

Chapter 2

The Recording Process

CHAPTER 2

THE RECORDING PROCESS

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 how they are used to record 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**

CHAPTER 2

THE RECORDING PROCESS

After studying this chapter, you should be able to:

- 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 purpose**

THE ACCOUNT

STUDY OBJECTIVE 1

- An **account** is an individual accounting record of increases and decreases in a specific asset, liability, or owner's equity item.
- There are separate accounts for the items we used in transactions such as **cash**, **salaries expense**, **accounts payable**, etc.

BASIC FORM OF ACCOUNT

STUDY OBJECTIVE 2

- The simplest form an account consists of
 - 1 the title of the account
 - 2 a left or debit side
 - 3 a right or credit side
- The alignment of these parts resembles the letter T = **T account**

Title of Account	
Left or debit side	Right or credit side
Debit balance	Credit balance

DEBITS AND CREDITS

- **Debit** indicates left and **Credit** indicates right
- Recording \$ on the **left** side of an account is debiting the account
- Recording \$ on the **right** side is crediting the account
- If the total of debit amounts is bigger than credits, the account has a **debit** balance
- If the total of credit amounts is bigger than debits, the account has a **credit** balance

TABULAR SUMMARY COMPARED TO ACCOUNT FORM

Tabular Summary

Cash
\$15,000
-7,000
1,200
1,500
-1,700
-250
600
-1,300
<u><u>\$ 8,050</u></u>

Account Form

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

DEBITING AN ACCOUNT

Cash

Debits	Credits
15,000	

Example: The owner makes an initial investment of \$15,000 to start the business. **Cash** is debited as the owner's **Capital** is credited.

CREDITING AN ACCOUNT

Cash	
Debits	Credits
	7,000

Example: Monthly rent of \$7,000 is paid.
Cash is credited as **Rent Expense** is debited.

DEBITING / CREDITING AN ACCOUNT

Cash

Debits	Credits
15,000	7,000
8,000	

Example: **Cash** is debited for \$15,000 and credited for \$7,000, leaving a debit balance of \$8,000.

DOUBLE-ENTRY SYSTEM

- equal debits and credits made accounts for each transaction
- total debits always equal the total credits
- accounting equation always stays in balance



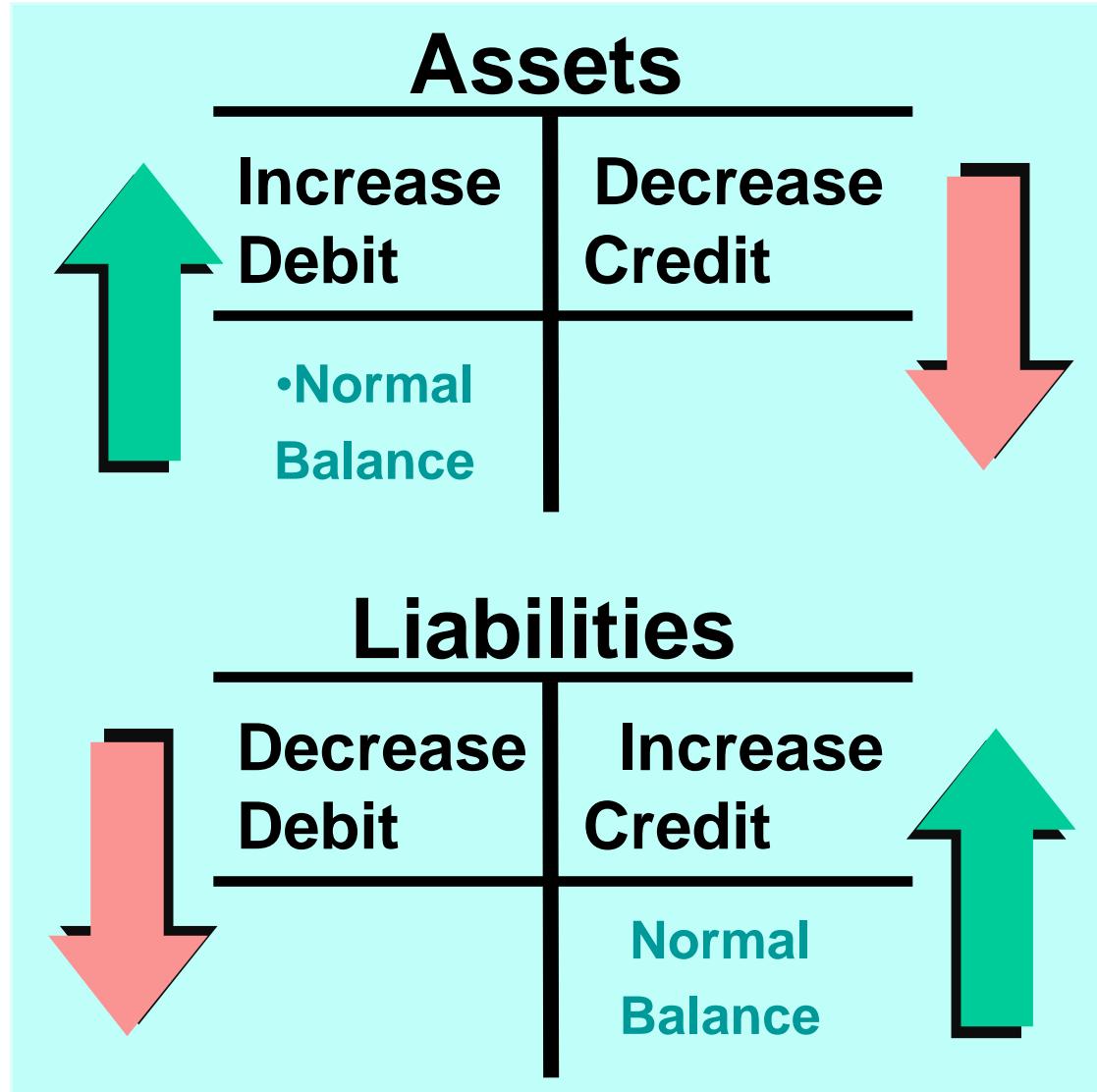
DEBIT AND CREDIT EFFECTS — ASSETS AND LIABILITIES

Debits	Credits
Increase assets	Decrease assets
Decrease liabilities	Increase liabilities

NORMAL BALANCE

- every account has a designated **normal** balance.
 - It is either a debit or credit.
- accounts rarely have an abnormal balance.

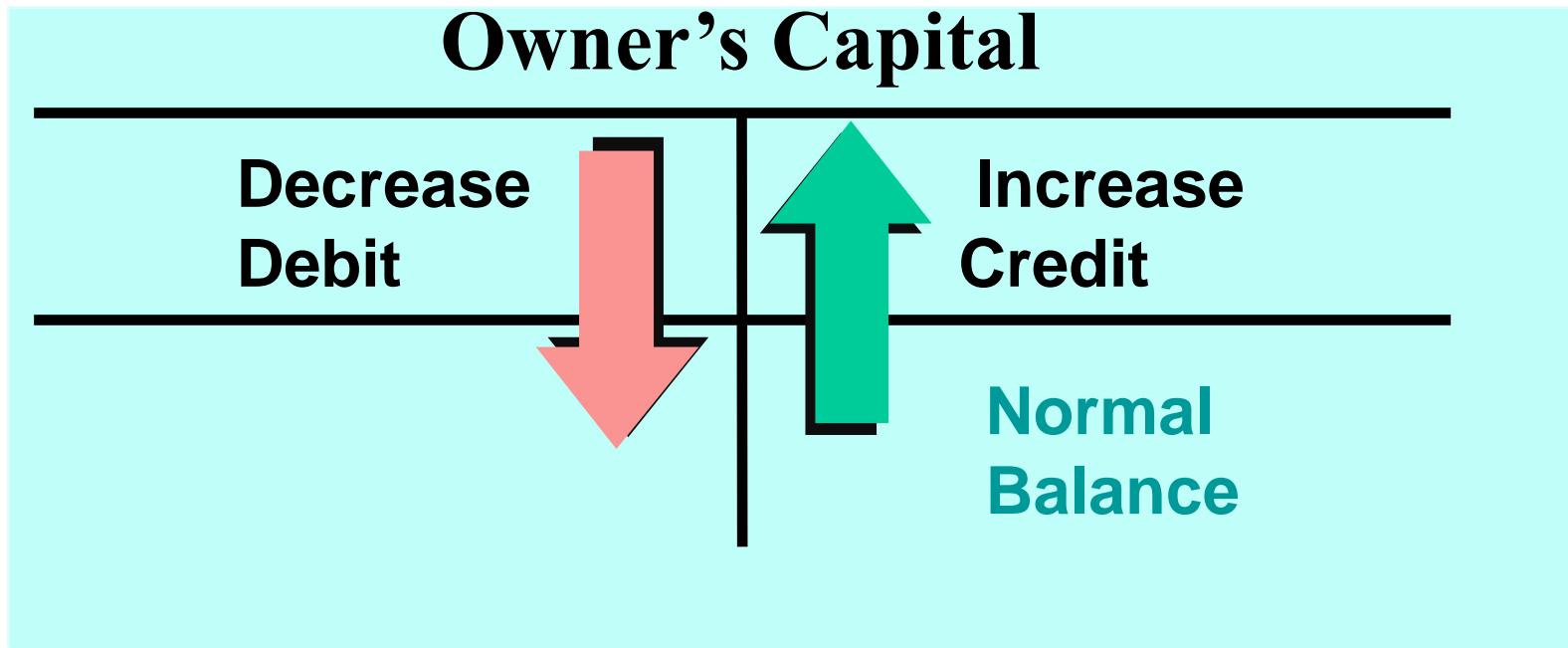
NORMAL BALANCES — ASSETS AND LIABILITIES



DEBIT AND CREDIT EFFECTS — OWNER'S CAPITAL

Debits	Credits
Decrease owner's capital	Increase owner's capital

NORMAL BALANCE — OWNER'S CAPITAL



DEBIT AND CREDIT EFFECTS — OWNER'S DRAWING

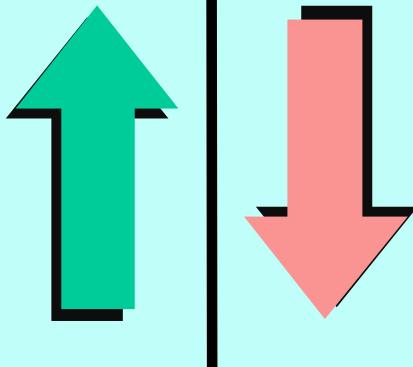
Debits	Credits
Increase owner's drawing	Decrease owner's drawing

Remember, **Drawing** is a **contra-account** – an account that is backwards from the account it accompanies (the **Capital** account).

NORMAL BALANCE – OWNER'S DRAWING

Owner's Drawing

Increase
Debit
**Normal
Balance**

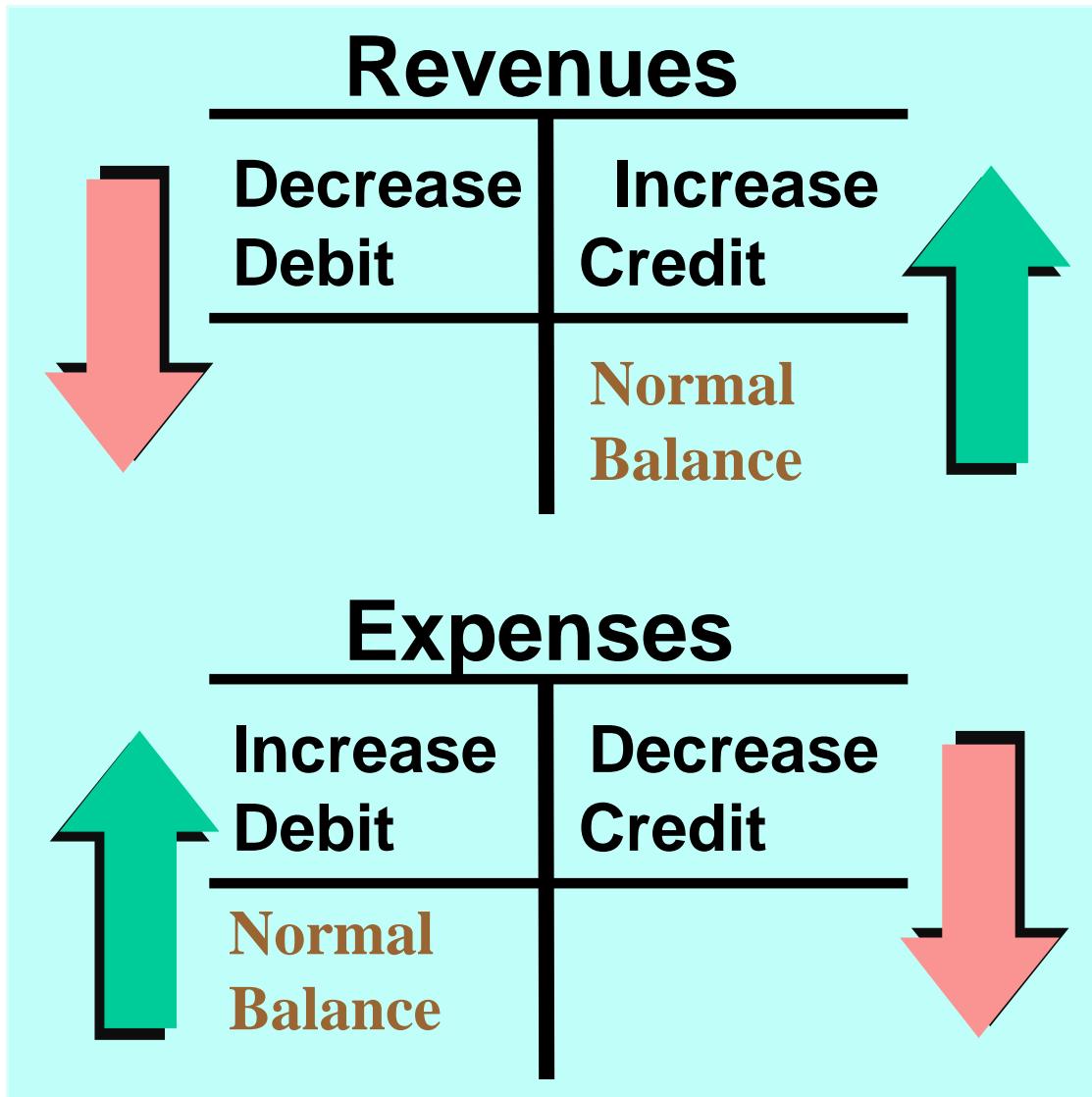


Decrease
Credit

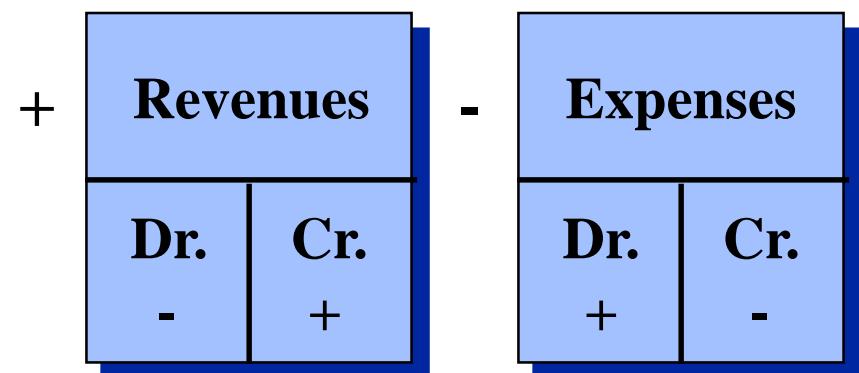
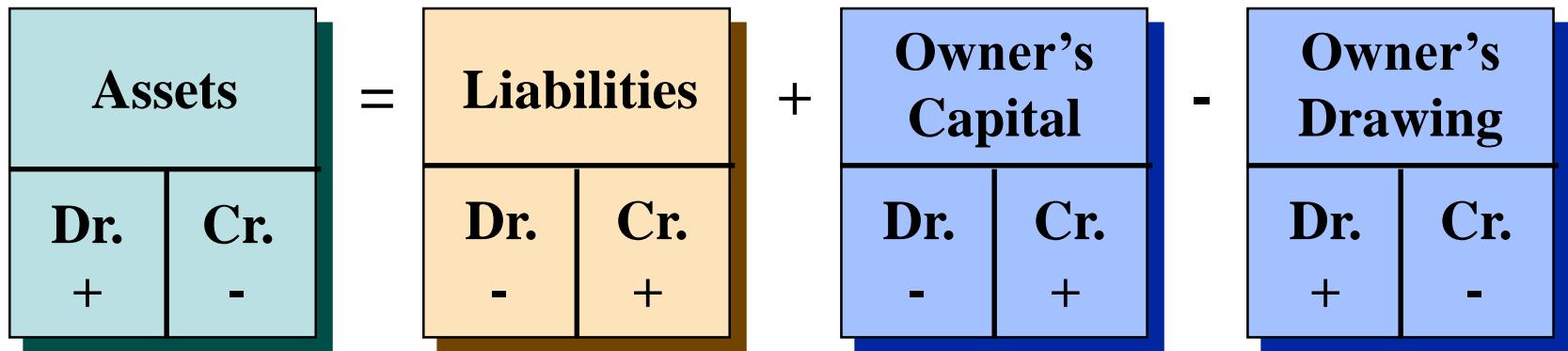
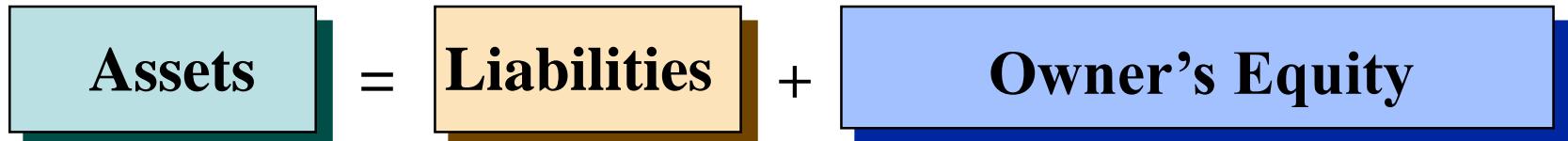
DEBIT AND CREDIT EFFECTS — REVENUES AND EXPENSES

Debits	Credits
Decrease revenues Increase expenses	Increase revenues Decrease expenses

NORMAL BALANCES — REVENUES AND EXPENSES



EXPANDED BASIC EQUATION AND DEBIT/CREDIT RULES AND EFFECTS



Review

Which of the following is not true of the terms **debit** and **credit**.

- a. They can be abbreviated as Dr. and Cr.
- b. They can be interpreted to mean increase and decrease.
- c. They can be used to describe the balance of an account.
- d. They can be interpreted to mean left and right.

Review

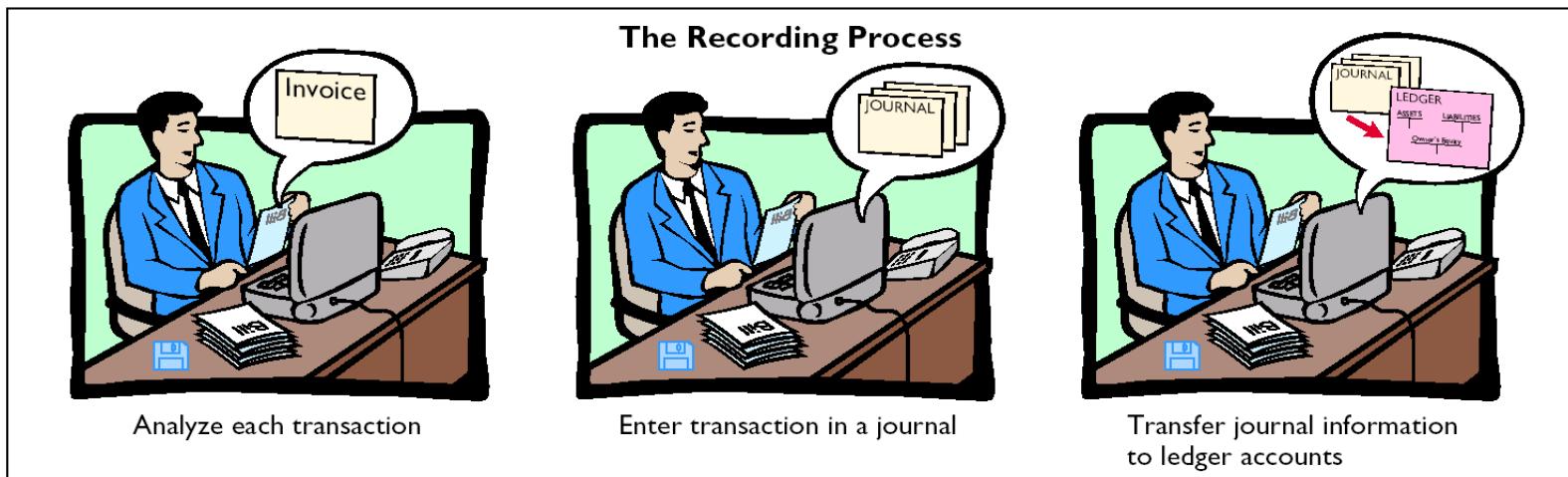
Which of the following is not true of the terms **debit** and **credit**.

- a. They can be abbreviated as Dr. and Cr.
- b. They can be interpreted to mean increase and decrease.
- c. They can be used to describe the balance of an account.
- d. They can be interpreted to mean left and right.

THE RECORDING PROCESS

STUDY OBJECTIVE 3

- 1 analyze each transaction (+, -)**
- 2 enter transaction in a journal**
- 3 transfer journal information to ledger accounts**



THE JOURNAL

STUDY OBJECTIVE 4

- **Transactions**
 - Are initially recorded in chronological order before they are transferred to the ledger accounts.
- A **general journal** has
 - 1 spaces for dates**
 - 2 account titles and explanations**
 - 3 references**
 - 4 two amount columns**

THE JOURNAL

A **journal** makes several contributions to recording process:

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

JOURNALIZING

- Entering transaction data in the journal is known as **journalizing**.
- Separate journal entries are made for each transaction.
- A complete entry consists of:
 - 1 the date of the transaction,
 - 2 the accounts and amounts to be debited and credited,
 - 3 a brief explanation of transaction.

TECHNIQUE OF JOURNALIZING

The date of the transaction is entered into the date column.

GENERAL JOURNAL					J1
Date	Account Titles and Explanation	Ref.	Debit	Credit	
2005 Sept. 1	Cash R. Neal, Capital (Invested cash in business)		15,000	15,000	
1	Computer Equipment Cash (Purchased equipment for cash)		7,000	7,000	

TECHNIQUE OF JOURNALIZING

The **debit** account title is entered at the extreme left margin of the Account Titles and Explanation column. The **credit** account title is indented on the next line.

GENERAL JOURNAL					J1
Date	Account Titles and Explanation	Ref.	Debit	Credit	
2005 Sept. 1	Cash R. Neal, Capital (Invested cash in business)		15,000	15,000	
1	Computer Equipment Cash (Purchased equipment for cash)		7,000	7,000	

TECHNIQUE OF JOURNALIZING

The amounts for the **debits** are recorded in the Debit column and the amounts for the **credits** are recorded in the Credit column.

GENERAL JOURNAL					J1
Date	Account Titles and Explanation	Ref.	Debit	Credit	
2005 Sept. 1	Cash R. Neal, Capital (Invested cash in business)		15,000	15,000	
1	Computer Equipment Cash (Purchased equipment for cash)		7,000	7,000	

TECHNIQUE OF JOURNALIZING

A brief explanation of the transaction is given.

GENERAL JOURNAL					J1
Date	Account Titles and Explanation	Ref.	Debit	Credit	
2005 Sept. 1	Cash R. Neal, Capital <i>(Invested cash in business)</i>		15,000	15,000	
1	Computer Equipment Cash <i>(Purchased equipment for cash)</i>		7,000	7,000	

TECHNIQUE OF JOURNALIZING

A space is left between journal entries. The blank space separates individual journal entries and makes the entire journal easier to read.

GENERAL JOURNAL					J1
Date	Account Titles and Explanation	Ref.	Debit	Credit	
2005 Sept. 1	Cash R. Neal, Capital (Invested cash in business)		15,000	15,000	
1	Computer Equipment Cash (Purchased equipment for cash)		7,000	7,000	

TECHNIQUE OF JOURNALIZING

The column entitled Ref. is left blank at the time journal entry is made and is used later when the journal entries are transferred to the ledger accounts.

GENERAL JOURNAL					J1
Date	Account Titles and Explanation	Ref.	Debit	Credit	
2005 Sept. 1	Cash R. Neal, Capital (Invested cash in business)		15,000	15,000	
1	Computer Equipment Cash (Purchased equipment for cash)		7,000	7,000	

SIMPLE AND COMPOUND JOURNAL ENTRIES

If an entry involves only two accounts, one debit and one credit, it is considered a **simple entry**.

GENERAL JOURNAL					J1
Date	Account Titles and Explanation	Ref.	Debit	Credit	
2005 July 1	Cash K. Browne, Capital (Invested cash in the business)		20,000	20,000	

COMPOUND JOURNAL ENTRY

When three or more accounts are required in one journal entry, the entry is referred to as a **compound entry**.

GENERAL JOURNAL					J1
Date	Account Titles and Explanation	Ref.	Debit	Credit	
2005 July 1	Delivery Equipment Cash Accounts Payable (Purchased truck for cash with balance on account)		14,000	8,000 6,000	

1 2 3

COMPOUND JOURNAL ENTRY

This is the wrong format; all debits must be listed before the credits are listed.

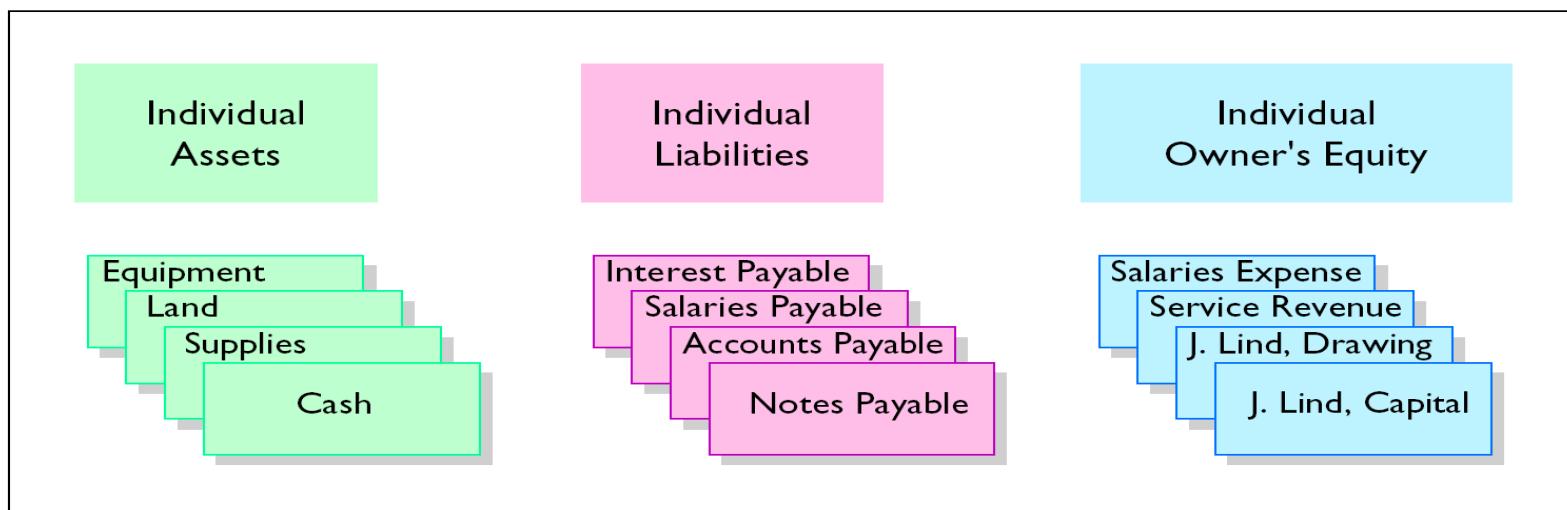
GENERAL JOURNAL					J1
Date	Account Titles and Explanation	Ref.	Debit	Credit	
2005 July 1	Cash Delivery Equipment Accounts Payable (Purchased truck for cash with balance on account)		14,000	8,000 6,000	

THE LEDGER

STUDY OBJECTIVE 5

A Group of accounts maintained by a company is called the **ledger**.

A **general ledger** contains all the assets, liabilities, and owner's equity accounts



POSTING A JOURNAL ENTRY

GENERAL JOURNAL						J1
Date	Account Titles and Explanation	Ref.	Debit	Credit		
2005 Sept. 1	Cash R. Neal, Capital (invested cash in business)	10 25	15,000	15,000		

GENERAL LEDGER

CASH						NO. 10
Date	Explanation	Ref.	Debit	Credit	Balance	
2005 Sept. 1		J1	15,000		15,000	

R. NEAL, CAPITAL						NO. 25
Date	Explanation	Ref.	Debit	Credit	Balance	
2005 Sept. 1		J1		15,000	15,000	

In the ledger, enter in the appropriate columns of the account(s) debited the date, journal page, and debit amount shown in the journal.

POSTING A JOURNAL ENTRY

GENERAL JOURNAL					J1
Date	Account Titles and Explanation	Ref.	Debit	Credit	
2005 Sept. 1	Cash R. Neal, Capital (invested cash in business)	10 25	15,000	15,000	

GENERAL LEDGER

CASH					NO. 10
Date	Explanation	Ref.	Debit	Credit	Balance
2005 Sept. 1		J1	15,000		15,000
R. NEAL, CAPITAL					NO. 25
Date	Explanation	Ref.	Debit	Credit	Balance
2005 Sept. 1		J1		15,000	15,000

In the reference column of the journal, write the account number to which the debit amount was posted.

POSTING A JOURNAL ENTRY

GENERAL JOURNAL

J1

Date	Account Titles and Explanation	Ref.	Debit	Credit
2005 Sept. 1	Cash R. Neal, Capital (invested cash in business)	10 25	15,000	15,000

GENERAL LEDGER

CASH

NO. 10

Date	Explanation	Ref.	Debit	Credit	Balance
2005 Sept. 1		J1	15,000		15,000

R. NEAL, CAPITAL

NO. 25

Date	Explanation	Ref.	Debit	Credit	Balance
2005 Sept. 1		J1		15,000	15,000

In the ledger, enter in the appropriate columns of the account(s) credited the date, journal page, and credit amount shown in the journal.

POSTING A JOURNAL ENTRY

GENERAL JOURNAL						J1
Date	Account Titles and Explanation	Ref.	Debit	Credit		
2005 Sept. 1	Cash R. Neal, Capital (invested cash in business)	10 25	15,000	15,000		

GENERAL LEDGER

CASH						NO. 10
Date	Explanation	Ref.	Debit	Credit	Balance	
2005 Sept. 1		J1	15,000		15,000	

R. NEAL, CAPITAL						NO. 25
Date	Explanation	Ref.	Debit	Credit	Balance	
2005 Sept. 1		J1		15,000	15,000	

In the reference column of the journal, write the **account number** to which the credit amount was posted.

CHART OF ACCOUNTS

A Chart of Accounts lists the accounts and the account numbers which identify their location in the ledger.

PIONEER ADVERTISING AGENCY

Chart of Accounts

Assets

- 101 Cash**
- 112 Accounts Receivable
- 126 Advertising Supplies**
- 130 Prepaid Insurance**
- 157 Office Equipment**
- 158 Accumulated Depreciation—Office Equipment

Liabilities

- 200 Notes Payable**
- 201 Accounts Payable**
- 209 Unearned Revenue**
- 212 Salaries Payable
- 230 Interest Payable

Owner's Equity

- 301 C. R. Byrd, Capital**
- 306 C. R. Byrd, Drawing**
- 350 Income Summary

Revenues

- 400 Service Revenue**

Expenses

- 631 Advertising Supplies Expense
- 711 Depreciation Expense
- 722 Insurance Expense
- 726 Salaries Expense**
- 729 Rent Expense**
- 905 Interest Expense

INVESTMENT OF CASH BY OWNER

Transaction

**October 1, C.R. Byrd invests \$10,000 cash in an advertising business known as:
The Pioneer Advertising Agency.**

Basic Analysis

- The asset Cash is increased \$10,000**
- Owner's equity, C. R. Byrd, Capital is increased \$10,000.**

Debit-Credit Analysis

Debits increase assets: debit Cash \$10,000.
Credits increase owner's equity: credit C.R. Byrd, Capital \$10,000.

PURCHASE OF OFFICE EQUIPMENT

JOURNAL ENTRY

Date	Account Titles and Explanation	Ref.	Debit	Credit
Oct. 1	Cash C. R. Byrd, Capital (Owner invests \$10,000 In the business)	101 301	10,000	10,000

POSTING

Cash	101
Oct. 1 10,000	

C. R. Byrd, Capital	301
	Oct. 1 10,000

INVESTMENT OF CASH BY OWNER

Transaction

October 1, C. R. Byrd purchases \$5,000 of equipment by issuing a 3-month, 12% note payable.

Basic Analysis

- The asset **Office Equipment** is increased \$5,000.
- The liability, **Notes Payable** is increased \$5,000.

Debit-Credit Analysis

Debits increase assets: debit **Office Equipment \$5,000**.
Credits increase liabilities: credit **Notes Payable \$5,000**.

PURCHASE OF OFFICE EQUIPMENT

JOURNAL ENTRY

Date	Account Titles and Explanation	Ref.	Debit	Credit
Oct. 1	Office Equipment Notes Payable (Issued 3-month, 12% note for office equipment)	157 200	5,000	5,000

POSTING

Office Equipment	157
Oct. 1 5,000	

Notes Payable	200
	Oct. 1 5,000

RECEIPT OF CASH FOR FUTURE SERVICE

Transaction

October 2, a \$1,200 cash advance is received from a client, for advertising services expected to be completed by December 31.

Basic Analysis

Asset Cash is increased \$1,200
Liability Unearned Fees is increased \$1,200
•Service has not been rendered yet.
Liabilities often have the word “payable” in their title, Unearned fees are a liability.

Debit-Credit Analysis

Debits increase assets: debit Cash **\$1,200**.
Credits increase liabilities: credit Unearned Fees **\$1,200**.

RECEIPT OF CASH FOR FUTURE SERVICE

JOURNAL ENTRY

Date	Account Titles and Explanation	Ref.	Debit	Credit
Oct. 2	Cash Unearned Fees (Received advance from R. Knox for future services)	101 209	1,200	1,200

POSTING

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

Unearned Fees		209
Oct. 2		
		1,200

PAYMENT OF MONTHLY RENT

Transaction

October 3, office rent for October is paid in cash, \$900.

Basic Analysis

**The expense Rent is increased \$900
Payment pertains only to the current month
Asset Cash is decreased \$900.**

Debit-Credit Analysis

Debits increase expenses: debit Rent Expense **\$900.
Credits decrease assets: credit Cash **\$900**.**

PAYMENT OF RENT EXPENSE

JOURNAL ENTRY

Date	Account Titles and Explanation	Ref.	Debit	Credit
Oct. 3	Rent Expense Cash (Paid \$900 for October rent)	729 101	900	900

POSTING

Rent Expense	729
Oct. 3 900	

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

PAYMENT FOR INSURANCE

Transaction

October 4, \$600 Paid one-year insurance policy-expires next year on September 30.

Basic Analysis

- Asset Prepaid Insurance increases **\$600**
- Payment extends to more than the current month
- Asset Cash is decreased **\$600.**
- Payments of expenses benefiting more than one period are prepaid expenses or prepayments.

Debit-Credit Analysis

Debits increase assets: debit Prepaid Insurance **\$600.** **Credits decrease assets:** credit Cash **\$600.**

PAYMENT FOR INSURANCE

JOURNAL ENTRY

Date	Account Titles and Explanation	Ref.	Debit	Credit
Oct. 4	Prepaid Insurance Cash (Paid one-year policy; effective date October 1)	130 101	600	600

POSTING

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

Prepaid Insurance		130
Oct. 4	600	

PURCHASE OF SUPPLIES ON CREDIT

Transaction

October 5, an estimated 3-month supply of advertising materials is purchased on account from Aero Supply for \$2,500.

Basic Analysis

The asset Advertising Supplies is increased \$2,500; the liability Accounts Payable is increased \$2,500.

Debit-Credit Analysis

Debits increase assets: debit Advertising Supplies **\$2,500. Credits increase liabilities: credit Accounts Payable **\$2,500**.**

PURCHASE OF SUPPLIES ON CREDIT

JOURNAL ENTRY

Date	Account Titles and Explanation	Ref.	Debit	Credit
Oct. 5	Advertising Supplies Accounts Payable (Purchased supplies on account from Aero Supply)	126 201	2,500	2,500

POSTING

Advertising Supplies	126
Oct. 5 2,500	

Accounts Payable	201
	Oct. 5 2,500

HIRING OF EMPLOYEES

Transaction

October 9, hire 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 only an agreement between the employer and the employees to enter into a business transaction beginning on October 15.

Debit-Credit Analysis

A debit-credit analysis is not needed because there is no accounting entry.

WITHDRAWAL OF CASH BY OWNER

Transaction

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

Basic Analysis

The owner's equity account C. R. Byrd, Drawing is increased \$500.
The asset Cash is decreased \$500.

Debit-Credit Analysis

Debits increase drawings: debit C. R. Byrd, Drawing **\$500**. Credits decrease assets: credit Cash **\$500**.

WITHDRAWAL OF CASH BY OWNER

JOURNAL ENTRY

Date	Account Titles and Explanation	Ref.	Debit	Credit
Oct. 20	C. R. Byrd, Drawing Cash (Withdrew cash for personal use)	306 101	500	500

POSTING

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

C. R. Byrd, Drawing		306
Oct. 20	500	

PAYMENT OF SALARIES

Transaction

October 26, employee salaries of \$4,000 are owed and paid in cash. (See October 9 transaction.)

Basic Analysis

The expense account Salaries Expense is increased \$4,000; the asset Cash is decreased \$4,000.

Debit-Credit Analysis

Debits increase expenses: debit Salaries Expense **\$4,000**. Credits decrease assets: credit Cash **\$4,000**.

PAYMENT OF SALARIES

JOURNAL ENTRY

Date	Account Titles and Explanation	Ref.	Debit	Credit
Oct. 26	Salaries Expense Cash (Paid salaries to date)	726 101	4,000	4,000

POSTING

Cash		101
Oct. 1	10,000	Oct. 3
2	1,200	4

20 500

26 4,000

Salaries Expense		726
Oct. 26	4,000	

RECEIPT OF CASH FOR FEES EARNED

Transaction

October 31, received \$10,000 in cash from Copa Company for advertising services rendered in October.

Basic Analysis

The asset **Cash** is increased \$10,000; the revenue **Fees Earned** is increased \$10,000.

Debit-Credit Analysis

Debits increase assets: debit **Cash \$10,000**. Credits increase revenues: credit **Fees Earned \$10,000**.

RECEIPT OF CASH FOR FEES EARNED

JOURNAL ENTRY

Date	Account Titles and Explanation	Ref.	Debit	Credit
Oct. 31	Cash Fees Earned (Received cash for fees earned)	101 400	10,000	10,000

POSTING

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

THE TRIAL BALANCE

STUDY OBJECTIVE 7

- The **trial balance** is a list of accounts and their balances at a given time.
- The primary purpose of a trial balance is to prove debits = credits after posting.
- If debits and credits do not agree, the trial balance can be used to uncover errors in journalizing and posting.

THE TRIAL BALANCE

The Steps in preparing the Trial Balance are:

1. List the account titles and balances
2. Total the debit and credit columns
3. Prove the equality of the two columns

A TRIAL BALANCE

PIONEER ADVERTISING AGENCY
Trial Balance
October 31, 2005

	Debit	Credit
Cash	\$ 15,200	
Advertising Supplies	2,500	
Prepaid Insurance	600	
Office Equipment	5,000	
Notes Payable		\$ 5,000
Accounts Payable		2,500
Unearned Fees		1,200
C. R. Byrd, Capital		10,000
C. R. Byrd, Drawing	500	
Fees Earned		10,000
Salaries Expense	4,000	
Rent Expense	900	
	\$ 28,700	\$ 28,700

The total debits must equal the total credits.

LIMITATIONS OF A TRIAL BALANCE

- A trial balance does not prove all transactions have been recorded or the ledger is correct.
- Numerous errors may exist even though the trial balance columns agree. For example, the trial balance may balance even when:
 - a transaction is not journalized
 - a correct journal entry is not posted
 - a journal entry is posted twice
 - incorrect accounts used in journalizing or posting
 - offsetting errors are made in recording

Review

Which one of the following represents the expanded basic accounting equation?

- a. Assets = Liabilities + Owner's Capital + Owner's Drawings – Revenue - Expenses.
- b. Assets + Owner's Drawings + Expenses = Liabilities + Owner's Capital + Revenue.
- c. Assets – Liabilities – Owner's Drawings = Owner's Capital + Revenue – Expenses.
- d. Assets = Revenue + Expenses – Liabilities.

Review

Which one of the following represents the expanded basic accounting equation?

- a. Assets = Liabilities + Owner's Capital + Owner's Drawings – Revenue - Expenses.
- b. Assets + Owner's Drawings + Expenses = Liabilities + Owner's Capital + Revenue.
- c. Assets – Liabilities – Owner's Drawings = Owner's Capital + Revenue – Expenses.
- d. Assets = Revenue + Expenses – Liabilities.