Chapter 2

Recording Business Transactions

Chapter Overview

The chapter introduces the account and the ledger, and then briefly describes specific asset, liability, and equity accounts. The concept of double-entry bookkeeping and the rules of debit and credit for assets, liabilities, and equity are described. The rules of debit and credit are then expanded to include specific types of equity accounts, and then expanded again to include revenues and expense accounts. The “T-account” is illustrated. The normal balances of accounts are explained. The accounting equation is tied to the rules of debit and credit.

Details of journals, ledgers, and the posting process are presented, including an illustration of a 4-column ledger account with a running balance. A chart of accounts is illustrated. The process of recording transactions (journalizing) is illustrated. A series of entries are analyzed, journalized, and posted to T-accounts in the ledger. The trial balance is defined and illustrated. Some typical accounting errors revealed by a trial balance are described. How the debt ratio is used to evaluate business performance is discussed.

An ethics sidebar helps give students perspective on real world ethical dilemmas. A decisions sidebar helps students see how the debt ratio can be used to make a real world decision. A review highlights the information students should have acquired from the chapter. A summary problem reviews opening accounts, journalizing, posting, and preparing a trial balance. A quick check gives students a chance to assess their knowledge of the chapter learning objectives.

**Learning Objectives**

1. Explain accounts as they relate to the accounting equation and describe common accounts
2. Define debits, credits, and normal account balances using double-entry accounting and T-accounts
3. Record transactions in a journal and post journal entries to the ledger
4. Prepare the trial balance and illustrate how to use the trial balance to prepare financial statements
5. Use the debt ratio to evaluate business performance

**Chapter 2: Teaching Outline**

1) Explain accounts as they relate to the accounting equation and describe common accounts

1. Review the Accounting Equation
2. Review the Following terms and give examples of Common Accounts:
   1. Account
   2. Assets—Exhibit 2-1 Asset Accounts
   3. Liabilities—Exhibit 2-2 Liability Accounts
   4. Equity—Exhibit 2-3 Equity Accounts
3. Chart of Accounts
   1. Exhibit 2-4 Chart of Accounts – Smart Touch Learning
4. Ledger

2) Define debits, credits, and normal account balances using double-entry accounting and T-accounts

1. Double-entry System
2. The T-Account
3. The Accounting Equation and the Rules of Debit and Credit
4. Increases and Decreases in the Accounts and the Normal Account Balances
5. Exhibit 2-5 Rules of Debit and Credit and Normal Balances for Each Account Type

3) Record transactions in a journal and post journal entries to the ledger

1. Define the following terms:
   1. Source Documents
   2. Journal
   3. Posting
2. Exhibit 2-6 Flow of Accounting Data
3. Journalize with 17 Specific Smart Touch Learning Examples
4. The Ledger Accounts After Posting
5. Exhibit 2-7 Smart Touch Learning’s Accounts after Posting Journal Entries in November and December
6. The Four-Column Account: An Alternative to the T-Account
7. Exhibit 2-8 T-Account vs. Four-Column Account
8. Exhibit 2-9 Posting References

4) Prepare the trial balance and illustrate how to use the trial balance to prepare financial statements

1. Preparing Financial Statements from the Trial Balance
2. Exhibit 2-10 Trial Balance
3. Exhibit 2-11 Smart Touch Learning’s Financial Statements
4. Correcting Trial Balance Errors

5) Use the debt ratio to evaluate business performance

Chapter 2: Summary Handout for Students

1. Accounting equation: ASSETS = LIABILITIES + EQUITY
   * Exhibit 2-1 Asset Accounts
   * Exhibit 2-2 Liability Accounts
   * Exhibit 2-3 Equity Accounts
2. Chart of accounts: a list of all the accounts with their account number
3. Ledger: a collection of all the accounts of a business, the changes in those accounts, and their balances
4. Record transactions in the journal using the rules of debit, credit, and double-entry accounting

* Debits = Credits
* Every transaction affects at least two accounts
* Type of account determines whether it increases with a debit or a credit
* Asset, expense, and dividends accounts increase with a debit
* Liability, revenue, and common stock accounts increase with a credit
* The normal balance of an account is on the side of an increase to the account
* Journal entries should have:
  + Date of the transaction
  + Title of the account debited, along with the dollar amount
  + Indented title of the account credited, along with the dollar amount
  + Brief explanation of transaction

1. Post transactions from the journal to the ledger
2. Revenues and expenses affect equity

* Revenues are increases (earned) in equity from providing goods or services to customers
* Expenses are decreases (incurred) in equity through the operation of a business by either using up assets or increasing liabilities (or a combination of both)
* The trial balance lists all the accounts in the ledger with their balances
* Total debits equal total credits

1. Debt Ratio: Total Liabilities/Total Assets

Chapter 2: Lecture Outline Tips: Key Topics

An understanding of Chapter 2 is essential for student success in the remaining financial accounting chapters. Spend adequate time in the beginning with accounting terminology. Accounting is a “foreign” language to many students, and, as true with a real foreign language, you must start with the basics. Students seemingly understand assets and liabilities more easily than equity. An asset can be touched, a liability can be confirmed by looking at an invoice, but equity is conceptual. Equity is the owner's claims to the business assets; what’s left over after liabilities are subtracted from assets. It may be helpful to ask students to attempt to calculate their personal equity. Students may own a car or home that has an outstanding loan or mortgage.

Keep it simple when discussing T-accounts and the rules of debit and credit. Debit means left and credit means right, period. A debit does not mean increase and a credit does not mean decrease. Increases and decreases depend on the account type. Emphasize that **every** entry must balance (debits = credits) and be accurate for the accounting system to generate correct and useful information. An incorrect journal entry that is posted to the right accounts will still produce incorrect information.

An account can only have one balance. Debits and credits within the same account are subtracted to determine the account balance, just like positives and negatives from a mathematical standpoint. The normal balance is the side used to record increases in the account.

When discussing the posting process, inform students to be very careful when transferring amounts to the ledger. It is common for students at this point to reverse a posting, recording a debit as a credit, or vice versa. A debit is placed on the left side and a credit is placed on the right side. If the trial balance doesn’t balance, it is common for students to have reversed a posting.

Lastly, it may be helpful for students to view the accounting system from both ends. The natural process is to journalize, post, and prepare a trial balance. However, once the chapter content is discussed, you can also begin with the trial balance and have students trace back to the ledger and journal to find a specific transaction. They can also get experience doing this when correcting a trial balance that doesn’t balance.

# Chapter 2 Assignment Grid

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Learning Objective** | **Short Exercises**  ***Easy*** | **Exercises**  ***Moderate*** | **Problems (Group A) *Difficult*** | **Problems (Group B) *Difficult*** |
| 1 | 1 | 10, 11, 12 |  |  |
| 2 | 2, 3 | 10, 12, 13 |  |  |
| 3 | 4, 5, 6, 7 | 10, 14, 15, 16, 17, 18, 19, 20, 21, 24 | 29, 30, 31, 32 | 36, 37, 38, 39 |
| 4 | 8 | 10, 22, 23, 24, 25, 26, 27 | 29, 30, 31, 32, 33, 34, 35 | 36, 37, 38, 39, 40, 41, 42 |
| 5 | 9 | 28 | 35 | 42 |

**Other End of Chapter Materials:**

|  |
| --- |
| Continuing Problem P2-43 |
| Practice Set P2-44 |
| Decision Case 2-1 |
| Decision Case 2-2 |
| Ethical Issue 2-1 |
| Fraud Case 2-1 |
| Financial Statement Case 2-1 |
| Team Project 2-1 |
| Communication Activity 2-1 |

#### Answer Key to Chapter 2 Quiz:

|  |  |
| --- | --- |
| 1. B  2. C  3. B  4. C  5. A | 6. A   1. A 2. B 3. A   10. D |

Name Date Section

**CHAPTER 2**

**TEN-MINUTE QUIZ**

***Circle the letter of the best response.***

1. Which sequence correctly summarizes the accounting process?
2. Journalize transactions, prepare a trial balance, post to the accounts
3. Journalize transactions, post to the accounts, prepare a trial balance
4. Prepare a trial balance, journalize transactions, post to the accounts
5. Post to the accounts, journalize transactions, prepare a trial balance
6. The right side of an account is used to record which of the following?
7. Debit or credit, depending on the type of account
8. Increases
9. Credits
10. Debits
11. Suppose Howard Corporation has Accounts receivables of $23,000, Furniture totaling $108,000, and Cash of $68,000. The business has a $94,000 Note payable and owes $52,000 on account. How much is Howard’s owner's equity?
12. $39,000
13. $53,000
14. $146,000
15. $199,000
16. Your business purchased supplies of $5,500 on account. The journal entry to record this transaction is as follows:
17. Supplies 5,500

Accounts receivable 5,500

1. Inventory 5,500

Accounts Payable 5,500

1. Supplies 5,500

Accounts payable 5,500

1. Accounts payable 5,500

Supplies 5,500

1. Which journal entry records your payment for the supplies purchase described in question 4?
2. Accounts payable 5,500

Cash 5,500

1. Cash 5,500

Accounts payable 5,500

1. Cash 5,500

Accounts receivable 5,500

1. Accounts receivable 5,500

Cash 5,500

1. Posting a $5,500 purchase of supplies on account appears as follows:
2. Supplies Accounts payable

5,500 | | 5,500

1. Cash Supplies

| 5,500 5,500 |

1. Supplies Accounts payable

| 5,500 5,500 |

1. Supplies Accounts receivable

5,500 | | 5,500

1. The detailed record of all increases and decreases that have occurred in an individual asset, liability, or equity during a specific period is called
2. an account.
3. a journal.
4. a ledger.
5. a trial balance.
6. Hughes Copies, Inc. recorded a purchase of equipment on account by debiting Equipment and crediting Cash. What will the trial balance show for this error?
7. Too much for cash
8. Too little for cash
9. Too much for liabilities
10. Cannot determine from the data given
11. Which of the following statements is correct?
12. Accounts Payable is increased with a credit.
13. Prepaid Expenses are decreased with a debit.
14. Unearned Revenue is increased with a debit.
15. Rent Expense is increased with a credit.

10. Carter’s, Inc. began the year with total assets of $97,000, liabilities of $75,000, and equity of $22,000. During the year, the business earned revenue of $128,000 and paid expenses of $63,000. Carter’s also paid dividends in cash of $15,000. How would the business record expenses paid of $63,000?

1. Cash 63,000

Expenses 63,000

1. Accounts payable 63,000

Cash 63,000

1. Expenses 63,000

Accounts payable 63,000

1. Expenses 63,000

Cash 63,000