

CHAPTER 2

The Recording Process

ASSIGNMENT CLASSIFICATION TABLE

<u>Learning Objectives</u>	<u>Questions</u>	<u>Brief Exercises</u>	<u>Do It!</u>	<u>Exercises</u>	<u>A Problems</u>	<u>B Problems</u>
1. Explain what an account is and how it helps in the recording process.	1			1		
2. Define debits and credits and explain their use in recording business transactions.	2, 3, 4, 5, 6, 7, 8, 9, 14, 21	1, 2, 5	1	2, 4, 6, 7, 14	1A, 2A, 3A, 5A	1B, 2B, 3B, 5B
3. Identify the basic steps in the recording process.	10, 19	4		6, 7		
4. Explain what a journal is and how it helps in the recording process.	11, 12, 13, 14, 16	3, 6	2	3, 5, 6, 7, 10, 11, 12	1A, 2A, 3A, 5A	1B, 2B, 3B, 5B
5. Explain what a ledger is and how it helps in the recording process.	17			8		
6. Explain what posting is and how it helps in the recording process.	15, 17	7, 8	3	9, 12	2A, 3A, 5A	2B, 3B, 5B
7. Prepare a trial balance and explain its purposes.	18, 20	9, 10	4	9, 10, 11, 13, 14, 15	2A, 3A, 4A, 5A	2B, 3B, 4B, 5B

ASSIGNMENT CHARACTERISTICS TABLE

Problem Number	Description	Difficulty Level	Time Allotted (min.)
1A	Journalize a series of transactions.	Simple	20–30
2A	Journalize transactions, post, and prepare a trial balance.	Simple	30–40
3A	Journalize and post transactions and prepare a trial balance.	Moderate	40–50
4A	Prepare a correct trial balance.	Moderate	30–40
5A	Journalize transactions, post, and prepare a trial balance.	Moderate	40–50
1B	Journalize a series of transactions.	Simple	20–30
2B	Journalize transactions, post, and prepare a trial balance.	Simple	30–40
3B	Journalize transactions, post, and prepare a trial balance.	Moderate	40–50
4B	Prepare a correct trial balance.	Moderate	30–40
5B	Journalize transactions, post, and prepare a trial balance.	Moderate	40–50

BLOOM'S TAXONOMY TABLE

Correlation Chart between Bloom's Taxonomy, Learning Objectives and End-of-Chapter Exercises and Problems

Learning Objective	Knowledge	Comprehension	Application	Analysis	Synthesis	Evaluation
1. Explain what an account is and how it helps in the recording process.	Q2-1 E2-1					
2. Define debits and credits and explain their use in recording business transactions.	Q2-21	Q2-2 Q2-7 BE2-2 Q2-3 Q2-8 BE2-5 Q2-4 Q2-9 DI2-1 Q2-5 Q2-14 E2-2 Q2-6 BE2-1 E2-4	E2-6 P2-3A P2-5B E2-7 P2-5A E2-14 P2-1B P2-1A P2-2B P2-2A P2-3B			
3. Identify the basic steps in the recording process.	Q2-10	Q2-19 BE2-4	E2-6 E2-7			
4. Explain what a journal is and how it helps in the recording process.	Q2-12	Q2-11 Q2-13 Q2-14	Q2-16 E2-7 P2-5A BE2-3 E2-10 P2-1B BE2-6 E2-11 P2-2B DI2-2 E2-12 P2-3B E2-3 P2-1A P2-5B E2-5 P2-2A E2-6 P2-3A			
5. Explain what a ledger is and how it helps in the recording process.	E2-8	Q2-17				
6. Explain what posting is and how it helps in the recording process.		Q2-15 Q2-17	BE2-7 E2-12 P2-2B BE2-8 P2-2A P2-3B DI2-3 P2-3A P2-5B E2-9 P2-5A			
7. Prepare a trial balance and explain its purposes.		Q2-18 E2-15	BE2-9 E2-11 P2-5A DI2-4 E2-14 P2-2B E2-9 P2-2A P2-3B E2-10 P2-3A P2-5B	Q2-20 P2-4B BE2-10 E2-13 P2-4A		
Broadening Your Perspective		Financial Reporting	Decision-Making Across the Organization Real-World Focus	Comparative Analysis Ethics Case	Communication Decision Making Across the Organization	Ethics Case

LEARNING OBJECTIVES

- 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.**

CHAPTER REVIEW

The Account

1. (L.O. 1) An **account** is an individual accounting record of increases and decreases in a specific asset, liability, or equity item.
2. In its simplest form, an account consists of (a) the title of the account, (b) a left or debit side, and (c) a right or credit side. The alignment of these parts resembles the letter T, and therefore the account form is called a **T-account**.

Debits and Credits

3. (L.O. 2) The terms **debit** and **credit** mean left and right, respectively.
 - a. The act of entering an amount on the left side of an account is called **debiting** the account and making an entry on the right side is **crediting** the account.
 - b. When the debit amounts exceed the credits, an account has a **debit balance**; when the reverse is true, the account has a **credit balance**.
4. In a **double-entry** system, equal debits and credits are made in the accounts for each transaction. Thus, the total debits will always equal the total credits.
5. The effects of debits and credits on **assets** and **liabilities** and the normal balances are:

<u>Accounts</u>	<u>Debits</u>	<u>Credits</u>	<u>Normal Balance</u>
Assets	Increase	Decrease	Debit
Liabilities	Decrease	Increase	Credit

6. Accounts are kept for each of the five subdivisions of equity: Share Capital—Ordinary, Retained Earnings, Dividends, Revenues, and Expenses.
7. The effects of debits and credits on the equity accounts and the normal balances are:

<u>Accounts</u>	<u>Debits</u>	<u>Credits</u>	<u>Normal Balance</u>
Share Capital—Ordinary	Decrease	Increase	Credit
Retained Earnings	Decrease	Increase	Credit
Dividends	Increase	Decrease	Debit
Revenues	Decrease	Increase	Credit
Expenses	Increase	Decrease	Debit

8. The expanded basic equation is:

$$\text{Assets} = \text{Liabilities} + \text{Share Capital} + \text{Retained Earnings} - \text{Dividends} + \text{Revenues} - \text{Expenses}$$

The Recording Process

9. (L.O. 3) The basic steps in the recording process are:
 - a. Analyze each transaction for its effect on the accounts.
 - b. Enter the transaction information in a journal.
 - c. Transfer the journal information to the appropriate accounts in the ledger.

The Journal

10. (L.O. 4) Transactions are initially recorded in a journal.
 - a. A journal is referred to as a book of original entry.
 - b. A **general journal** is the most basic form of journal.
11. The journal makes several significant contributions to the recording process:
 - a. It discloses in one place the complete effect of a transaction.
 - b. It provides a chronological record of transactions.
 - c. It helps to prevent or locate errors because the debit and credit amounts for each entry can be readily compared.
12. Entering transaction data in the journal is known as **journalizing**. When three or more accounts are required in one journal entry, the entry is known as a **compound entry**.

The Ledger

13. (L.O. 5) The ledger is the entire group of accounts maintained by a company. It keeps in one place all the information about changes in account balances and it is a source of useful data for management.
14. The **standard form of a ledger account** has three columns and the balance in the account is determined after each transaction.
15. (L.O. 6) **Posting** is the procedure of transferring journal entries to the ledger accounts. The following steps are used in posting:
 - a. In the ledger, enter in the appropriate columns of the account(s) debited the date, journal page, and debit amount.
 - b. In the reference column of the journal, write the account number to which the debit amount was posted.
 - c. Perform the same steps in a. and b. for the credit amount.

The Chart of Accounts

16. A **chart of accounts** is a listing of the accounts and the account numbers which identify their location in the ledger. The numbering system usually starts with the statement of financial position accounts and follows with the income statement accounts.

The Basic Steps

17. The basic steps in the recording process are illustrated as follows:

Transaction On September 4, Fesmire Inc. pays \$3,000 cash to a creditor in full payment of the balance due.

Basic analysis The liability Accounts Payable is decreased \$3,000, and the asset Cash is decreased \$3,000.

Debit-credit analysis Debits decrease liabilities: debit Accounts Payable \$3,000.
Credits decrease assets: credit Cash \$3,000.

Journal entry	Sept. 4	Accounts Payable	26	3,000	
		Cash (Paid creditor in full)	1		3,000

Posting	Cash	1	Accounts Payable	26
	Sept. 4	3,000	Sept. 4	3,000

The Trial Balance

18. (L.O. 7) A **trial balance** is a list of accounts and their balances at a given time. The primary purpose of the trial balance is to prove the mathematical equality of the debits and credits after posting.
19. A trial balance does not prove that all transactions have been recorded or that the ledger is correct because the trial balance may still balance when
 - a. a transaction is not journalized.
 - b. a correct journal entry is not posted.
 - c. an entry is posted twice.
 - d. incorrect accounts are used in journalizing or posting.
 - e. offsetting errors are made in recording the amount of a transaction.

LECTURE OUTLINE

A. The Account.

An account is an accounting record of increases and decreases in a specific asset, liability, or equity item.

An account consists of three parts:

1. A title.
2. A left or debit side.
3. A right or credit side.

TEACHING TIP

Use **ILLUSTRATION 2-1** to explain the concept of an account. Emphasize that a T-account is used frequently in the classroom because it can be constructed quickly and it contains the three major parts of an account.

B. Debits and Credits.

The terms debit and credit are directional signals: Debit indicates left, and credit indicates right.

TEACHING TIP

ILLUSTRATION 2-2 can be used to explain the debit and credit rules for increasing and decreasing accounts. Emphasize that the normal balance of an account is the same as the increase side.

1. Assets, dividends, and expenses are increased by debits and decreased by credits.

2. Liabilities, share capital—ordinary, retained earnings, and revenues are increased by credits and decreased by debits.

TEACHING TIP

ILLUSTRATION 2-3 is a short exercise that can be used in class to review the normal balances of accounts introduced in Chapters 1 and 2.

C. Steps in the Recording Process.

Businesses use three basic steps in the recording process:

1. Analyze each transaction for its effects on the accounts.
2. Enter the transaction information in a journal.
3. Transfer the journal information to the appropriate accounts in the ledger.

TEACHING TIP

Use **ILLUSTRATION 2-4** to present a conceptual overview of the basic steps in the recording process.

D. The General Journal/Journalizing.

Entering transaction data in the general journal is called journalizing.

TEACHING TIP

ILLUSTRATION 2-5 can be used to demonstrate the proper form and content when entering a transaction in the general journal.

The general journal:

1. Discloses in one place 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 for each entry can be easily compared.
4. A simple journal entry involves only two accounts (one debit and one credit) whereas a compound journal entry involves three or more accounts.

TEACHING TIP

ILLUSTRATION 2-6 is a short exercise that can be used in class to demonstrate the analysis and recording of business transactions in a general journal.

E. The Ledger.

The ledger is the entire group of accounts maintained by a company. A general ledger contains all the assets, liabilities, and equity accounts.

TEACHING TIP

Use **ILLUSTRATION 2-7** to discuss the different forms of accounts.

1. The ledger provides information about changes in specific account balances for a company.

ACCOUNTING ACROSS THE ORGANIZATION

When Wal-Mart was just getting started, Sam Walton kept a little pigeonhole on the wall for cash receipts and paperwork of each store. He had a blue binder ledger book for each store.

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

Answer: Using separate pigeonholes and blue binders for each store enabled Walton to accumulate and track the performance of each individual store easily.

Keeping separate records for each store provided Walton with more information about performance of individual stores and managers, and greater control. Walton would want and need the same advantages if he were starting his business today. The difference is that he might now use a computerized system for small businesses.

F. Posting/Chart of Accounts.

1. Posting is transferring journal entries to the ledger accounts.
2. Posting involves the following steps:
 - a. In the ledger, enter, in the appropriate columns of the account(s) debited, the date, journal page, and debit amount shown in the journal.
 - b. In the reference column of the journal, write the account number to which the debit amount was posted.
 - c. In the ledger, enter, in the appropriate columns of the account(s) credited, the date, journal page, and credit amount shown in the journal.
 - d. In the reference column of the journal, write the account number to which the credit amount was posted.

3. A chart of accounts lists the accounts and the account numbers that identify their location in the ledger. Accounts are usually numbered starting with the statement of financial position accounts followed by income statement accounts.

TEACHING TIP

ILLUSTRATION 2-8 is a short exercise that can be used in class to demonstrate the mechanics of posting from the journal to the ledger accounts.

G. Trial Balance.

A trial balance is a list of accounts and their balances at a given time.

1. Its primary purpose is to prove (check) that the debits equal the credits after posting.
2. It can be used by the company to uncover errors in journalizing and posting.
3. It is useful in preparing financial statements.

ETHICS INSIGHT

Bank regulators fined Bank One Corporation \$1.8 million because they felt the reliability of the bank's accounting system caused it to violate regulatory requirements. Recently statistical and communication problems were to blame for a € 55.5 billion error in the accounts of Hypo Real Estate Holding.

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?

Answer: A company's accounting equation (its books) can be in balance yet its financial statements have errors or misstatements because of the following: entire transactions were not recorded; transactions were recorded at wrong amounts; transactions were recorded in the wrong accounts; transactions were recorded in the wrong accounting period. Audits of financial statements uncover some, but obviously not all, errors or misstatements.

20 MINUTE QUIZ

Circle the correct answer.

True/False

1. Assets are increased by debits and liabilities are decreased by credits.
True False
2. The Share Capital—Ordinary account is increased by credits.
True False
3. An account will have a credit balance if the total debit amounts exceed the total credit amounts.
True False
4. The ledger is the entire group of accounts maintained by a company.
True False
5. The basic steps in the recording process are (1) to analyze each transaction, (2) to enter the transaction in a journal, and (3) to transfer the journal entry to the appropriate ledger accounts.
True False
6. Transferring journal entries to the ledger accounts is called posting and should be performed in chronological order.
True False
7. $\text{Assets} = \text{liabilities} + \text{share capital} + \text{retained earnings} - \text{dividends} + \text{revenues} - \text{expenses}$ is a correct form of the expanded basic accounting equation.
True False
8. In posting, one should enter “J2” in the Post. Ref. Column on page two of the journal.
True False
9. When the columns of the trial balance equal each other, it proves no errors occurred in recording and posting.
True False
10. The double-entry system is possible because all business transactions may be expressed in equal debit and credit entries.
True False

Multiple Choice

1. Transactions are initially recorded in the
 - a. general ledger.
 - b. general journal.
 - c. trial balance.
 - d. balance sheet.
2. The right side of an account is referred to as the
 - a. footing.
 - b. chart side.
 - c. debit side.
 - d. credit side.
3. A purchase of office equipment for cash requires a credit to
 - a. Equipment.
 - b. Cash.
 - c. Accounts Payable.
 - d. Share Capital—Ordinary.
4. The equality of the accounting equation can be proven by preparing a
 - a. trial balance.
 - b. journal.
 - c. general ledger.
 - d. T-account.
5. Which of the following accounts would be increased with a debit?
 - a. Interest Payable
 - b. Share Capital—Ordinary
 - c. Service Revenue
 - d. Dividends

ANSWERS TO QUIZ

True/False

- | | |
|----------|----------|
| 1. False | 6. True |
| 2. True | 7. True |
| 3. False | 8. False |
| 4. True | 9. False |
| 5. True | 10. True |

Multiple Choice

1. b.
2. d.
3. b.
4. a.
5. d.

ILLUSTRATION 2-1
THREE PARTS OF AN ACCOUNT

(1) ACCOUNT TITLE	
(Left Side)	(Right Side)
(2) DEBIT	(3) CREDIT

Total Debits > Total Credits = Debit Balance
 Total Credits > Total Debits = Credit Balance
 Total Debits = Total Credits = Zero Balance

Example:

CASH			
9/1 Balance	12,000	9/10	2,000
9/5	<u>2,000</u>	9/20	<u>1,000</u>
9/30 Balance	11,000		

→ (Debit Balance)

ACCOUNTS PAYABLE			
9/6	3,000	9/1 Balance	6,000
9/21	<u>2,000</u>	9/17	<u>9,000</u>
		9/30 Balance	10,000

→ (Credit Balance)

ILLUSTRATION 2-2 DOUBLE ENTRY RECORDING RULES

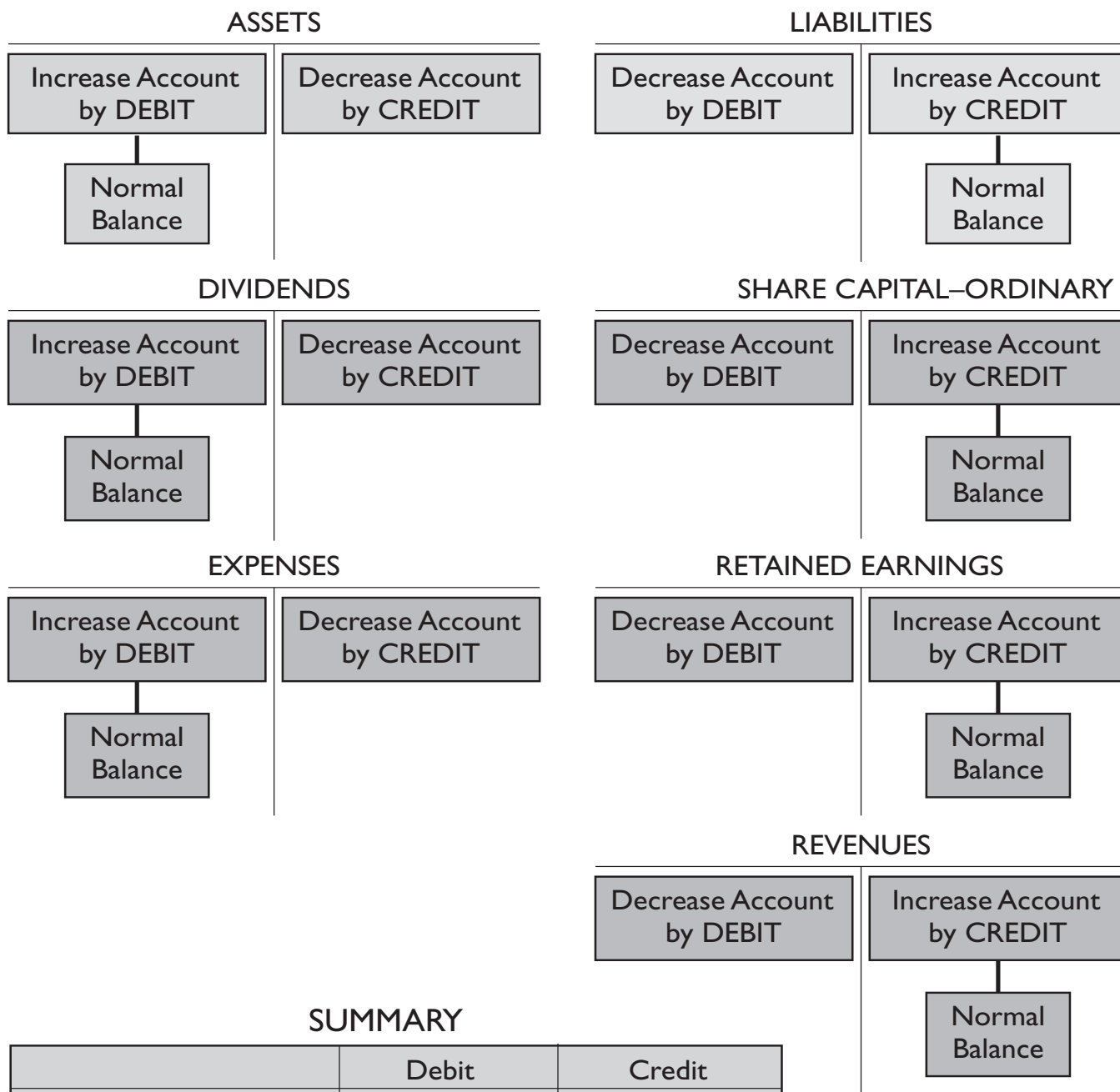


ILLUSTRATION 2-3

NORMAL ACCOUNT BALANCES

Review the **normal balances** of accounts introduced in Chapters One and Two. Review how an increase in the account would be recorded (DR/CR).

- Instructions:** (a) For each account, indicate the normal balance (Debit/Credit).
 (b) For each account, indicate how an increase in the account is recorded (DR/CR).

<u>Account</u>	<u>Normal Balance</u>	<u>Increase in Account</u>
1. Cash (EXAMPLE)	DR	DR
2. Accounts Receivable		
3. Rent Expense		
4. Service Revenue		
5. Accounts Payable		
6. Share Capital—Ord.		
7. Dividends		
8. Unearned Service Rev.		
9. Insurance Expense		
10. Notes Payable		
11. Retained Earnings		

Answer:

<u>Account</u>	<u>Normal Balance</u>	<u>Increase in Account</u>
1. Cash	DR	DR
2. Accounts Receivable	DR	DR
3. Rent Expense	DR	DR
4. Service Revenue	CR	CR
5. Accounts Payable	CR	CR
6. Share Capital—Ord.	CR	CR
7. Dividends	DR	DR
8. Unearned Service Rev.	CR	CR
9. Insurance Expense	DR	DR
10. Notes Payable	CR	CR
11. Retained Earnings	CR	CR

Note: The normal balance is the same as increase in the account.

ILLUSTRATION 2-4
THE RECORDING PROCESS

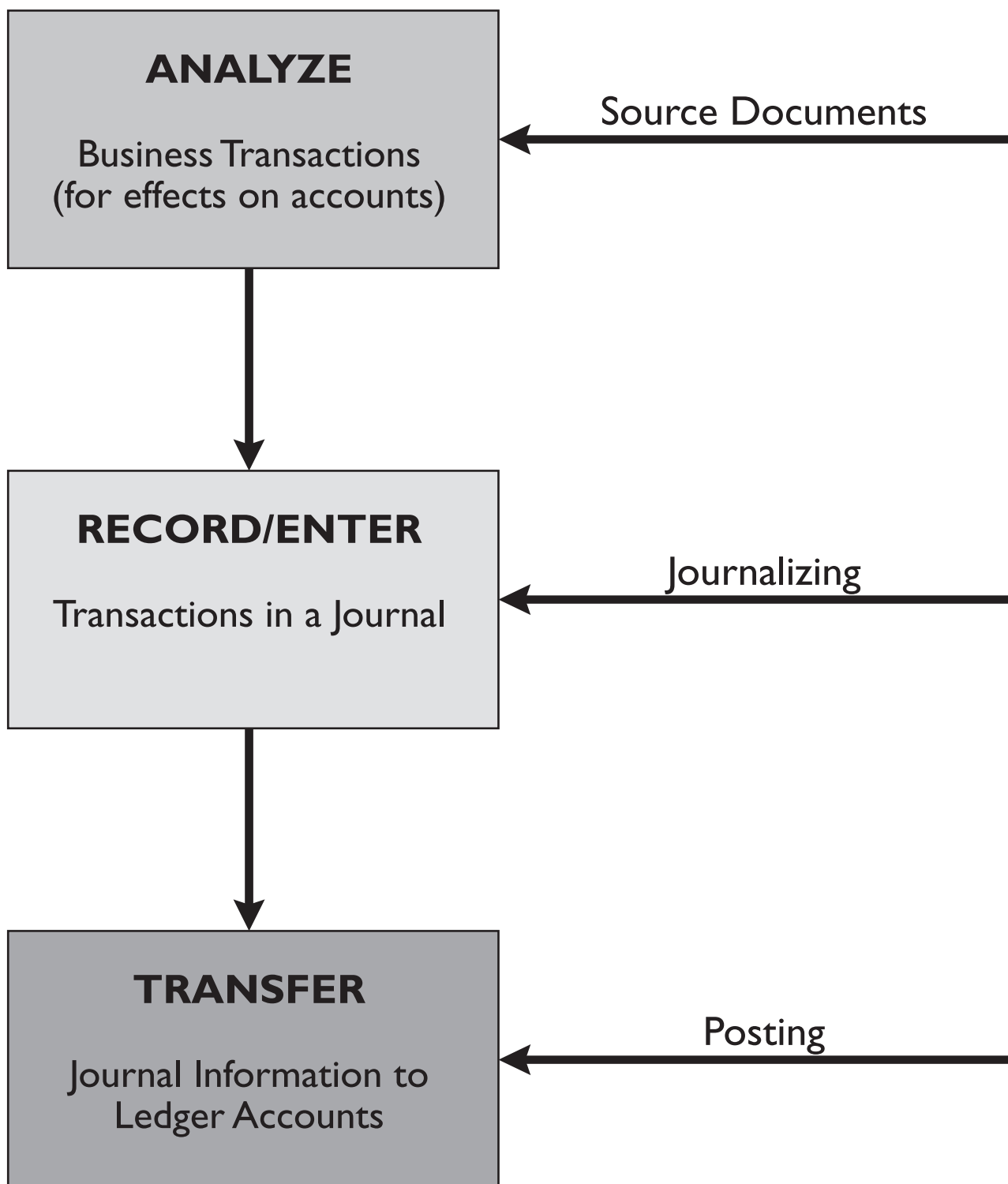


ILLUSTRATION 2-5
JOURNALIZING

General Journal

	Date	Account Titles and Explanation	Ref.	Debit	Credit
1. →	2014 Sept. 1				
2. →		Cash →		15,000	
3. →		Share Capital—Ordinary →			15,000
4. →		(Issued shares for cash)			
5. →					

- Key:
- 1. Enter date in **Date Column**.
 - 2. Enter debit account title(s) at left margin of **Account Titles and Explanation** Column and amounts in **Debit** Column.
 - 3. Enter credit account title(s) [INDENT CREDIT ACCOUNT TITLE(S)] and amounts in **Credit** Column.
 - 4. Enter explanation under account titles.
 - 5. **Ref. Column** is left blank until posting.

ILLUSTRATION 2-6

ANALYZING AND JOURNALIZING TRANSACTIONS

Steps in the Recording Process

Instructions: Analyze and journalize the transactions provided.

- Sept. 1 A shareholder invested \$5,000 in his video services corporation.
 2 The corporation paid \$500 cash for the store rent.
 5 The corporation purchased video supplies of \$1,000.
 9 The corporation purchased video equipment for \$12,000 paying \$2,000 in cash and signed a \$10,000 twenty-four month 9% note payable.
 12 The corporation provided video services and collected cash of \$3,000.
 15 Declared and paid a \$500 cash dividend to the shareholder.

Answer:

General Journal			Jl	
Date	Account Titles and Explanation	Ref.	Debit	Credit
2014 Sept. 1	Cash Share Capital—Ordinary (Shares issued for cash)		5,000	5,000
2	Rent Expense Cash (Paid rent)		500	500
5	Supplies Cash (Paid cash for supplies)		1,000	1,000
9	Equipment Cash Notes Payable (Purchased equipment, paying cash and issuing note payable)		12,000	2,000 10,000
12	Cash Service Revenue (Received cash for services provided)		3,000	3,000
15	Dividends Cash (Declared and paid a cash dividend)		500	500

ILLUSTRATION 2-7 FORMS OF ACCOUNTS AND BALANCES

1. Tabular
2. Account (or T-Account)
3. Three-Column

All forms must show increases and decreases to the account in order to determine the account balances (amounts are assumed).

101

Cash		
9/1	Bal.	+12,000
9/5		+ 500
9/10		– 2,000
9/20		– 1,500
9/30	Bal.	9,000

Cash				
9/1	Bal.	12,000	9/10	2,000
9/5		500	9/20	1,500
9/30	Bal.	9,000		

Three-Column Account Form

Cash

No. 101

Date	Explanation	Ref.	Debit	Credit	Balance
2014 Sept. 1	Balance				12,000
5		Jl	500		12,500
10		Jl		2,000	10,500
20		Jl		1,500	9,000
30	Balance				9,000

POSTING

ILLUSTRATION 2-8
STEPS IN POSTING

Instructions: Post the first two entries recorded in the General Journal.

General Journal

Jl

Date	Account Titles and Explanation	Ref.	Debit	Credit
2014 Sept. 1	Cash Share Capital—Ordinary (Shareholder's investment of cash in business)	101 311	5,000	5,000
2	Rent Expense Cash (Paid rent)	729 101	500	500

Cash

No. 101

Date	Explanation	Ref.	Debit	Credit	Balance
2014 Sept. 1		Jl	5,000		5,000
2		Jl		500	4,500

Share Capital—Ordinary

No. 311

Date	Explanation	Ref.	Debit	Credit	Balance
2014 Sept. 1		Jl		5,000	5,000

Rent Expense

No. 729

Date	Explanation	Ref.	Debit	Credit	Balance
2014 Sept. 2		Jl	500		500

