

# CHAPTER 2

## The Recording Process

### ASSIGNMENT CLASSIFICATION TABLE

<u>Study Objectives</u>	<u>Questions</u>	<u>Brief Exercises</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				
2. Define debits and credits and explain how they are used to record business transactions.	2, 3, 4, 5, 6, 7, 8, 9, 14	1, 2, 5	1, 3, 10	1A, 2A, 3A, 5A	1B, 2B, 3B, 5B
3. Identify the basic steps in the recording process.	10, 19	4			
4. Explain what a journal is and how it helps in the recording process.	11, 12, 13, 14, 16	3, 6	2, 4, 6, 7, 8	1A, 2A, 3A, 5A	1B, 2B, 3B, 5B
5. Explain what a ledger is and how it helps in the recording process.	17				
6. Explain what posting is and how it helps in the recording process.	15, 17	7, 8	5, 8	2A, 3A, 5A	2B, 3B, 5B
7. Prepare a trial balance and explain its purposes.	18, 20	9, 10	5, 6, 7, 9, 10	2A, 3A, 4A, 5A	2B, 3B, 4B, 5B

## ASSIGNMENT CHARACTERISTICS TABLE

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



# STUDY OBJECTIVES

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.**
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. (S.O. 1) An **account** is an individual accounting record of increases and decreases in a specific asset, liability, or stockholders' 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. (S.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 stockholders' equity: Common Stock, Retained Earnings, Dividends, Revenues, and Expenses.
7. The effects of debits and credits on the stockholders' equity accounts and the normal balances are:

<u>Accounts</u>	<u>Debits</u>	<u>Credits</u>	<u>Normal Balance</u>
Common Stock	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:

$$\text{Assets} = \text{Liabilities} + \text{Common Stock} + \text{Retained Earnings} - \text{Dividends} + \text{Revenues} - \text{Expenses}$$

## The Recording Process

9. (S.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. (S.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. (S.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 money columns and the balance in the account is determined after each transaction.
15. (S.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 balance sheet accounts and follows with the income statement accounts.

## The Basic Steps

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

<b>Transaction</b>	On September 4, Fesmire Inc. pays \$3,000 cash to a creditor in full payment of the balance due.
<b>Basic analysis</b>	The liability Accounts Payable is decreased \$3,000, and the asset Cash is decreased \$3,000.
<b>Debit-credit analysis</b>	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	1		3,000
	(Paid creditor in full)			

**Posting**

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

**The Trial Balance**

18. (S.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 individual accounting record of increases and decreases in a specific asset, liability, or stockholders' equity item.

An account consists of three parts:

1. The title of the account.
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 term 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, expenses, and the Dividends account are increased by debits and decreased by credits.



2. Liabilities, common stock, 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

The basic steps in the recording process are:

1. Analyze each transaction for its effects on the accounts.
2. Enter the transaction information in a journal (book of original entry).
3. Transfer the journal information to the appropriate accounts in the ledger (book of accounts).

**TEACHING TIP**

**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. Emphasize that practice makes perfect in journalizing.

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 readily compared.
4. A simple entry involves only two accounts (one debit and one credit) whereas a compound 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 stockholders' 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.
2. The ledger should be arranged in the order in which accounts are presented in the financial statements, beginning with the balance sheet accounts.

## F. Posting/Chart of Accounts

1. Posting is the procedure of transferring journal entries to the ledger accounts. Posting accumulates the effects of journalized transactions in the individual 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 balance sheet accounts followed by the 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 to uncover errors in journalizing and posting.
3. It is useful in the preparation of financial statements.

## 20 MINUTE QUIZ

Circle the correct answer.

### True/False

- Assets are increased by debits and liabilities are decreased by credits.  
True      False
  - The Common Stock account is increased by credits.  
True      False
  - An account will have a credit balance if the total debit amounts exceed the total credit amounts.  
True      False
  - The ledger is the entire group of accounts and is referred to as the book of original entry.  
True      False
  - 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
  - Posting should be performed in chronological order—all the debits and credits of one journal entry should be posted before proceeding to the next journal entry.  
True      False
  - $\text{Assets} = \text{liabilities} + \text{common stock} + \text{retained earnings} - \text{dividends} + \text{revenues} - \text{expenses}$  is a correct form of the expanded basic accounting equation.  
True      False
  - In posting, one should enter "J2" in the Post. Ref. Column on page two of the journal.  
True      False
  - When the columns of the trial balance equal each other, it proves no errors occurred in recording and posting.  
True      False
  - 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. Office Equipment.
  - b. Cash.
  - c. Accounts Payable.
  - d. Stockholders' Equity.
  
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. Rent Payable
  - b. Common Stock
  - c. Service Revenue
  - d. Dividends

# ANSWERS TO QUIZ

## True/False

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

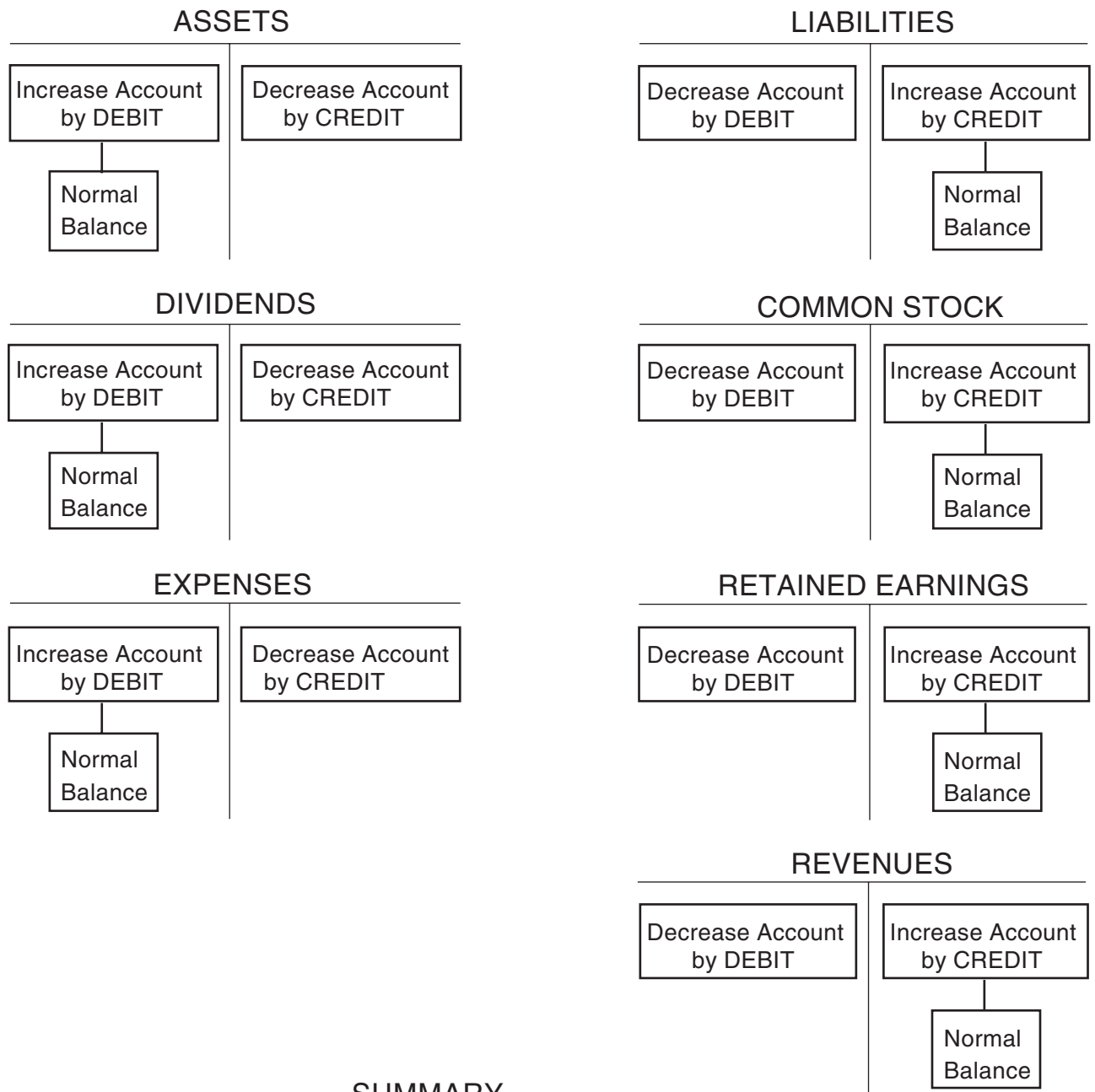
→ (Debit Balance)

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



### SUMMARY

	Debit	Credit
ASSETS	Increase (N)	Decrease
LIABILITIES	Decrease	Increase(N)
COMMON STOCK	Decrease	Increase(N)
RETAINED EARNINGS	Decrease	Increase(N)
DIVIDENDS	Increase(N)	Decrease
REVENUES	Decrease	Increase(N)
EXPENSES	Increase(N)	Decrease

**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).

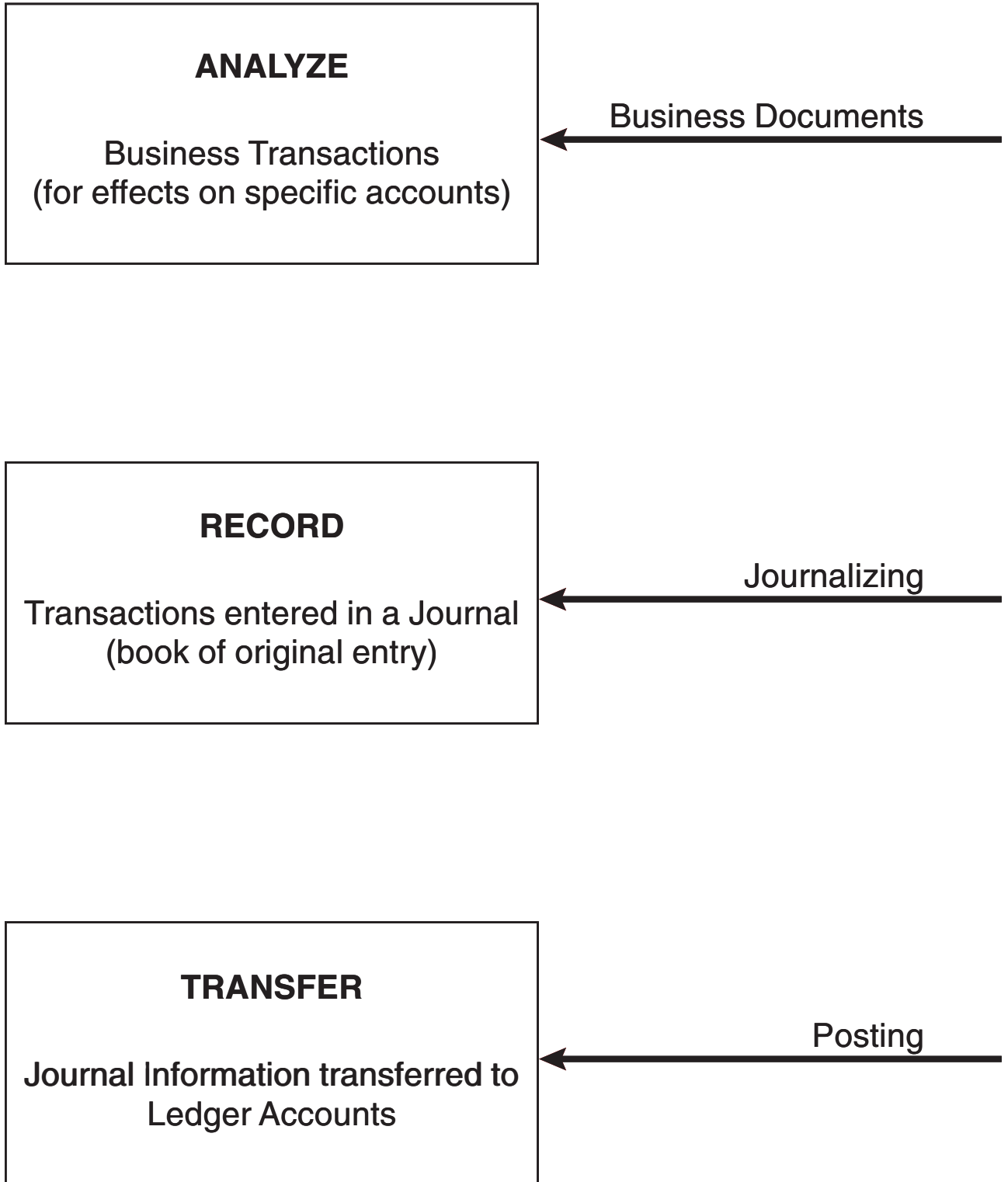
<u>Account</u>	<u>Normal Balance</u>	<u>Increase in Account</u>
1. Cash (EXAMPLE)	DR	DR
2. Accounts Receivable	_____	_____
3. Rent Expense	_____	_____
4. Service Revenue	_____	_____
5. Accounts Payable	_____	_____
6. Common Stock	_____	_____
7. Dividends	_____	_____
8. Unearned Revenue	_____	_____
9.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

Note: The normal balance is 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. →	2006 Sept. 1				
2. →		Cash		15,000	
3. →		Common Stock			15,000
4. →		(To record sale of stock)			
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 Stockholder 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 stockholders.

Answer:

### General Journal

Jl

Date	Account Titles and Explanation	Ref.	Debit	Credit
2006 Sept. 1	Cash Common Stock (Shares of stock 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 notes payable)		12,000	2,000 10,000
12	Cash Service Revenue (Collected 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.	<u>9,000</u>

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
2006					
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 JI

Date	Account Titles and Explanation	Ref.	Debit	Credit
2006 Sept. 1	Cash Common Stock (Issued shares of stock for cash)	101 340	5,000	5,000
2	Rent Expense Cash (Paid rent)	560 101	500	500

Cash No. 101

Date	Account Titles and Explanation	Ref.	Debit	Credit	Balance
2006 Sept. 1		Jl	5,000		5,000
2		Jl		500	4,500

Common Stock No. 340

Date	Account Titles and Explanation	Ref.	Debit	Credit	Balance
2006 Sept. 1		Jl		5,000	5,000

Rent Expense No. 560

Date	Account Titles and Explanation	Ref.	Debit	Credit	Balance
2006 Sept. 2		Jl	500		500

