec. 1	\$0	\$0	\$0	\$0	\$0		\$0	\$0	\$0		\$0	\$0
(1)	+200,000										+200,000	
(2)	+100,000								+100,000			
(3)	-120,000				+120,000							
(4)	-60,000			+60,000								
(5)			+23,000				+23,000					
(6)	+43,000											Service +43,000 Revenue
(7)		+20,000										Service +20,000 Revenue
(8)	+6,000							+6,000				
(9)	-28,000											Salaries -28,000 Expense
(10)	-4,000											-4,000 Dividends
Dec. 31	\$137,000	\$20,000	\$23,000	\$60,000	\$120,000		\$23,000	\$6,000	\$100,000		\$200,000	\$31,000
			\$360,000			=			\$360,000			

Concept Check 2-2

What effect does the payment of dividends have on the accounting equation?

- a. Assets decrease and equity increases
- ☒ b. Assets decrease and equity decreases
- c. Assets decrease and liabilities increase
- d. Assets increase and equity increases

Payment of dividends causes the cash account (which is an asset) to decrease and also causes retained earnings (which is an equity account) to decrease. So the correct answer is the payment of dividends decreases both assets and equity.



PART B

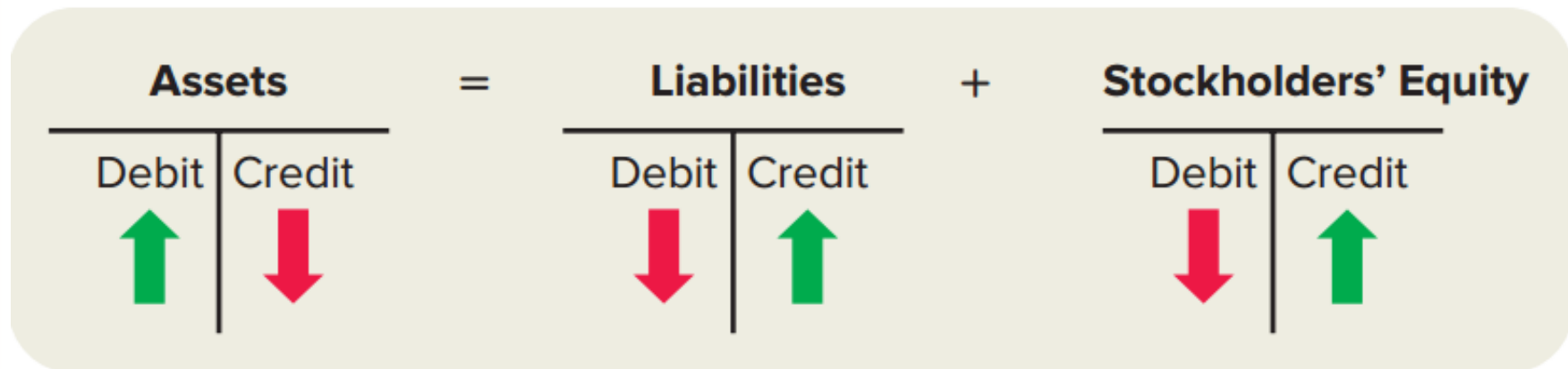
DEBITS AND CREDITS

Learning Objective 3

LO2-3 Assess whether the impact of external transactions results in a debit or credit to an account balance.

Illustration 2-5

Debit and Credit Effects on Accounts in the Basic Accounting Equation



1. Left side—Assets increase with **debits**.
 2. Right side—Liabilities and stockholders' equity increase with **credits**.
- The *opposite* is true to **decrease** the balance of any of these accounts.

Common Mistake

- Some students think the term “debit” always means increase, and “credit” always means decrease.
- While this is true for assets, it is not true for liabilities and stockholders’ equity.
- Liabilities and stockholders’ equity increase with a credit and decrease with a debit.

Key Point

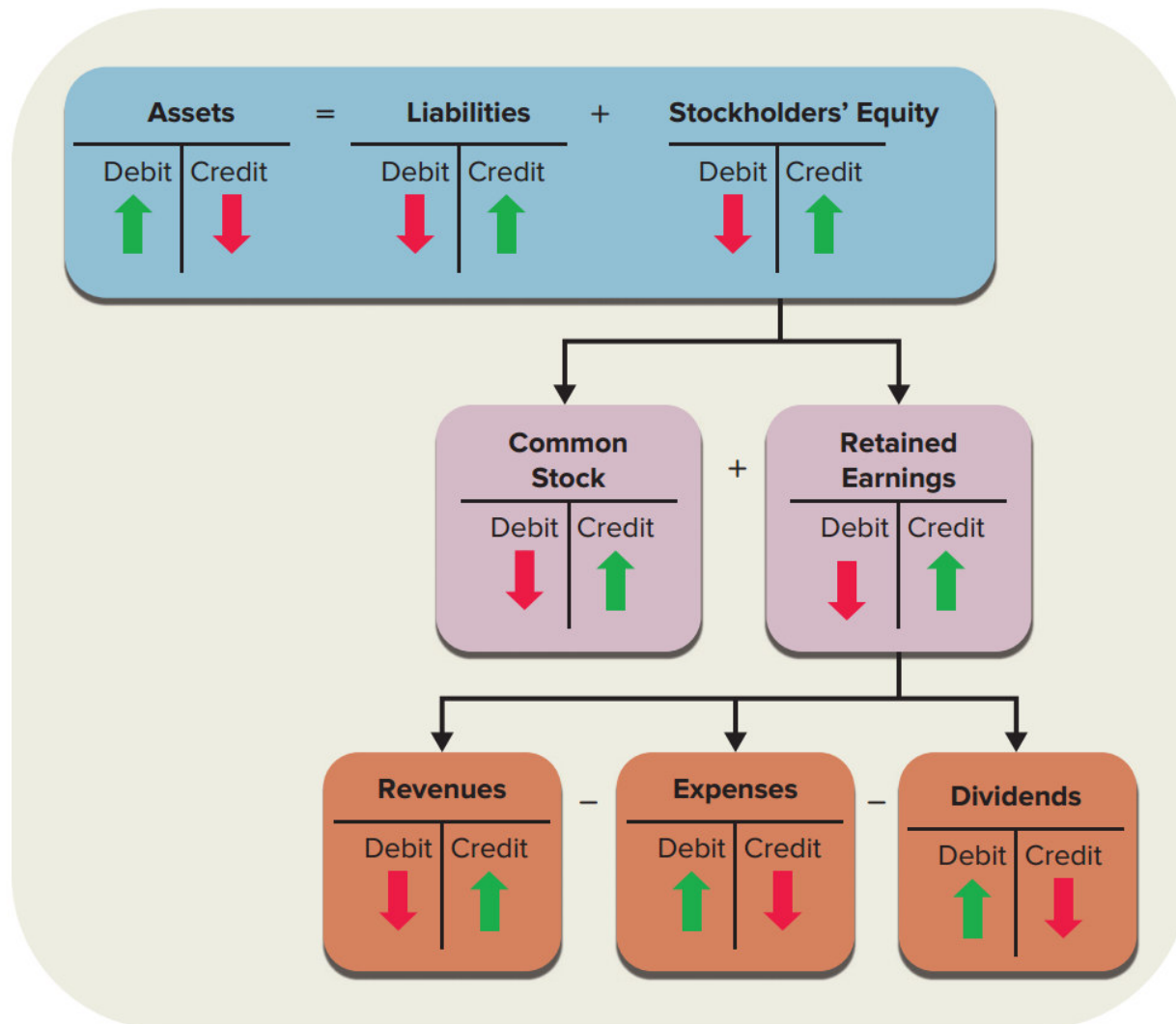
For the basic accounting equation:

- (Assets = Liabilities + Stockholders' Equity), assets (left side) increase with debits.
- Liabilities and stockholders' equity (right side) increase with credits.

The opposite is true to decrease any of these accounts.

Illustration 2-6

Debit and Credit Effects on Accounts in the Expanded Accounting Equation



Key Point

- The **Retained Earnings** account is a stockholders' equity account that *normally has a credit balance*.
- The Retained Earnings account has three components—revenues, expenses, and dividends.
- The difference between revenues (increased by credits) and expenses (increased by debits) equals net income.
- Net income increases the balance of Retained Earnings.
- Dividends (increased by debits) decrease the balance of Retained Earnings.

Illustration 2-7

Debit and Credit Effects on Each Account Type

- A simple memory aid

D E A L O R				
	Dividends	Liabilities		
	Expenses	Owners' Equity		
	Assets	Revenue		
Debit and Credit Rules:	Debit	↑	Credit	↑
	Credit	↓	Debit	↓

Concept Check 2-3

What does the word debit mean?

- a. Left side
- b. Right side
- c. Increase
- d. Decrease

The word debit means left side and the word credit means right side. The effects of debits and credits on account balances are different depending on the type of account being used. Sometimes a debit increases an account balance and sometimes it decreases an account balance.

Learning Objective 4

LO2-4 Record transactions in a journal using debits and credits.

Illustration 2-8

Format for Recording a Business Transaction, or Journal Entry

<u>Date</u>	<u>Debit</u>	<u>Credit</u>
Account Name	Amount	
Account Name.....		Amount
<i>(Description of transaction)</i>		

- Prior to the widespread use of computers, companies recorded their transactions in paper-based journals. Thus, the term ***journal entry***.

Common Mistake

Many students forget to indent the credit account names.

For the account credited, be sure to indent both the account name and the amount.

Recording Transactions—Example

- On December 1, Eagle Soccer Academy sells shares of common stock to investors for cash of \$200,000.
 - ❑ Debit to Cash for \$200,000
 - ❑ Credit to Common Stock for \$200,000

<u>December 1</u>	<u>Debit</u>	<u>Credit</u>
Cash (+A).....	200,000	
Common Stock (+SE).....		200,000
<i>(Issue common stock for cash)</i>		

Key Point

For each transaction, *total debits must equal total credits.*

Common Mistake

- Students sometimes hear the phrase “assets are the debit accounts” and believe it indicates that assets can only be debited. This is incorrect! *Assets, or any account, can be either debited or credited.* Rather, this phrase indicates that debiting the asset account will increase the balance and that *an asset account normally will have a debit balance.*
- Similarly, the phrase “liabilities and stockholders’ equity are the credit accounts” does not mean that these accounts cannot be debited. They will be debited when their balances decrease. Rather, the phrase means that *crediting the liabilities and stockholders’ equity accounts increases their balances,* and they *normally will have a credit balance.*

Learning Objective 5

LO2-5 Post transactions to the general ledger.

Illustration 2-10

General Ledger Account

- **Posting** is the process of transferring the debit and credit information from the journal to individual general ledger accounts.
- The **general ledger** provides, in a single collection, each account with its individual transactions and resulting account balance.

Account: Title				
Date	Description	Debit	Credit	Balance

Posting Transaction to Accounts (1 of 10)

- On December 1, Eagle Soccer Academy sells shares of common stock to investors for cash of \$200,000.

(1) <u>December 1</u>	<u>Debit</u>	<u>Credit</u>
Cash (+A)	200,000	
Common Stock (+SE)		200,000
<i>(Issue common stock for cash)</i>		

Account: Cash				
Date	Descriptions	Debit	Credit	Balance
Dec. 1	Beginning Balance			0
Dec. 1	Issue common stock for cash	200,000		200,000

Account: Common Stock				
Date	Descriptions	Debit	Credit	Balance
Dec. 1	Beginning Balance			0
Dec. 1	Issue common stock for cash		200,000	200,000

Posting Transaction to Accounts (2 of 10)

- On December 1, Eagle borrows cash from a bank, \$100,000.

(2) <u>December 1</u>	<u>Debit</u>	<u>Credit</u>
Cash (+A)	100,000	
Notes Payable (+L)		100,000
<i>(Borrow cash by signing three-year note)</i>		

Account: Cash				
Date	Descriptions	Debit	Credit	Balance
Dec. 1	Beginning balance			0
Dec. 1	Issue common stock for cash	200,000		200,000
Dec. 1	Borrow cash by signing note	100,000		300,000

Account: Notes Payable				
Date	Descriptions	Debit	Credit	Balance
Dec. 1	Beginning balance			0
Dec. 1	Borrow cash by signing note		100,000	100,000

T-account

A T-account includes the account title at the top, one side for recording debits, and one side for recording credits.

- The **left side** of the T-account is the **debit column**.
- The **right side** is the **credit column**.

Here are the T-accounts for Cash and Notes Payable after posting transaction (2).

Cash		Notes Payable	
(1) 200,000			(2) 100,000
(2) 100,000			
Bal. 300,000			Bal. 100,000

Posting Transaction to Accounts (3 of 10)

- On December 1, Eagle purchases equipment with cash, \$120,000.

	<u>Debit</u>	<u>Credit</u>
(3) <u>December 1</u>		
Equipment (+A)	120,000	
Cash (-A)		120,000
<i>(Purchase equipment with cash)</i>		

Post to accounts

- T-account:** Simplified version of general ledger account
- Includes the account title at the top, left side for recording debits, and right side for recording credits

Equipment		Cash	
(3)	120,000	(1)	200,000
		(2)	100,000
Bal.	120,000	Bal.	180,000

Posting Transaction to Accounts (4 of 10)

- On December 1, Eagle pays one year of rent in advance, \$60,000 (\$5,000 per month).

(4) <u>December 1</u>	<u>Debit</u>	<u>Credit</u>
Prepaid Rent (+A)	60,000	
Cash (–A)		60,000
<i>(Prepay one year of rent with cash)</i>		

Prepaid Rent		Cash	
(4)	60,000	(1) 200,000	(3) 120,000
		(2) 100,000	(4) 60,000
Bal.	60,000	Bal. 120,000	

Posting Transaction to Accounts (5 of 10)

- On December 6, Eagle purchases supplies on account, \$23,000.

(5) <u>December 6</u>	<u>Debit</u>	<u>Credit</u>
Supplies (+A)	23,000	
Accounts Payable (+L)		23,000
<i>(Purchase supplies on account)</i>		

Supplies		Accounts Payable	
(5)	23,000	(5)	23,000
Bal.	23,000	Bal.	23,000

Posting Transaction to Accounts (6 of 10)

- On December 12, Eagle provides soccer training to customers for cash, \$43,000.

<u>(6) December 12</u>	<u>Debit</u>	<u>Credit</u>
Cash (+A)	43,000	
Service Revenue (+R, +SE)		43,000
<i>(Provide training to customers for cash)</i>		

Cash		Service Revenue	
(1) 200,000	(3) 120,000		(6) 43,000
(2) 100,000	(4) 60,000		
(6) 43,000			
Bal. 163,000			Bal. 43,000

Posting Transaction to Accounts (7 of 10)

- On December 17, Eagle provides soccer training to customers on account, \$20,000.

<u>(7) December 17</u>	<u>Debit</u>	<u>Credit</u>
Accounts Receivable (+A)	20,000	
Service Revenue (+R, +SE)		20,000
<i>(Provide training to customers on account)</i>		

Accounts Receivable		Service Revenue	
(7)	20,000		(6) 43,000
			(7) 20,000
Bal.	20,000		Bal. 63,000

Posting Transaction to Accounts (8 of 10)

- On December 23, Eagle receives cash in advance for 12 soccer training sessions to be given in the future, \$6,000.

<u>(8) December 23</u>	<u>Debit</u>	<u>Credit</u>
Cash (+A)	6,000	
Deferred Revenue (+L)		6,000
<i>(Receive cash in advance from customers)</i>		

Cash		Deferred Revenue	
(1) 200,000	(3) 120,000		(8) 6,000
(2) 100,000	(4) 60,000		
(6) 43,000			
(8) 6,000			
Bal. 169,000		Bal.	6,000

Posting Transaction to Accounts (9 of 10)

- On December 28, Eagle pays salaries to employees, \$28,000.

<u>(9) December 28</u>	<u>Debit</u>	<u>Credit</u>
Salaries Expense (+E, -SE)	28,000	
Cash (-A)		28,000
<i>(Pay salaries to employees)</i>		

Salaries Expense		Cash	
(9) 28,000		(1) 200,000	(3) 120,000
		(2) 100,000	(4) 60,000
		(6) 43,000	(9) 28,000
		(8) 6,000	
Bal. 28,000		Bal. 141,000	

Posting Transaction to Accounts (10 of 10)

- On December 30, Eagle pays cash dividends to shareholders, \$4,000.

(10) <u>December 30</u>		<u>Debit</u>	<u>Credit</u>
Dividends (+D, -SE)	4,000	
Cash (-A)		4,000
<i>(Pay cash dividends)</i>			

Dividends		Cash	
(10)	4,000	(1) 200,000	(3) 120,000
		(2) 100,000	(4) 60,000
		(6) 43,000	(9) 28,000
		(8) 6,000	(10) 4,000
Bal.	4,000	Bal. 137,000	

Key Point

Posting is the process of transferring the debit and credit information from transactions recorded in the journal to individual accounts in the general ledger.

Illustration 2-11 (1 of 3)

Summary of Journal Entries Recorded for Transactions of Eagle Soccer Academy

(1) <u>December 1</u>	<u>Debit</u>	<u>Credit</u>
Cash (+A)	200,000	
Common Stock (+SE)		200,000
<i>(Issue common stock for cash)</i>		
(2) <u>December 1</u>	<u>Debit</u>	<u>Credit</u>
Cash (+A)	100,000	
Notes Payable (+L)		100,000
<i>(Borrow cash by signing three-year note)</i>		
(3) <u>December 1</u>	<u>Debit</u>	<u>Credit</u>
Equipment (+A)	120,000	
Cash (-A)		120,000
<i>(Purchase equipment with cash)</i>		
(4) <u>December 1</u>	<u>Debit</u>	<u>Credit</u>
Prepaid Rent (+A)	60,000	
Cash (-A)		60,000
<i>(Prepay rent with cash)</i>		

Continued

Illustration 2-11 (2 of 3)

Summary of Journal Entries Recorded for Transactions of Eagle Soccer Academy

(5) <u>December 6</u>	<u>Debit</u>	<u>Credit</u>
Supplies (+A)	23,000	
Accounts Payable (+L)		23,000
<i>(Purchase supplies on account)</i>		
(6) <u>December 12</u>	<u>Debit</u>	<u>Credit</u>
Cash (+A)	43,000	
Service Revenue (+R, +SE)		43,000
<i>(Provide training to customers for cash)</i>		
(7) <u>December 17</u>	<u>Debit</u>	<u>Credit</u>
Accounts Receivable (+A)	20,000	
Service Revenue (+R, +SE)		20,000
<i>(Provide training to customers on account)</i>		
(8) <u>December 23</u>	<u>Debit</u>	<u>Credit</u>
Cash (+A)	6,000	
Deferred Revenue (+L)		6,000
<i>(Receive cash in advance from customers)</i>		

Continued

Illustration 2-11 (3 of 3)

Summary of Journal Entries Recorded for Transactions of Eagle Soccer Academy

<u>(9) December 28</u>	<u>Debit</u>	<u>Credit</u>
Salaries Expense (+E, -SE)	28,000	
Cash (-A)		28,000
<i>(Pay salaries to employees)</i>		

<u>(10) December 30</u>	<u>Debit</u>	<u>Credit</u>
Dividends (+D, -SE)	4,000	
Cash (-A)		4,000
<i>(Pay cash dividends)</i>		

Illustration 2-12

Posting of External Transactions of Eagle Soccer Academy from Journal Entries to General Ledger Accounts

Assets				=	Liabilities		+	Stockholders' Equity			
Cash		Accounts Receivable			Accounts Payable			Common Stock		Retained Earnings	
(1) 200,000		(3) 120,000	(7) 20,000			(5) 23,000			(1) 200,000		0
(2) 100,000		(4) 60,000									
(6) 43,000		(9) 28,000	Bal. 20,000			Bal. 23,000			Bal. 200,000		0
(8) 6,000		(10) 4,000									
Bal. 137,000											
Supplies		Prepaid Rent			Deferred Revenue			Service Revenue		Salaries Expense	
(5) 23,000		(4) 60,000				(8) 6,000			(6) 43,000	(9) 28,000	
									(7) 20,000		
Bal. 23,000		Bal. 60,000				Bal. 6,000			Bal. 63,000	Bal. 28,000	
Equipment					Notes Payable			Dividends			
(3) 120,000						(2) 100,000		(10) 4,000			
Bal. 120,000						Bal. 100,000		Bal. 4,000			

Transaction numbers are shown in parentheses. Account balances are in bold.

Concept Check 2-4

Which of the following is used to provide a chronological record of all transactions affecting a firm?

- a. The general ledger
- ☒ b. The journal
- c. The trial balance
- d. The income statement

The journal is a chronological record of the economic events that have taken place. (The general ledger is used to accumulate the balances of the accounts, and the trial balance is a summarized listing of all the debit and credit accounts. The income statement is a financial statement used to determine whether the business was profitable.)

Concept Check 2-5

Which of the following accounts would be debited when a company pays \$12,000 in advance for one year of rent?

- a. Cash
- b. Rent Expense
- ☒ c. Prepaid Rent
- d. Rental Income

This transaction creates a prepaid account—specifically prepaid rent. Prepaid rent is an asset account. In order to increase an asset account you would debit it. The correct answer is the prepaid rent account would be debited for \$12,000 when the rent was paid in advance. (Cash would be credited.)

Learning Objective 6

LO2-6 Prepare a trial balance.

Trial Balance

- A ***trial balance*** is a list of all accounts and their balances at a particular date, showing that total debits equal total credits.
- Another purpose of the trial balance is to assist us in preparing adjusting entries for *internal* transactions (Chapter 3).
- Used for **internal purposes** only
 - ❑ Not published to external parties
 - ❑ Not required to follow an order of listing

Common Mistake

Just because the *debits and credits are equal* in a trial balance *does not necessarily mean that all balances are correct*.

A trial balance could contain offsetting errors.

For example, if we overstate cash and revenue each by \$1,000:

- Both accounts will be in error.
- But the trial balance will still balance, since the overstatement to cash increases debits by \$1,000 and the overstatement to revenue increases credits by \$1,000.

Illustration 2-13

Trial Balance of Eagle Soccer Academy

EAGLE SOCCER ACADEMY Trial Balance December 31, 2024		
<u>Accounts</u>	<u>Debit</u>	<u>Credit</u>
Cash	\$ 137,000	
Accounts Receivable	20,000	
Supplies	23,000	
Prepaid Rent	60,000	
Equipment	120,000	
Accounts Payable		\$ 23,000
Deferred Revenue		6,000
Notes Payable		100,000
Common Stock		200,000
Retained Earnings		0
Dividends	4,000	
Service Revenue		63,000
Salaries Expense	28,000	
Totals	<u>\$392,000</u>	<u>\$392,000</u>

Must
Equal

Concept Check 2-6

Which of the following accounts would appear in the credit column of a trial balance?

- a. Prepaid Rent
- b. Dividends
- ☒ c. Common Stock
- d. Salaries Expense

The trial balance is a listing of all accounts and their balances at a given date. The only account listed above that would have a credit balance and therefore appear in the credit column of the trial balance is the common stock account. This is an equity account and equity accounts are increased by credits. (All other accounts listed have debit balances and therefore appear in the debit column.)

Order of Accounts

- The trial balance is used for internal purposes only and provides a check on the equality of the debits and credits.
- The trial balance simplifies preparation of the published financial statements.

End of Chapter 2