

2 The Recording Process

Learning Objectives

- 1 Describe how accounts, debits, and credits are used to record business transactions.
- 2 Indicate how a journal is used in the recording process.
- 3 Explain how a ledger and posting help in the recording process.
- 4 Prepare a trial balance.

2-1

LEARNING OBJECTIVE 1 Describe how accounts, debits, and credits are used to record business transactions.

The Account

- Record of increases and decreases in a specific asset, liability, owners' 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.

2-2 LO 1

The Account

DEBIT AND CREDIT PROCEDURES

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 at least one other account.
- DEBITS must equal CREDITS.**

2-3 LO 1

Debits and Credits

If the sum of Debit entries are **greater than** the sum of Credit entries, the account will have a debit balance.

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

2-4 LO 1

Debits and Credits

If the sum of Credit entries are **greater than** the sum of Debit entries, the account will have a credit balance.

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

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Debits and Credits

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

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

- Assets** - Debits should exceed credits.
- Liabilities** - Credits should exceed debits.
- Normal balance** is on the increase side.

2-6 LO 1

Debits and Credits

Owner's Equity	
Debit / Dr.	Credit / Cr.
↓	↑
Normal Balance	

- Owner's investments and revenues increase owner's equity (credit).
- Owner's drawings and expenses decrease owner's equity (debit).

Owner's Capital	
Debit / Dr.	Credit / Cr.
↓	↑
Normal Balance	

Owner's Drawing	
Debit / Dr.	Credit / Cr.
↑	↓
Normal Balance	

Helpful Hint Because revenues increase owner's equity, a revenue account has the same debit/credit rules as the Owner's Capital account. Expenses have the opposite effect.

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LO 1

Debits and Credits

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

- The purpose of earning **revenues** is to benefit the owner(s).
- The effect of debits and credits on revenue accounts is the **same** as their effect on Owner's Capital.
- Expenses** have the opposite effect: expenses decrease owner's equity.

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

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LO 1

Debits/Credits Rules

Normal Balance	Normal Balance
Debit	Credit

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

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

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

Owner's Equity	
Debit / Dr.	Credit / Cr.
↓	↑
Normal Balance	

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

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LO 1

Debits/Credits Rules

	Balance Sheet			Income Statement	
	Asset	=	Liability + Equity	Revenue	- Expense
Debit	↑		↓ ↓	↓	↑
Credit	↓		↑ ↑	↑	↓

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LO 1

Summary of Debit/Credit Rules

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

Illustration 2-11

Basic Equation	Assets = Liabilities +			Owner's Equity													
Expanded Equation	Assets		=	Liabilities		+	Owner's Capital		-	Owner's Drawing		+	Revenues		-	Expenses	
Debit/Credit Effects	Dr. +	Cr. -		Dr. -	Cr. +		Dr. -	Cr. +		Dr. +	Cr. -		Dr. -	Cr. +		Dr. +	Cr. -

The equation must be in balance after every transaction. Total **Debits** must equal total **Credits**.

2-11

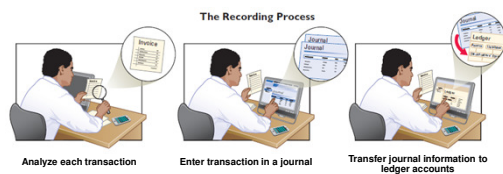
LO 1

LEARNING OBJECTIVE 2

Indicate how a journal is used in the recording process.

Steps in the Recording Process

Illustration 2-12



Business documents, such as a sales slip, a check, or a bill, provide evidence of the transaction.

2-12

LO 2

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.

2-13

LO 2

Steps in the Recording Process

JOURNALIZING - Entering transaction data in the journal.

Illustration: On September 1, Ray Neal invested \$15,000 cash in the business, and Softbyte purchased computer equipment for \$7,000 cash.

Illustration 2-13

GENERAL JOURNAL				
Date	Account Title	Ref.	Debit	Credit
Sept. 1	Cash		15,000	
	Owner's Capital			15,000
	Equipment		7,000	
	Cash			7,000

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LO 2

Steps in the Recording Process

SIMPLE AND COMPOUND ENTRIES

Illustration: On July 1, Butler Company purchases a delivery truck costing \$14,000. It pays \$8,000 cash now and agrees to pay the remaining \$6,000 on account.

Illustration 2-14
Compound journal entry

GENERAL JOURNAL				
Date	Account Title	Ref.	Debit	Credit
July 1	Equipment		14,000	
	Cash			8,000
	Accounts payable			6,000

2-15

LO 2

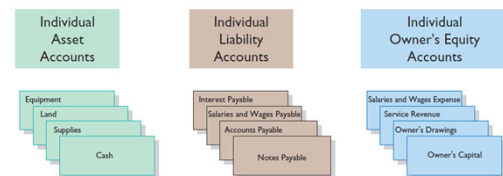
LEARNING OBJECTIVE 3

Explain how a ledger and posting help in the recording process.

The Ledger

- ◆ **General Ledger** contains all the asset, liability, and owner's equity accounts.

Illustration 2-15



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LO 3

The Ledger

STANDARD FORM OF ACCOUNT

Illustration 2-16
Three-column form of account

CASH					NO. 101
Date	Explanation	Ref.	Debit	Credit	Balance
2017					
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

2-17

LO 3

Ledger

POSTING

Transferring journal entries to the ledger accounts.

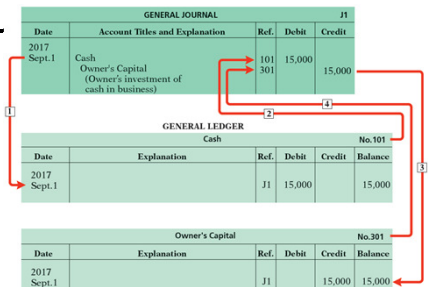


Illustration 2-17
Posting a journal entry

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.

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LO 3

Chart of Accounts

Illustration 2-18

PIONEER ADVERTISING Chart of Accounts			
Assets		Owner's Equity	
101 Cash		301 Owner's Capital	
112 Accounts Receivable		306 Owner's Drawings	
126 Supplies		350 Income Summary	
130 Prepaid Insurance			
157 Equipment		Revenues	
158 Accumulated Depreciation—Equipment		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	

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LO 3

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.

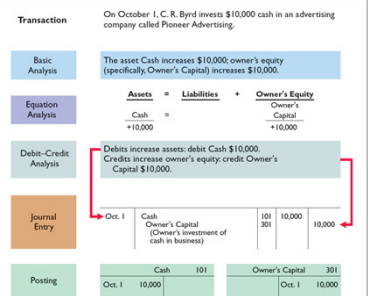


Illustration 2-19

2-20

LO 3

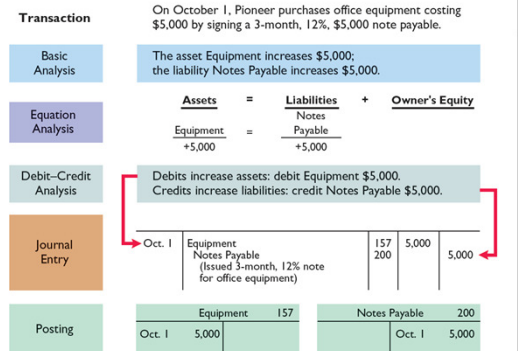


Illustration 2-20

Purchase of office equipment

LO 3

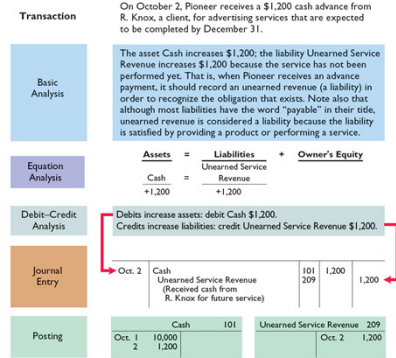


Illustration 2-21
Receipt of cash for future service

2-22

LO 3

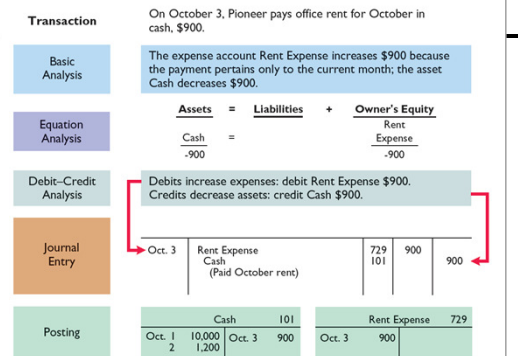


Illustration 2-22

Payment of monthly rent

LO 3

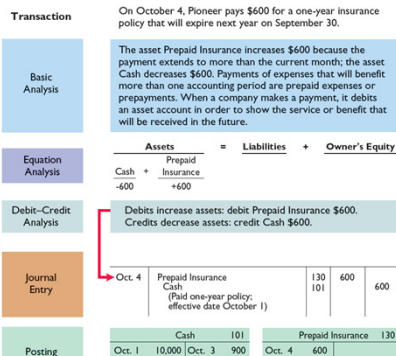


Illustration 2-23
Payment for insurance

2-24

LO 3

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		+	Owner's Equity	
Supplies	+2,500	=	Accounts Payable	+2,500			

Debit-Credit Analysis Debits increase assets: debit Supplies \$2,500. Credits increase liabilities: credit Accounts Payable \$2,500.

Journal Entry

Date	Account	Debit	Credit
Oct. 5	Supplies	126	
	Accounts Payable		201
	(Purchased supplies on account from Aero Supply)		

Posting

Supplies		Accounts Payable	
Oct. 5	2,500	Oct. 5	2,500

Illustration 2-24
Purchase of supplies on credit

2-25 LO 3

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.)

Illustration 2-25
Hiring of employees

2-26 LO 3

Transaction On October 20, C. R. Byrd withdraws \$500 cash for personal use.

Basic Analysis The owner's equity account Owner's Drawings increases \$500; the asset Cash decreases \$500.

Equation Analysis

Assets		=	Liabilities		+	Owner's Equity	
Cash	-500	=				Owner's Drawings	-500

Debit-Credit Analysis Debits increase drawings: debit Owner's Drawings \$500. Credits decrease assets: credit Cash \$500.

Journal Entry

Date	Account	Debit	Credit
Oct. 20	Owner's Drawings	306	
	Cash		101
	(Withdrew cash for personal use)		

Posting

Cash		Owner's Drawings	
Oct. 1	10,000	Oct. 3	900
2	1,200	4	600
		20	500
		26	4,000

Illustration 2-26
Withdrawal of cash by owner

2-27 LO 3

Transaction On October 26, Pioneer owes employee salaries of \$4,000 and pays them in cash. (See October 9 event.)

Basic Analysis The expense account Salaries and Wages Expense increases \$4,000; the asset Cash decreases \$4,000.

Equation Analysis

Assets		=	Liabilities		+	Owner's Equity	
Cash	-4,000	=				Salaries and Wages Expense	-4,000

Debit-Credit Analysis Debits increase expenses: debit Salaries and Wages Expense \$4,000. Credits decrease assets: credit Cash \$4,000.

Journal Entry

Date	Account	Debit	Credit
Oct. 26	Salaries and Wages Expense	726	
	Cash		101
	(Paid salaries to date)		

Posting

Cash		Salaries and Wages Expense	
Oct. 1	10,000	Oct. 3	900
2	1,200	4	600
		20	500
		26	4,000

Illustration 2-27
Payment of salaries

2-28 LO 3

Transaction On October 31, Pioneer receives \$10,000 in cash from Copa Company for advertising services performed in October.

Basic Analysis The asset Cash increases \$10,000; the revenue account Service Revenue increases \$10,000.

Equation Analysis

Assets		=	Liabilities		+	Owner's Equity	
Cash	+10,000	=				Service Revenue	+10,000

Debit-Credit Analysis Debits increase assets: debit Cash \$10,000. Credits increase revenues: credit Service Revenue \$10,000.

Journal Entry

Date	Account	Debit	Credit
Oct. 31	Cash	101	
	Service Revenue		400
	(Received cash for services performed)		

Posting

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

Illustration 2-28
Receipt of cash for services performed

2-29 LO 3

Summary Journalizing and Posting

Illustration 2-29

GENERAL JOURNAL				PAGE J1	
Date	Account Titles and Explanation	Ref.	Debit	Credit	
2017					
Oct. 1	Cash	101	10,000		
	Owner's Capital	301		10,000	
	(Owner's investment of cash in business)				
1	Equipment	157	5,000		
	Notes Payable	200		5,000	
	(Issued 3-month, 12% note for office equipment)				
2	Cash	101	1,200		
	Unearned Service Revenue	209		1,200	
	(Received cash from R. Knox for future service)				
3	Rent Expense	729	900		
	Cash	101		900	
	(Paid October rent)				

2-30 LO 3

GENERAL JOURNAL			PAGE J1	
Date	Account Titles and Explanation	Ref.	Debit	Credit
4	Prepaid Insurance	130	600	
	Cash	101		600
	(Paid one-year policy; effective date October 1)			
5	Supplies	126	2,500	
	Accounts Payable	201		2,500
	(Purchased supplies on account from Aero Supply)			
20	Owner's Drawings	306	500	
	Cash	101		500
	(Withdrew cash for personal use)			
26	Salaries and Wages Expense	726	4,000	
	Cash	101		4,000
	(Paid salaries to date)			
31	Cash	101	10,000	
	Service Revenue	400		10,000
	(Received cash for services performed)			

GENERAL LEDGER									
Cash					Accounts Payable				
Date	Explanation	Ref.	Debit	Credit	Date	Explanation	Ref.	Debit	Credit
2017					2017				
Oct. 1	J1		10,000	10,000	Oct. 5	J1		2,500	2,500
2	J1		1,200	11,200					
3	J1			900					
4	J1			9,700					
20	J1		500	9,200					
26	J1		4,000	5,200					
31	J1		10,000	15,200					
Supplies					Owner's Capital				
Date	Explanation	Ref.	Debit	Credit	Date	Explanation	Ref.	Debit	Credit
2017					2017				
Oct. 5	J1		2,500	2,500	Oct. 1	J1		10,000	10,000
Prepaid Insurance					Owner's Drawings				
Date	Explanation	Ref.	Debit	Credit	Date	Explanation	Ref.	Debit	Credit
2017					2017				
Oct. 4	J1		600	600	Oct. 20	J1		500	500
Equipment					Service Revenue				
Date	Explanation	Ref.	Debit	Credit	Date	Explanation	Ref.	Debit	Credit
2017					2017				
Oct. 1	J1		5,000	5,000	Oct. 31	J1		10,000	10,000
Notes Payable					Salaries and Wages Expense				
Date	Explanation	Ref.	Debit	Credit	Date	Explanation	Ref.	Debit	Credit
2017					2017				
Oct. 1	J1			5,000	Oct. 26	J1		4,000	4,000
Rent Expense					Rent Expense				
Date	Explanation	Ref.	Debit	Credit	Date	Explanation	Ref.	Debit	Credit
2017					2017				
Oct. 3	J1		900	900	Oct. 3	J1		900	900

LEARNING OBJECTIVE

4

Prepare a trial balance.

PIONEER ADVERTISING		
Trial Balance		
October 31, 2017		
	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
Owner's Capital		10,000
Owner's Drawings	500	
Service Revenue		10,000
Salaries and Wages Expense	4,000	
Rent Expense	900	
	<u>\$28,700</u>	<u>\$28,700</u>

Trial Balance

Limitations of a Trial Balance

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

ETHICS NOTE

An *error* is the result of an unintentional mistake; it is neither ethical nor unethical. An *irregularity* is an intentional misstatement, which is viewed as unethical.

Dollar Signs and Underlining

Dollar Signs

- ◆ Do not appear in journals or ledgers.
- ◆ Typically used only in the trial balance and the financial statements.
- ◆ Shown only for the first item in the column and for the total of that column.

Underlining

- ◆ A single line is placed under the column of figures to be added or subtracted.
- ◆ Totals are double-underlined.

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