

# CH 2 – Recording Business Transactions

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## Summary

This chapter formalizes the **record → post → balance → report** cycle. You will identify accounts and their effects on the **accounting equation** ( $A = L + SE$ ), analyze with **T-Accounts**, record **journal entries**, post to ledgers, and prepare a **Trial Balance** (as of Oct 31, 2020) before producing the Income Statement, Statement of Retained Earnings, and Balance Sheet.

Highlights: A=L+SE classification • Journal entries • T-Accounts • Trial Balance •

Period-end summarization • Linkage to financial statements • Continuous cycle.

## The Accounting Equation (Foundation)

$$[Assets] = [Liabilities] + [Shareholder's Equity]$$

Every transaction touches at least two accounts so the equation stays balanced.

## Account families (quick map)

Type	Increases with	Typical examples
Assets	Debit	Cash, Accounts Receivable, Supplies, Inventory, Prepaid, Equipment
Liabilities	Credit	Accounts Payable, Salaries Payable, Notes Payable, Unearned Revenue
Shareholders' Equity	Credit	Common Shares, Retained Earnings

## Debits, Credits, and Normal Balances

- **Debits** are left-side entries; **Credits** are right-side entries.
- **Normal balance** means the side that **increases** that account:  
Assets (Debit), Liabilities (Credit), Equity (Credit); Revenues (Credit), Expenses (Debit), Dividends (Debit).

## Minimal “sign” rules you will actually use

- Increase **Assets / Expenses / Dividends** with **Debit**; decrease with **Credit**.
- Increase **Liabilities / Equity / Revenues** with **Credit**; decrease with **Debit**.
- **Total Debits must equal Total Credits** in every journal entry.

## T-Accounts (Visualization for Posting)

A T-Account is a two-column running balance for a single account. You **post** each journal entry line into the target T-Account (left = debits, right = credits), then read the ending balance.

### Example: T-Account layout (Cash)

[ Debit | Credit ]

[ 10,000 | ]

[ 500 | ]

[ | 300 ]

Ending balance = 10,200 Debit

## Journal Entries (Formal Record)

Write a date, list debited accounts first (amounts in the Debit column), then credited accounts (amounts in the Credit column), followed by a short explanation.

### Journal entry template (table form)

Date	Account & Explanation	Debit / Credit
Oct 1	Cash	Debit 50,000
	Common Shares	Credit 50,000
	(Owner investment)	

## From Transactions → Journal → T-Accounts → Trial Balance

Workflow you will repeat:

- 1) **Identify** accounts and directions (A/L/SE; increase/decrease).
- 2) **Journalize** the transaction.
- 3) **Post** each journal line to its T-Account.
- 4) **Foot** the T-Accounts (find balances).
- 5) **Trial Balance**: list all accounts with ending balances; check Debits = Credits as of the date.

## Worked Example (Illustrative, E2-18 style)

Below is a compact month for a service company. The numbers are simple placeholders to show the complete flow.

### 1) Transaction list (classification first)

#	Transaction	Accounts touched	A=L+SE impact
1	Issue shares for cash 50,000	Cash ↑, Common Shares ↑	A ↑ 50,000 = SE ↑ 50,000
2	Buy supplies on account 3,700	Supplies ↑, Accounts Payable ↑	A ↑ 3,700 = L ↑ 3,700
3	Perform services on account 10,000	Accounts Receivable ↑, Service Revenue ↑	A ↑ 10,000 = SE ↑ 10,000
4	Receive cash on A/R 200	Cash ↑, Accounts Receivable ↓	A +200 -200 = 0
5	Pay on account 1,800	Accounts Payable ↓, Cash ↓	L -1,800 = A -1,800
6	Pay expenses (rent 1,100; salary 1,200; utilities 400)	Rent Exp ↑, Salary Exp ↑, Utilities Exp ↑, Cash ↓	SE -2,700 (via expenses) = A -2,700
7	Declare dividends 2,100; pay cash	Dividends ↑, Cash ↓	SE -2,100 = A -2,100

### 2) Journal entries (debits first, credits second)

Date	Account & Explanation	Debit / Credit
Oct 1	Cash	Dr 50,000
	Common Shares	Cr 50,000
	(Owner investment)	
Oct 2	Supplies	Dr 3,700
	Accounts Payable	Cr 3,700
	(Purchased supplies on account)	

Date	Account & Explanation	Debit / Credit
Oct 10	Accounts Receivable	Dr 10,000
	Service Revenue	Cr 10,000
	(Services on account)	
Oct 15	Cash	Dr 200
	Accounts Receivable	Cr 200
	(Collected on account)	
Oct 18	Accounts Payable	Dr 1,800
	Cash	Cr 1,800
	(Paid on account)	
Oct 25	Rent Expense	Dr 1,100
	Salary Expense	Dr 1,200
	Utilities Expense	Dr 400
	Cash	Cr 2,700
	(Paid operating expenses)	
Oct 28	Dividends	Dr 2,100
	Cash	Cr 2,100
	(Declared & paid dividends)	

### 3) Post to T-Accounts (ending balances)

For each account, add the debits and credits, then net to a **normal-balance side**.

**Examples:**

Cash:  $+50,000 +200 -1,800 -2,700 -2,100 = 43,600$  Debit

Accounts Receivable:  $+10,000 -200 = 9,800$  Debit

Supplies:  $+3,700 = 3,700$  Debit

Accounts Payable:  $+3,700 -1,800 = 1,900$  Credit

Common Shares:  $+50,000 = 50,000$  Credit

Service Revenue:  $+10,000 = 10,000$  Credit

Expenses (Rent 1,100; Salary 1,200; Utilities 400): **2,700 Debit**

Dividends: **2,100 Debit**

### 4) Trial Balance (as of Oct 31, 2020)

Account Title	Debit	Credit
Cash	43,600	
Accounts Receivable	9,800	
Supplies	3,700	
Accounts Payable		1,900
Common Shares		50,000
Dividends	2,100	
Service Revenue		10,000
Rent Expense	1,100	
Salary Expense	1,200	

Account Title	Debit	Credit
Utilities Expense	400	
<b>Totals</b>	<b>61,900</b>	<b>61,900</b>

## From Trial Balance to Financial Statements (Preview)

- **Income Statement** (period): Revenues – Expenses = **Net Income**.  
Here:  $10,000 - 2,700 = 7,300$ .
- **Statement of Retained Earnings**: Beg RE + NI – Dividends = End RE.  
If Beg RE = 0 (first month):  $0 + 7,300 - 2,100 = 5,200$ .
- **Balance Sheet** (as at date):  $A = L + SE$ .  
 $\text{Equity} = \text{Common Shares} + \text{End RE} = 50,000 + 5,200 = 55,200$ .

## Quick Checks (Self-Test)

- If you **perform services on account**, which accounts move and how?  
**A/R ↑ (Debit), Service Revenue ↑ (Credit)**.
- Paying **on account**?  
**Accounts Payable ↓ (Debit), Cash ↓ (Credit)**.
- Trial Balance doesn't balance—what do you check first?  
**Journal line totals, posting direction (Dr vs Cr), arithmetic in T-Accounts.**

## One-Page Reference (At a Glance)

Step	What to produce
1. Classify	Accounts & $A=L+SE$ effects
2. Journalize	Debits first; credits second; explanation
3. Post	Update each account's T-Account
4. Foot	Compute each account's ending balance
5. Trial Balance	List balances; Debits = Credits as of date

Use this flow for each month. Debits and Credits must match at the journal level **and** at the trial balance level.