Before studying this chapter, you should know or, if necessary, review:

- What are assets, liabilities, owner’s capital, owner’s drawings, revenues, and expenses. (Ch. 1, pp. 12–13)
- Why assets equal liabilities plus owner’s equity. (Ch. 1, p. 12)
- What transactions are and how they affect the basic accounting equation. (Ch. 1, pp. 14–20)
No Such Thing as a Perfect World

When she got a job doing the accounting for Forster's Restaurants, Tanis Anderson had almost finished her business administration degree at Simon Fraser University. But even after Tanis completed her degree requirements, her education still continued—this time, in the real world.

Tanis's responsibilities include paying the bills, tracking food and labor costs, and managing the payroll for The Mug and Musket, a popular destination restaurant in Surrey, British Columbia. “My title is Director of Finance,” she laughs, “but really that means I take care of whatever needs doing!”

The use of judgment is a big part of the job. As Tanis says, “I learned all the fundamentals in my business classes, but school prepares you for a perfect world, and there is no such thing.”

She feels fortunate that her boss understands her job is a learning experience as well as a responsibility. “Sometimes he’s let me do something he knew perfectly well was a mistake so I can learn something through experience,” she admits.

To help others gain the benefits of her real-world learning, Tanis is always happy to help students in the area who want to use Forster's as the subject of a project or report. “It's the least I can do,” she says.

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.
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.
In Chapter 1, we analyzed business transactions in terms of the accounting equation. The cumulative effects of these transactions were presented in tabular form. Imagine a restaurant and gift shop such as The Mug and Musket using the same tabular format as Softbyte to keep track of every one of its transactions. In a single day, this restaurant and gift shop engages in hundreds of business transactions. To record each transaction this way would be impractical, expensive, and unnecessary. Instead, a set of procedures and records are used to keep track of transaction data more easily.

This chapter introduces and illustrates these basic procedures and records. The content and organization of Chapter 2 are as follows.

### The Recording Process

- **Debit and credits**
- **Expansion of basic equation**

### The Account

An **account** is an individual accounting record of increases and decreases in a specific asset, liability, or owner’s equity item. For example, Softbyte (the company discussed in Chapter 1) would have separate accounts for Cash, Accounts Receivable, Accounts Payable, Service Revenue, Salaries Expense, and so on. In its simplest form, an account consists of three parts: (1) the title of the account, (2) a left or debit side, and (3) a right or credit side. Because the alignment of these parts of an account resembles the letter T, it is referred to as a **T account**. The basic form of an account is shown in Illustration 2-1.

**Illustration 2-1**

Basic form of account

<table>
<thead>
<tr>
<th>Title of Account</th>
</tr>
</thead>
<tbody>
<tr>
<td>Left or debit side</td>
</tr>
<tr>
<td>Debit balance</td>
</tr>
</tbody>
</table>

**STUDY OBJECTIVE 1**

Explain what an account is and how it helps in the recording process.
The T account is a standard shorthand in accounting that helps make clear the effects of transactions on individual accounts. We will use it often throughout this book to explain basic accounting relationships. (Note that when we are referring to a specific account, we capitalize its name.)

Debits and Credits

Today, the term debit indicates left, and credit indicates right. They are commonly abbreviated as Dr. for debit and Cr. for credit. These terms come from Latin words that originally meant “debtor” and “creditor.” Today they are directional signals: They indicate which side of a T account a number will be recorded on. Entering an amount on the left side of an account is called debiting the account; making an entry on the right side is crediting the account.

The procedure of having debits on the left and credits on the right is an accounting custom, or rule (like the custom of driving on the right-hand side of the road in the United States). This rule applies to all accounts. When the totals of the two sides are compared, an account will have a debit balance if the total of the debit amounts exceeds the credits. An account will have a credit balance if the credit amounts exceed the debits.

The recording of debits and credits in an account is shown in Illustration 2-2 for the cash transactions of Softbyte. The data are taken from the cash column of the tabular summary in Illustration 1-8.

In the tabular summary every positive item represents a receipt of cash; every negative amount represents a payment of cash. Notice that in the account form the increases in cash are recorded as debits, and the decreases in cash are recorded as credits. Having increases on one side and decreases on the other helps in determining the total of each side of the account as well as the overall balance in the account. The account balance, a debit of $8,050, indicates that Softbyte has had $8,050 more increases than decreases in cash.

Debit and Credit Procedure

In Chapter 1 you learned the effect of a transaction on the basic accounting equation. Remember that each transaction must affect two or more accounts to keep the basic accounting equation in balance. In other words, for each transaction debits must equal credits in the accounts. The equality of debits and credits provides the basis for the double-entry system of recording transactions.

Under the double-entry system the dual (two-sided) effect of each transaction is recorded in appropriate accounts. This universally used system provides a logical

1These terms and their abbreviations come from the Latin words debere (Dr.) and credere (Cr.).
method for recording transactions. It also offers a means of proving the accuracy of the recorded amounts. If every transaction is recorded with equal debits and credits, then the sum of all the debits to the accounts must equal the sum of all the credits.

The double-entry system for determining the equality of the accounting equation is much more efficient than the plus/minus procedure used in Chapter 1. There, it was necessary after each transaction to compare total assets with total liabilities and owner’s equity to determine the equality of the two sides of the accounting equation.

**ASSETS AND LIABILITIES.** We know that both sides of the basic equation \( \text{Assets} = \text{Liabilities} + \text{Owner’s equity} \) must be equal. It follows that increases and decreases in assets and liabilities must be recorded opposite from each other. In Illustration 2-2, increases in cash—an asset—were entered on the left side, and decreases in cash were entered on the right side. Therefore, increases in liabilities must be entered on the right or credit side, and decreases in liabilities must be entered on the left or debit side. The effects that debits and credits have on assets and liabilities are summarized as follows.

<table>
<thead>
<tr>
<th>Debits</th>
<th>Credits</th>
</tr>
</thead>
<tbody>
<tr>
<td>Increase assets</td>
<td>Decrease assets</td>
</tr>
<tr>
<td>Decrease liabilities</td>
<td>Increase liabilities</td>
</tr>
</tbody>
</table>

Debits to a specific asset account should exceed the credits to that account. Credits to a liability account should exceed debits to that account. The **normal balance of an account is on the side where an increase in the account is recorded.** Thus, asset accounts normally show debit balances, and liability accounts normally show credit balances. The normal balances can be diagrammed as follows.

<table>
<thead>
<tr>
<th>Assets</th>
<th>Liabilities</th>
</tr>
</thead>
<tbody>
<tr>
<td>Debit for increase</td>
<td>Credit for decrease</td>
</tr>
<tr>
<td>Debit for decrease</td>
<td>Credit for increase</td>
</tr>
</tbody>
</table>

Knowing the normal balance in an account may help you trace errors. For example, a credit balance in an asset account such as Land or a debit balance in a liability account such as Wages Payable would indicate recording errors. Occasionally, an abnormal balance may be correct. The Cash account, for example, will have a credit balance when a company has overdrawn its bank balance (i.e., written a “bad” check).

**OWNER’S EQUITY.** As indicated in Chapter 1, owner’s equity is increased by owner’s investments and by revenues. It is decreased by owner’s drawings and by expenses. In a double-entry system, accounts are kept for each of these types of transactions, as explained below.

**Owner’s Capital.** Investments by owners are credited to the Owner’s Capital account. Credits increase this account and debits decrease it. For example, when cash
is invested in the business, Cash is debited (increased) and Owner’s Capital is credited (increased). When the owner’s investment in the business is reduced, Owner’s Capital is debited (decreased).

The rules of debit and credit for the Owner’s Capital account are stated as follows.

<table>
<thead>
<tr>
<th>Debits</th>
<th>Credits</th>
</tr>
</thead>
<tbody>
<tr>
<td>Decrease Owner’s Capital</td>
<td>Increase Owner’s Capital</td>
</tr>
</tbody>
</table>

The normal balance in this account can be diagrammed as follows.

**Illustration 2-5**
Debit and credit effects—Owner’s Capital

**Owner’s Drawing.** An owner may withdraw cash or other assets for personal use. Withdrawals could be debited directly to Owner’s Capital to indicate a decrease in owner’s equity. However, it is preferable to establish a separate account, called the Owner’s Drawing account. This separate account makes it easier to determine total withdrawals for each accounting period. **The drawing account decreases owner’s equity. It is not an income statement account like revenues and expenses.** Owner’s Drawing is increased by debits and decreased by credits. Normally, the drawing account will have a debit balance.

The rules of debit and credit for the drawing account are stated as follows.

<table>
<thead>
<tr>
<th>Debits</th>
<th>Credits</th>
</tr>
</thead>
<tbody>
<tr>
<td>Increase Owner’s Drawing</td>
<td>Decrease Owner’s Drawing</td>
</tr>
</tbody>
</table>

The normal balance can be diagrammed as follows.

**Revenues and Expenses.** Remember that the ultimate purpose of earning revenues is to benefit the owner(s) of the business. When revenues are earned, owner’s
equity is increased. Therefore, the effect of debits and credits on revenue accounts is the same as their effect on Owner's Capital. Revenue accounts are increased by credits and decreased by debits.

Expenses have the opposite effect: expenses decrease owner's equity. Since expenses are the negative factor in computing net income, and revenues are the positive factor, it is logical that the increase and decrease sides of expense accounts should be the reverse of revenue accounts. Thus, expense accounts are increased by debits and decreased by credits.

The effect of debits and credits on revenues and expenses can be stated as follows.

<table>
<thead>
<tr>
<th>Debits</th>
<th>Credits</th>
</tr>
</thead>
<tbody>
<tr>
<td>Decrease revenues</td>
<td>Increase revenues</td>
</tr>
<tr>
<td>Increase expenses</td>
<td>Decrease expenses</td>
</tr>
</tbody>
</table>

Credits to revenue accounts should exceed debits, and debits to expense accounts should exceed credits. Thus, revenue accounts normally show credit balances and expense accounts normally show debit balances. The normal balances can be diagrammed as follows.

**Expansion of the Basic Equation**
You have already learned the basic accounting equation. Illustration 2-11 expands this equation to show the accounts that comprise owner's equity. In addition, the debit/credit rules and effects on each type of account are illustrated. Study this diagram carefully. It will help you understand the fundamentals of the double-entry system. Like the basic equation, the expanded basic equation must be in balance (total debits equal total credits).
In practically every business, 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).

Although it is possible to enter transaction information directly into the accounts without using a journal or ledger, few businesses do so.

The sequence of events in the recording process begins with the transaction. Evidence of the transaction is provided by a business document, such as a sales slip, a check, a bill, or a cash register tape. This evidence is analyzed to determine the effects of the transaction on specific accounts. The transaction is then entered in the
The basic steps in the recording process occur repeatedly. The analysis of transactions was illustrated in Chapter 1. Further examples will be given in this and later chapters. The other steps in the recording process are explained in the next sections.

**Accounting in Action**

While most companies record transactions very carefully, the reality is that sometimes even the most careful companies make mistakes in their accounting records. For example, Hanover Compressor at one time announced that it was restating its financial results for an error that had been made in each of the previous five years. It had accidentally omitted the cost of compressors manufactured at one of its plants, causing the cost of its inventory to be misstated. Bank One Corporation was fined $1.8 million by banking regulators because regulators felt that its accounting system was unreliable and caused the bank to violate certain minimum banking requirements. Finally, before a major overhaul of its accounting system, the financial records of Waste Management Company were in such disarray that of the company’s 57,000 employees, 10,000 were receiving pay slips that were in error.

**The Journal**

Transactions are initially recorded in chronological order in journals before being transferred to the accounts. Thus, the journal is referred to as the book of original entry. For each transaction the journal shows the debit and credit effects on specific accounts. (In a computerized system, “journals” are now kept as files, and “accounts” are recorded in computer databases.)

Companies may use various kinds of journals, but every company has the most basic form of journal, a general journal. Typically, a general journal has spaces for dates, account titles and explanations, references, and two amount columns. Whenever we use the term journal in this textbook without a modifying adjective, we mean the general journal.

The journal makes several significant contributions to the recording process:

1. It discloses in one place the complete effects of a transaction.
2. It provides a chronological record of transactions.
3. It helps to prevent or locate errors because the debit and credit amounts for each entry can be readily 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, and (3) a brief explanation of the transaction.

Illustration 2-13 shows the technique of journalizing, using the first two transactions of Softbyte. These transactions were: September 1, Ray Neal invested $15,000 cash in the business, and computer equipment was purchased for $7,000 cash. The numbered J1 indicates that these two entries are recorded on the first page of the journal. The standard form and content of journal entries are as follows.

**General Journal**

<table>
<thead>
<tr>
<th>Date</th>
<th>Account Titles and Explanation</th>
<th>Ref.</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005 Sept. 1</td>
<td>Cash</td>
<td></td>
<td>15,000</td>
<td>15,000</td>
</tr>
<tr>
<td></td>
<td>R. Neal, Capital</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(Owner's investment of cash in business)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1</td>
<td>Computer Equipment</td>
<td></td>
<td>7,000</td>
<td>7,000</td>
</tr>
<tr>
<td></td>
<td>Cash</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(Purchase of equipment for cash)</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

1. The date of the transaction is entered in the Date column. The date recorded should include the year, month, and day of the transaction.
2. The debit account title (that is, the account to be debited) is entered first at the extreme left margin of the column headed “Account Titles and Explanation,” and the amount of the debit is recorded in the Debit column.
3. The credit account title (that is, the account to be credited) is indented and entered on the next line in the column headed “Account Titles and Explanation,” and the amount of the credit is recorded in the Credit column.
4. A brief explanation of the transaction is given on the line below the credit account title.
5. A space is left between journal entries. The blank space separates individual journal entries and makes the entire journal easier to read.
6. The column titled Ref. (which stands for reference) is left blank when the journal entry is made. This column is used later when the journal entries are transferred to the ledger accounts. At that time, the ledger account number is placed in the Reference column to indicate where the amount in the journal entry was transferred.

It is important to use correct and specific account titles in journalizing. Since most accounts appear later in the financial statements, wrong account titles lead to incorrect financial statements. Some flexibility exists initially in selecting account titles. The main criterion is that each title must appropriately describe the content of the account. For example, the account title used for the cost of delivery trucks may be Delivery Equipment, Delivery Trucks, or Trucks. Once a company chooses the specific title to use, all later transactions involving the account should be recorded under that account title.\(^2\)

If an entry involves only two accounts, one debit and one credit, it is considered a simple entry. Some transactions, however, require more than two accounts in jour-

\(^2\)In homework problems, when specific account titles are given, they should be used. When account titles are not given, you may select account titles that identify the nature and content of each account. The account titles used in journalizing should not contain explanations such as Cash Paid or Cash Received.
nalizing. When three or more accounts are required in one journal entry, the entry is referred to as a compound entry. To illustrate, assume that on July 1, Butler Company purchases a delivery truck costing $14,000 by paying $8,000 cash and the balance on account (to be paid later). The compound entry is as follows.

<table>
<thead>
<tr>
<th>Date</th>
<th>Account Titles and Explanation</th>
<th>Ref.</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005 July 1</td>
<td>Delivery Equipment</td>
<td></td>
<td>14,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Cash</td>
<td></td>
<td>8,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Accounts Payable</td>
<td></td>
<td>6,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(Purchased truck for cash with balance on account)</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

In a compound entry, the total debit and credit amounts must be equal. Also, the standard format requires that all debits be listed before the credits.

**B E F O R E Y O U G O O N . . .**

**Review It**
1. What is the sequence of the steps in the recording process?
2. What contribution does the journal make to the recording process?
3. What is the standard form and content of a journal entry made in the general journal?

**Do It**
In establishing her beauty salon, Hair It Is, Kate Browne engaged in the following activities:

1. Opened a bank account in the name of Hair It Is and deposited $20,000 of her own money in this account as her initial investment.
2. Purchased equipment on account (to be paid in 30 days) for a total cost of $4,800.
3. Interviewed three persons for the position of beautician.

In what form (type of record) should Kate record these three activities? Prepare the entries to record the transactions.

**ACTION PLAN**
- Understand which activities need to be recorded and which do not. Any that have economic effects should be recorded in a journal.
- Analyze the effects of transactions on asset, liability, and owner’s equity accounts.

**SOLUTION** Each transaction that is recorded is entered in the general journal. The three activities would be recorded as follows.

1. Cash
   K. Browne, Capital
   (Owner’s investment of cash in business)
   | 20,000 |
   | 20,000 |
2. Equipment
   Accounts Payable
   (Purchase of equipment on account)
   | 4,800 |
   | 4,800 |
3. No entry because no transaction has occurred.

Related exercise material: BE2-3, BE2-5, BE2-6, E2-2, E2-4, E2-6, E2-7, and E2-8.
The ledger should be arranged in the order in which accounts are presented in the financial statements, beginning with the balance sheet accounts. First in order are the asset accounts, followed by liability accounts, owner’s capital, owner’s drawing, revenues, and expenses. Each account is numbered for easier identification.

The ledger provides management with the balances in various accounts. For example, the Cash account shows the amount of cash that is available to meet current obligations. Amounts due from customers can be found by examining Accounts Receivable, and amounts owed to creditors can be found by examining Accounts Payable.

The entire group of accounts maintained by a company is called the ledger. The ledger keeps in one place all the information about changes in specific account balances.

Companies may use various kinds of ledgers, but every company has a general ledger. A general ledger contains all the assets, liabilities, and owner’s equity accounts, as shown in Illustration 2-15. A business can use a looseleaf binder or card file for the ledger. Each account is kept on a separate sheet or card. Whenever we use the term ledger in this textbook without a modifying adjective, we mean the general ledger.

The ledger should be arranged in the order in which accounts are presented in the financial statements, beginning with the balance sheet accounts. First in order are the asset accounts, followed by liability accounts, owner’s capital, owner’s drawing, revenues, and expenses. Each account is numbered for easier identification.

The ledger provides management with the balances in various accounts. For example, the Cash account shows the amount of cash that is available to meet current obligations. Amounts due from customers can be found by examining Accounts Receivable, and amounts owed to creditors can be found by examining Accounts Payable.

In his autobiography Sam Walton described the double-entry accounting system he began the WalMart empire with: “We kept a little pigeonhole on the wall for the cash receipts and paperwork of each [Wal-Mart] store. I had a blue binder ledger book for each store. When we added a store, we added a pigeonhole. We did this at least up to twenty stores. Then once a month, the bookkeeper and I would enter the merchandise, enter the sales, enter the cash, and balance it.”


Standard Form of Account
The simple T-account form used in accounting textbooks is often very useful for illustration purposes. However, in practice, the account forms used in ledgers are
Steps in the Recording Process

much more structured. A widely used form is shown in Illustration 2-16, using assumed data from a cash account.

<table>
<thead>
<tr>
<th>Cash</th>
<th>No. 101</th>
</tr>
</thead>
<tbody>
<tr>
<td>Date</td>
<td>Explanation</td>
</tr>
<tr>
<td>2005 June 1</td>
<td></td>
</tr>
<tr>
<td>2</td>
<td></td>
</tr>
<tr>
<td>9</td>
<td></td>
</tr>
<tr>
<td>17</td>
<td></td>
</tr>
<tr>
<td>20</td>
<td></td>
</tr>
<tr>
<td>30</td>
<td></td>
</tr>
</tbody>
</table>

This form is often called the three-column form of account because it has three money columns—debit, credit, and balance. The balance in the account is determined after each transaction. Note that the explanation space and reference columns are used to provide special information about the transaction.

Posting

The procedure of transferring journal entries to the ledger accounts is called posting. Posting involves the following steps.

1. In the ledger, enter in the appropriate columns of the account(s) debited the date, journal page, and debit amount shown in the journal.
2. In the reference column of the journal, write the account number to which the debit amount was posted.
3. In the ledger, enter in the appropriate columns of the account(s) credited the date, journal page, and credit amount shown in the journal.
4. In the reference column of the journal, write the account number to which the credit amount was posted.

These four steps are diagrammed in Illustration 2-17 (on page 56) using the first journal entry of Softbyte. The boxed numbers indicate the sequence of the steps.

Posting should be performed in chronological order. That is, all the debits and credits of one journal entry should be posted before proceeding to the next journal entry. Postings should be made on a timely basis to ensure that the ledger is up to date.

The reference column in the journal serves several purposes. The numbers in this column indicate the entries that have been posted. After the last entry has been posted, this column should be scanned to see that all postings have been made.

The reference column of a ledger account indicates the journal page from which the transaction was posted. The explanation space of the ledger account is used

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3 In homework problems, it will be permissible to journalize all transactions before posting any of the journal entries.
Chart of Accounts

The number and type of accounts used differ for each enterprise. The number of accounts depends on the amount of detail desired by management. For example, the management of one company may want one account for all types of utility expense. Another may keep separate expense accounts for each type of utility, such as gas, electricity, and water. Similarly, a single proprietorship like Softbyte will have fewer accounts than a corporate giant like *Ford Motor Company*. Softbyte may be able to manage and report its activities in twenty to thirty accounts, while Ford requires thousands of accounts to keep track of its worldwide activities.

Most companies have a **chart of accounts** that lists the accounts and the account numbers that identify their location in the ledger. The numbering system used to identify the accounts usually starts with the balance sheet accounts and follows with the income statement accounts.

In this and the next two chapters, we will be explaining the accounting for the proprietorship Pioneer Advertising Agency (a service enterprise). Accounts 101–199 indicate asset accounts; 200–299 indicate liabilities; 301–350 indicate owner’s equity accounts; 400–499, revenues; 601–799, expenses; 800–899, other revenues; and 900–999, other expenses.
The chart of accounts for Pioneer Advertising Agency (C. R. Byrd, owner) is shown in Illustration 2-18. Accounts shown in red are used in this chapter; accounts shown in black are explained in later chapters.

You will notice that there are gaps in the numbering system of the chart of accounts for Pioneer Advertising. Gaps are left to permit the insertion of new accounts as needed during the life of the business.

Illustrations 2-19 through 2-28 show the basic steps in the recording process, using the October transactions of the Pioneer Advertising Agency. Its accounting period is a month. A basic analysis and a debit-credit analysis precede the journalizing and posting of each transaction. For simplicity, the T-account form is used in the illustrations instead of the standard account form.

Study the transaction analyses in Illustrations 2-19 through 2-28 carefully. The purpose of transaction analysis is first to identify the type of account involved, and then to determine whether a debit or a credit to the account is required. You should always perform this type of analysis before preparing a journal entry. Doing so will help you understand the journal entries discussed in this chapter as well as more complex journal entries to be described in later chapters.

Keep in mind that every journal entry affects one or more of the following items: assets, liabilities, owner’s capital, owner’s drawing, revenues, or expenses. By becoming skilled at transaction analysis, you will be able to recognize quickly the impact of any transaction on these six items.
CHAPTER 2  The Recording Process

Illustration 2-19  Investment of cash by owner

Transaction  October 1, C. R. Byrd invests $10,000 cash in an advertising venture to be known as the Pioneer Advertising Agency.

Basic Analysis  The asset Cash is increased $10,000, and 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.

Journal Entry  Oct. 1  10,000
Cash 101

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

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

HELPFUL HINT
To correctly record a transaction, you must carefully analyze the event and translate that analysis into debit and credit language.

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 2-20  Purchase of office equipment

Transaction  October 1, office equipment costing $5,000 is purchased by signing a 3-month, 12%, $5,000 note payable.

Basic Analysis  The asset Office Equipment is increased $5,000, and 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.

Journal Entry  Oct. 1  5,000
Office Equipment 157

Oct. 1  5,000
Notes Payable 200

Posting  Oct. 1 5,000  Notes Payable 200
Oct. 1 5,000
October 2, a $1,200 cash advance is received from R. Knox, a client, for advertising services that are expected to be completed by December 31.

The asset Cash is increased $1,200; the liability Unearned Revenue is increased $1,200 because the service has not been provided yet. That is, when an advance payment is received, an unearned revenue (a liability) should be recorded in order to recognize the obligation that exists. Note also that although many liabilities have the word “payable” in their title, unearned revenue is considered a liability even though the word payable is not used.

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

The expense Rent is increased $900 because the payment pertains only to the current month; the asset Cash is decreased $900.
CHAPTER 2 The Recording Process

Illustration 2-23
Payment for insurance

October 4, $600 is paid for a one-year insurance policy that will expire next year on September 30.

The asset Prepaid Insurance is increased $600 because the payment extends to more than the current month; the asset Cash is decreased $600. Note that payments of expenses that will benefit more than one accounting period are identified as prepaid expenses or prepayments. When a payment is made, an asset account is debited in order to show the service or benefit that will be received in the future.

Illustration 2-24
Purchase of supplies on credit

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

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

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.)

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

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

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

Illustration 2-25
Hiring of employees

Illustration 2-26
Withdrawal of cash by owner
CHAPTER 2  The Recording Process

Illustration 2-27
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.

Journal Entry

Posting

Oct. 26
Salaries Expense
Cash
(Paid salaries to date)

Oct. 3
900
4
600
20
500
26
4,000

Oct. 26
4,000

Oct. 1
10,000
2
1,200

Oct. 26
10,000

Illustration 2-28
Receipt of cash for services provided

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

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

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

Journal Entry

Posting

Oct. 31
Cash
Service Revenue
(Received cash for services provided)

Oct. 31
10,000

Oct. 1
10,000
2
1,200
31
10,000

Oct. 31
10,000

Oct. 1
10,000

Oct. 31
10,000

TEACHING HELP
You could mention that journals, posting, ledgers, etc. give the impression that accounting can be boring. Emphasize that computerization now handles much of the manual work, and secondly that accounting puts you in the center of the action because you learn about the entire business very quickly. In short, accounting is popular because it provides an opportunity to see how business really works.
E-business is having a tremendous impact on how companies share information within the company, and with people outside the company, such as suppliers, creditors, and investors. A new type of software, Extensible Markup Language (XML), is enabling the creation of a universal way to exchange data.

An organization called XBRL.org is using XML to develop an internationally accepted reporting format called the Extensible Business Reporting Language (XBRL). The organization is comprised of representatives from industry, accounting firms, investment houses, bankers, regulators, and others. The goal of this organization is to establish a framework that “the global business information supply chain will use to create, exchange, and analyze financial reporting information including, but not limited to, regulatory filings such as annual and quarterly financial statements, general ledger information, and audit schedules.”

Source: www.XBRL.org.

**BEFORE YOU GO ON...**

**Review It**
1. How does journalizing differ from posting?
2. What is the purpose of (a) the ledger and (b) a chart of accounts?

**Do It**
Kate Brown recorded the following transactions in a general journal during the month of March.

<table>
<thead>
<tr>
<th>Description</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>2,280</td>
<td></td>
</tr>
<tr>
<td>Service Revenue</td>
<td></td>
<td>2,280</td>
</tr>
<tr>
<td>Wages Expense</td>
<td>400</td>
<td></td>
</tr>
<tr>
<td>Cash</td>
<td></td>
<td>400</td>
</tr>
<tr>
<td>Utilities Expense</td>
<td>92</td>
<td></td>
</tr>
<tr>
<td>Cash</td>
<td></td>
<td>92</td>
</tr>
</tbody>
</table>

Post these entries to the Cash account of the general ledger to determine the ending balance in cash. The beginning balance in cash on March 1 was $600.

**ACTION PLAN**
- Recall that posting involves transferring the journalized debits and credits to specific accounts in the ledger.
- Determine the ending balance by netting the total debits and credits.

**SOLUTION**

<table>
<thead>
<tr>
<th>Date</th>
<th>Cash</th>
</tr>
</thead>
<tbody>
<tr>
<td>3/1</td>
<td>600</td>
</tr>
<tr>
<td></td>
<td>400</td>
</tr>
<tr>
<td>2,280</td>
<td></td>
</tr>
<tr>
<td>92</td>
<td></td>
</tr>
<tr>
<td>3/31</td>
<td>Bal.</td>
</tr>
<tr>
<td></td>
<td>2,388</td>
</tr>
</tbody>
</table>

Related exercise material: *BE2-7, BE2-8, E2-5, and E2-8.*
Summary Illustration of Journalizing and Posting
The journal for Pioneer Advertising Agency for October is shown in Illustration 2-29. The ledger is shown in Illustration 2-30, on page 65, with all balances in color.

**Illustration 2-29**
General journal entries

<table>
<thead>
<tr>
<th>Date</th>
<th>Account Titles and Explanation</th>
<th>Ref.</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Oct. 1</td>
<td>C. R. Byrd, Capital (Owner's investment of cash in business)</td>
<td>101</td>
<td>10,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>301</td>
<td>10,000</td>
<td></td>
</tr>
<tr>
<td>1</td>
<td>Office Equipment Notes Payable (Issued 3-month, 12% note for office</td>
<td>157</td>
<td>5,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>equipment)</td>
<td>200</td>
<td>5,000</td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>Cash Unearned Revenue (Received cash for future services)</td>
<td>101</td>
<td>1,200</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>209</td>
<td>1,200</td>
<td></td>
</tr>
<tr>
<td>3</td>
<td>Rent Expense Cash (Paid October rent)</td>
<td>729</td>
<td>900</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>101</td>
<td>900</td>
<td></td>
</tr>
<tr>
<td>4</td>
<td>Prepaid Insurance Cash (Paid one-year policy; effective date</td>
<td>130</td>
<td>600</td>
<td></td>
</tr>
<tr>
<td></td>
<td>October 1)</td>
<td>101</td>
<td>600</td>
<td></td>
</tr>
<tr>
<td>5</td>
<td>Advertising Supplies Accounts Payable (Purchased supplies on</td>
<td>126</td>
<td>2,500</td>
<td></td>
</tr>
<tr>
<td></td>
<td>account from Aero Supply)</td>
<td>201</td>
<td>2,500</td>
<td></td>
</tr>
<tr>
<td>20</td>
<td>C. R. Byrd, Drawing Cash (Withdrawn cash for personal use)</td>
<td>306</td>
<td>500</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>101</td>
<td>500</td>
<td></td>
</tr>
<tr>
<td>26</td>
<td>Salaries Expense Cash (Paid salaries to date)</td>
<td>726</td>
<td>4,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>101</td>
<td>4,000</td>
<td></td>
</tr>
<tr>
<td>31</td>
<td>Cash Service Revenue (Received cash for services provided)</td>
<td>101</td>
<td>10,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>400</td>
<td>10,000</td>
<td></td>
</tr>
</tbody>
</table>
STUDY OBJECTIVE 7
Prepare a trial balance and explain its purposes.

**The Trial Balance**

A trial balance is a list of accounts and their balances at a given time. Customarily, a trial balance is prepared at the end of an accounting period. The accounts are listed in the order in which they appear in the ledger; debit balances are listed in the left column and credit balances in the right column.

The primary purpose of a trial balance is to prove (check) that the debits equal the credits after posting. In other words, the sum of the debit account balances in the trial balance should equal the sum of the credit account balances. If the debits and credits do not agree, the trial balance can be used to uncover errors in journalizing and posting. In addition, it is useful in the preparation of financial statements, as will be explained in the next two chapters.
The steps for preparing a trial balance are:
1. List the account titles and their balances.
2. Total the debit and credit columns.
3. Prove the equality of the two columns.

The trial balance prepared from Pioneer Advertising’s ledger is shown below.

<table>
<thead>
<tr>
<th>Account</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>$15,200</td>
<td></td>
</tr>
<tr>
<td>Advertising Supplies</td>
<td>2,500</td>
<td></td>
</tr>
<tr>
<td>Prepaid Insurance</td>
<td>600</td>
<td></td>
</tr>
<tr>
<td>Office Equipment</td>
<td>5,000</td>
<td></td>
</tr>
<tr>
<td>Notes Payable</td>
<td></td>
<td>$5,000</td>
</tr>
<tr>
<td>Accounts Payable</td>
<td></td>
<td>2,500</td>
</tr>
<tr>
<td>Unearned Revenue</td>
<td></td>
<td>1,200</td>
</tr>
<tr>
<td>C. R. Byrd, Capital</td>
<td></td>
<td>10,000</td>
</tr>
<tr>
<td>C. R. Byrd, Drawing</td>
<td>500</td>
<td></td>
</tr>
<tr>
<td>Service Revenue</td>
<td></td>
<td>10,000</td>
</tr>
<tr>
<td>Salaries Expense</td>
<td>4,000</td>
<td></td>
</tr>
<tr>
<td>Rent Expense</td>
<td>900</td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$28,700</strong></td>
<td><strong>$28,700</strong></td>
</tr>
</tbody>
</table>

Note that the total debits ($28,700) equal the total credits ($28,700). Account numbers are sometimes shown to the left of the account titles in the trial balance.

A trial balance is a necessary checkpoint for uncovering certain types of errors before you proceed to other steps in the accounting process. For example, if only the debit portion of a journal entry has been posted, the trial balance would bring this error to light.

**Limitations of a Trial Balance**
A trial balance does not guarantee freedom from recording errors, however. It does not prove that all transactions have been recorded or that the ledger is correct. Numerous errors may exist even though the trial balance columns agree. For example, the 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, or (5) offsetting errors are made in recording the amount of a transaction. In other words, as long as equal debits and credits are posted, even to the wrong account or in the wrong amount, the total debits will equal the total credits.

**Locating Errors**
The procedure for preparing a trial balance is relatively simple. However, if the trial balance does not balance, locating an error in a manual system can be time-consuming, tedious, and frustrating. Errors generally result from mathematical mistakes, incorrect postings, or simply transcribing data incorrectly.

What do you do if you are faced with a trial balance that does not balance? First determine the amount of the difference between the two columns of the trial balance. After this amount is known, the following steps are often helpful:
1. If the error is $1, $10, $100, or $1,000, re-add the trial balance columns and re-compute the account balances.

2. If the error is divisible by 2, scan the trial balance to see whether a balance equal to half the error has been entered in the wrong column.

3. If the error is divisible by 9, retrace the account balances on the trial balance to see whether they are incorrectly copied from the ledger. For example, if a balance was $12 and it was listed as $21, a $9 error has been made. Reversing the order of numbers is called a transposition error.

4. If the error is not divisible by 2 or 9 (for example, $365), scan the ledger to see whether an account balance of $365 has been omitted from the trial balance, and scan the journal to see whether a $365 posting has been omitted.

**Use of Dollar Signs**

Note that dollar signs do not appear in the journals or ledgers. Dollar signs are usually used only in the trial balance and the financial statements. Generally, a dollar sign is shown only for the first item in the column and for the total of that column. A single line is placed under the column of figures to be added or subtracted; the total amount is double underlined to indicate the final sum.

**BEFORE YOU GO ON...**

**Review It**

1. What is a trial balance and what is its primary purpose?
2. How is a trial balance prepared?
3. What are the limitations of a trial balance?

**DEMONSTRATION PROBLEM**

Bob Sample opened the Campus Laundromat on September 1, 2005. During the first month of operations the following transactions occurred.

- **Sept. 1** Invested $20,000 cash in the business.
- **2** Paid $1,000 cash for store rent for the month of September.
- **3** Purchased washers and dryers for $25,000, paying $10,000 in cash and signing a $15,000, 6-month, 12% note payable.
- **4** Paid $1,200 for one-year accident insurance policy.
- **10** Received bill from the *Daily News* for advertising the opening of the laundromat $200.
- **20** Withdrew $700 cash for personal use.
- **30** Determined that cash receipts for laundry services for the month were $6,200.

The chart of accounts for the company is the same as in Pioneer Advertising Agency except for the following: No. 154 Laundry Equipment and No. 610 Advertising Expense.

**Instructions**

(a) Journalize the September transactions. (Use J1 for the journal page number.)
(b) Open ledger accounts and post the September transactions.
(c) Prepare a trial balance at September 30, 2005.
## ACTION PLAN
- Make separate journal entries for each transaction.
- In journalizing, make sure debits equal credits.
- In journalizing, use specific account titles taken from the chart of accounts.
- Provide appropriate description of journal entry.
- Arrange ledger in statement order, beginning with the balance sheet accounts.
- Post in chronological order.
- Use numbers in the reference column to indicate the amount has been posted.
- In the trial balance, list accounts in the order in which they appear in the ledger.
- List debit balances in the left column, and credit balances in the right column.

### SOLUTION TO DEMONSTRATION PROBLEM

#### (a) GENERAL JOURNAL

<table>
<thead>
<tr>
<th>Date</th>
<th>Account Titles and Explanation</th>
<th>Ref.</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005 Sept. 1</td>
<td>Cash</td>
<td>101</td>
<td>20,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Bob Sample, Capital (Owner's investment of cash in business)</td>
<td>301</td>
<td></td>
<td>20,000</td>
</tr>
<tr>
<td>2</td>
<td>Rent Expense</td>
<td>729</td>
<td>1,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Cash</td>
<td>101</td>
<td></td>
<td>1,000</td>
</tr>
<tr>
<td>3</td>
<td>Laundry Equipment</td>
<td>154</td>
<td>25,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Cash</td>
<td>101</td>
<td></td>
<td>10,000</td>
</tr>
<tr>
<td></td>
<td>Notes Payable (Purchased laundry equipment for cash and 6-month, 12% note payable)</td>
<td>200</td>
<td></td>
<td>15,000</td>
</tr>
<tr>
<td>4</td>
<td>Prepaid Insurance</td>
<td>130</td>
<td>1,200</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Cash</td>
<td>101</td>
<td></td>
<td>1,200</td>
</tr>
<tr>
<td>10</td>
<td>Advertising Expense</td>
<td>610</td>
<td></td>
<td>200</td>
</tr>
<tr>
<td></td>
<td>Accounts Payable (Received bill from Daily News for advertising)</td>
<td>201</td>
<td></td>
<td>200</td>
</tr>
<tr>
<td>20</td>
<td>Bob Sample, Drawing</td>
<td>306</td>
<td>700</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Cash</td>
<td>101</td>
<td></td>
<td>700</td>
</tr>
<tr>
<td></td>
<td>(Withdrew cash for personal use)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>30</td>
<td>Cash</td>
<td>101</td>
<td>6,200</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Service Revenue (Received cash for services provided)</td>
<td>400</td>
<td></td>
<td>6,200</td>
</tr>
</tbody>
</table>

#### (b) GENERAL LEDGER

**Cash No. 101**

<table>
<thead>
<tr>
<th>Date</th>
<th>Explanation</th>
<th>Ref.</th>
<th>Debit</th>
<th>Credit</th>
<th>Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005 Sept. 1</td>
<td>J1</td>
<td>101</td>
<td>20,000</td>
<td></td>
<td>20,000</td>
</tr>
<tr>
<td>2</td>
<td>J1</td>
<td>101</td>
<td>1,000</td>
<td></td>
<td>19,000</td>
</tr>
<tr>
<td>3</td>
<td>J1</td>
<td>101</td>
<td>10,000</td>
<td></td>
<td>9,000</td>
</tr>
<tr>
<td>4</td>
<td>J1</td>
<td>101</td>
<td>1,200</td>
<td></td>
<td>7,800</td>
</tr>
<tr>
<td>20</td>
<td>J1</td>
<td>101</td>
<td>700</td>
<td></td>
<td>7,100</td>
</tr>
<tr>
<td>30</td>
<td>J1</td>
<td>101</td>
<td>6,200</td>
<td></td>
<td>13,300</td>
</tr>
</tbody>
</table>

**Prepaid Insurance No. 130**

<table>
<thead>
<tr>
<th>Date</th>
<th>Explanation</th>
<th>Ref.</th>
<th>Debit</th>
<th>Credit</th>
<th>Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005 Sept. 4</td>
<td>J1</td>
<td>101</td>
<td>1,200</td>
<td></td>
<td>1,200</td>
</tr>
</tbody>
</table>

**Laundry Equipment No. 154**

<table>
<thead>
<tr>
<th>Date</th>
<th>Explanation</th>
<th>Ref.</th>
<th>Debit</th>
<th>Credit</th>
<th>Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005 Sept. 3</td>
<td>J1</td>
<td>101</td>
<td>25,000</td>
<td></td>
<td>25,000</td>
</tr>
</tbody>
</table>

**Notes Payable No. 200**

<table>
<thead>
<tr>
<th>Date</th>
<th>Explanation</th>
<th>Ref.</th>
<th>Debit</th>
<th>Credit</th>
<th>Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005 Sept. 3</td>
<td>J1</td>
<td>101</td>
<td>15,000</td>
<td></td>
<td>15,000</td>
</tr>
</tbody>
</table>

**Accounts Payable No. 201**

<table>
<thead>
<tr>
<th>Date</th>
<th>Explanation</th>
<th>Ref.</th>
<th>Debit</th>
<th>Credit</th>
<th>Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005 Sept. 10</td>
<td>J1</td>
<td>101</td>
<td>200</td>
<td></td>
<td>200</td>
</tr>
</tbody>
</table>

**Bob Sample, Capital No. 301**

<table>
<thead>
<tr>
<th>Date</th>
<th>Explanation</th>
<th>Ref.</th>
<th>Debit</th>
<th>Credit</th>
<th>Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005 Sept. 1</td>
<td>J1</td>
<td>101</td>
<td>20,000</td>
<td></td>
<td>20,000</td>
</tr>
</tbody>
</table>

**Bob Sample, Drawing No. 306**

<table>
<thead>
<tr>
<th>Date</th>
<th>Explanation</th>
<th>Ref.</th>
<th>Debit</th>
<th>Credit</th>
<th>Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005 Sept. 20</td>
<td>J1</td>
<td>101</td>
<td>700</td>
<td></td>
<td>700</td>
</tr>
</tbody>
</table>
SUMMARY OF STUDY OBJECTIVES

1. Explain what an account is and how it helps in the recording process. An account is a record of increases and decreases in specific asset, liability, and owner’s equity items.

2. Define debits and credits and explain how they are used to record business transactions. The terms debit and credit are synonymous with left and right. Assets, drawings, and expenses are increased by debits and decreased by credits. Liabilities, owner’s capital, and revenues are increased by credits and decreased by debits.

3. Identify the basic steps in the recording process. The basic steps in the recording process are: (a) analyze each transaction in terms of its effects on the accounts, (b) enter the transaction information in a journal, (c) transfer the journal information to the appropriate accounts in the ledger.

4. Explain what a journal is and how it helps in the recording process. The initial accounting record of a transaction is entered in a journal before the data are entered in the accounts. A journal (a) discloses in one place the complete effects of a transaction, (b) provides a chronological record of transactions, and (c) prevents or locates errors because the debit and credit amounts for each entry can be readily compared.

5. Explain what a ledger is and how it helps in the recording process. The entire group of accounts maintained by a company is referred to as the ledger. The ledger keeps in one place all the information about changes in specific account balances.

6. Explain what posting is and how it helps in the recording process. Posting is the procedure of transferring journal entries to the ledger accounts. This phase of the recording process accumulates the effects of journalized transactions in the individual accounts.

7. Prepare a trial balance and explain its purposes. A trial balance is a list of accounts and their balances at a given time. Its primary purpose is to prove the equality of debits and credits after posting. A trial balance also uncovers errors in journalizing and posting and is useful in preparing financial statements.
CHAPTER 2  The Recording Process

GLOSSARY

Account  A record of increases and decreases in specific asset, liability, or owner’s equity items. (p. 45).
Chart of accounts  A list of accounts and the account numbers that identify their location in the ledger. (p. 56).
Compound entry  A journal entry that involves three or more accounts. (p. 53).
Credit  The right side of an account. (p. 46).
Debit  The left side of an account. (p. 46).
Double-entry system  A system that records in appropriate accounts the dual effect of each transaction. (p. 46).
General journal  The most basic form of journal. (p. 51).
General ledger  A ledger that contains all asset, liability, and owner’s equity accounts. (p. 54).
Journal  An accounting record in which transactions are initially recorded in chronological order. (p. 51).
Journalizing  The entering of transaction data in the journal. (p. 52).
Ledger  The entire group of accounts maintained by a company. (p. 54).
Posting  The procedure of transferring journal entries to the ledger accounts. (p. 55).
Simple entry  A journal entry that involves only two accounts. (p. 52).
T account  The basic form of an account. (p. 45).
Three-column form of account  A form with columns for debit, credit, and balance amounts in an account. (p. 55).
Trial balance  A list of accounts and their balances at a given time. (p. 65).

SELF-STUDY QUESTIONS

Answers are at the end of the chapter.

1. Which of the following statements about an account is true?  
   a. In its simplest form, an account consists of two parts.  
   b. An account is an individual accounting record of increases and decreases in specific asset, liability, and owner’s equity items.  
   c. There are separate accounts for specific assets and liabilities but only one account for owner’s equity items.  
   d. The left side of an account is the credit or decrease side.

2. Debits:  
   a. increase both assets and liabilities.  
   b. decrease both assets and liabilities.  
   c. increase assets and decrease liabilities.  
   d. decrease assets and increase liabilities.

3. A revenue account:  
   a. is increased by debits.  
   b. is decreased by credits.  
   c. has a normal balance of a debit.  
   d. is increased by credits.

4. Accounts that normally have debit balances are:  
   a. assets, expenses, and revenues.  
   b. assets, expenses, and owner’s capital.  
   c. assets, liabilities, and owner’s drawings.  
   d. assets, owner’s drawings, and expenses.

5. Which of the following is not part of the recording process?  
   a. Analyzing transactions.  
   b. Preparing a trial balance.  
   c. Entering transactions in a journal.  
   d. Posting transactions.

6. Which of the following statements about a journal is false?  
   a. It is not a book of original entry.  
   b. It provides a chronological record of transactions.  
   c. It helps to locate errors because the debit and credit amounts for each entry can be readily compared.  
   d. It discloses in one place the complete effect of a transaction.

7. A ledger:  
   a. contains only asset and liability accounts.  
   b. should show accounts in alphabetical order.  
   c. is a collection of the entire group of accounts maintained by a company.  
   d. is a book of original entry.

8. Posting:  
   a. normally occurs before journalizing.  
   b. transfers ledger transaction data to the journal.  
   c. is an optional step in the recording process.  
   d. transfers journal entries to ledger accounts.

9. A trial balance:  
   a. is a list of accounts with their balances at a given time.  
   b. proves the mathematical accuracy of journalized transactions.  
   c. will not balance if a correct journal entry is posted twice.  
   d. proves that all transactions have been recorded.

10. A trial balance will not balance if:  
    a. a correct journal entry is posted twice.  
    b. the purchase of supplies on account is debited to Supplies and credited to Cash.  
    c. a $100 cash drawing by the owner is debited to Owner’s Drawing for $1,000 and credited to Cash for $100.  
    d. a $450 payment on account is debited to Accounts Payable for $45 and credited to Cash for $45.
1. Describe the parts of a T account.

2. “The terms debit and credit mean increase and decrease, respectively.” Do you agree? Explain.

3. John Alcorn, a fellow student, contends that the double-entry system means each transaction must be recorded twice. Is John correct? Explain.

4. Kathy Mendosa, a beginning accounting student, believes debit balances are favorable and credit balances are unfavorable. Is Kathy correct? Discuss.

5. State the rules of debit and credit as applied to (a) asset accounts, (b) liability accounts, and (c) the owner’s equity accounts (revenue, expenses, owner’s drawing, and owner’s capital).

6. What is the normal balance for each of the following accounts? (a) Accounts Receivable. (b) Cash. (c) Owner’s Drawing. (d) Accounts Payable. (e) Service Revenue. (f) Salaries Expense. (g) Owner’s Capital.

7. Indicate whether each of the following accounts is an asset, a liability, or an owner’s equity account and whether it has a normal debit or credit balance: (a) Accounts Receivable. (b) Accounts Payable. (c) Equipment. (d) Owner’s Drawing. (e) Supplies.

8. For the following transactions, indicate the account debited and the account credited.
   (a) Supplies are purchased on account.
   (b) Cash is received on signing a note payable.
   (c) Employees are paid salaries in cash.

9. Indicate whether the following accounts generally will have (a) debit entries only, (b) credit entries only, or (c) both debit and credit entries.

10. What are the basic steps in the recording process?

11. What are the advantages of using a journal in the recording process?

12. (a) When entering a transaction in the journal, should the debit or credit be written first?
    (b) Which should be indented, the debit or credit?

13. Describe a compound entry, and provide an example.

14. (a) Should business transaction debits and credits be recorded directly in the ledger accounts? (b) What are the advantages of first recording transactions in the journal and then posting to the ledger?

15. The account number is entered as the last step in posting the amounts from the journal to the ledger. What is the advantage of this step?

16. Journalize the following business transactions.
   (a) Alberto Rivera invests $7,000 cash in the business.
   (b) Insurance of $800 is paid for the year.
   (c) Supplies of $1,000 are purchased on account.
   (d) Cash of $7,500 is received for services rendered.

17. (a) What is a ledger?
    (b) What is a chart of accounts and why is it important?

18. What is a trial balance and what are its purposes?

19. Joe Kirby is confused about how accounting information flows through the accounting system. He believes the flow of information is as follows.
   (a) Debits and credits posted to the ledger.
   (b) Business transaction occurs.
   (c) Information entered in the journal.
   (d) Financial statements are prepared.
   (e) Trial balance is prepared.

   Is Joe correct? If not, indicate to Joe the proper flow of the information.

20. Two students are discussing the use of a trial balance. They wonder whether the following errors, each considered separately, would prevent the trial balance from balancing.
   (a) The bookkeeper debited Cash for $600 and credited Wages Expense for $600 for payment of wages.
   (b) Cash collected on account was debited to Cash for $900 and Service Revenue was credited for $90.

   What would you tell them?

BRIEF EXERCISES

BE2-1 For each of the following accounts indicate the effects of (a) a debit and (b) a credit on the accounts and (c) the normal balance of the account.

1. Accounts Payable.
2. Advertising Expense.
5. B. C. King, Capital.
6. B. C. King, Drawing.

Indicate debit and credit effects and normal balance. (SO 2)
Transactions for the Kaustav Sen Company for the month of June are presented below. Identify the accounts to be debited and credited for each transaction.

- June 1: Kaustav Sen invests $4,000 cash in a small welding business of which he is the sole proprietor.
- June 2: Purchases equipment on account for $900.
- June 3: $800 cash is paid to landlord for June rent.
- June 12: Bills J. Kronsnoble $300 for welding work done on account.

Using the data in BE2-2, journalize the transactions. (You may omit explanations.)

Tim Weber, a fellow student, is unclear about the basic steps in the recording process. Identify and briefly explain the steps in the order in which they occur.

J.A. Motzek has the following transactions during August of the current year. Indicate (a) the effect on the accounting equation and (b) the debit-credit analysis illustrated on pages 58–62 of the text.

- Aug. 1: Opens an office as a financial advisor, investing $5,000 in cash.
- Aug. 4: Pays insurance in advance for 6 months, $1,800 cash.
- Aug. 16: Receives $800 from clients for services provided.
- Aug. 27: Pays secretary $1,000 salary.

Using the data in BE2-5, journalize the transactions. (You may omit explanations.)

Selected transactions for the Gilles Company are presented in journal form below. Post the transactions to T accounts. Make one T account for each item and determine each account’s ending balance.

<table>
<thead>
<tr>
<th>Date</th>
<th>Account Titles and Explanation</th>
<th>Ref.</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>May 5</td>
<td>Accounts Receivable</td>
<td>6,000</td>
<td>6,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Service Revenue (Billed for services provided)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>12</td>
<td>Cash</td>
<td>2,400</td>
<td>2,400</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Accounts Receivable (Received cash in payment of account)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>15</td>
<td>Cash</td>
<td>3,000</td>
<td>3,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Service Revenue (Received cash for services provided)</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Selected journal entries for the Gilles Company are presented in BE2-7. Post the transactions using the standard form of account.

Prepare a trial balance. (SO 7, AP)

From the ledger balances given below, prepare a trial balance for the P.J. Farve Company at June 30, 2005. List the accounts in the order shown on page 57 of the text. All account balances are normal.

- Accounts Payable $9,000, Cash $6,800, P.J. Farve, Capital $20,000, P.J. Farve, Drawing $1,200, Equipment $17,000, Service Revenue $6,000, Accounts Receivable $3,000, Salaries Expense $6,000, and Rent Expense $1,000.

An inexperienced bookkeeper prepared the following trial balance. Prepare a correct trial balance, assuming all account balances are normal.
CHENG COMPANY
Trial Balance
December 31, 2005

<table>
<thead>
<tr>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>$16,800</td>
</tr>
<tr>
<td>Prepaid Insurance</td>
<td>$3,500</td>
</tr>
<tr>
<td>Accounts Payable</td>
<td>3,000</td>
</tr>
<tr>
<td>Unearned Revenue</td>
<td>4,200</td>
</tr>
<tr>
<td>P. Cheng, Capital</td>
<td>13,000</td>
</tr>
<tr>
<td>P. Cheng, Drawing</td>
<td>4,500</td>
</tr>
<tr>
<td>Service Revenue</td>
<td>25,600</td>
</tr>
<tr>
<td>Salaries Expense</td>
<td>18,600</td>
</tr>
<tr>
<td>Rent Expense</td>
<td>2,400</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$39,600</strong></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$52,000</strong></td>
</tr>
</tbody>
</table>

E X E R C I S E S

E2-1 Selected transactions for H. Burns, an interior decorator, in her first month of business, are as follows.

Jan. 2 Invested $15,000 cash in business.
3 Purchased used car for $4,000 cash for use in business.
9 Purchased supplies on account for $500.
11 Billed customers $1,800 for services performed.
16 Paid $200 cash for advertising.
20 Received $700 cash from customers billed on January 11.
23 Paid creditor $300 cash on balance owed.
28 Withdrew $2,000 cash for personal use of owner.

Instructions
For each transaction indicate the following.
(a) The basic type of account debited and credited (asset, liability, owner’s equity).
(b) The specific account debited and credited (cash, rent expense, service revenue, etc.).
(c) Whether the specific account is increased or decreased.
(d) The normal balance of the specific account.

Use the following format, in which the January 2 transaction is given as an example.

<table>
<thead>
<tr>
<th>Account Debited</th>
<th>Account Credited</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a) Basic Type</td>
<td>(b) Specific Account</td>
</tr>
<tr>
<td>(a) Basic Type</td>
<td>(b) Specific Account</td>
</tr>
</tbody>
</table>

Jan. 2 Asset Cash Increase Debit Owner’s Equity H. Burns, Capital Increase Credit

E2-2 Data for H. Burns, interior decorator, are presented in E2-1.

Instructions
Journalize the transactions using journal page J1. (You may omit explanations.)

E2-3 Presented below is information related to Robbins Real Estate Agency.

Oct. 1 Lynn Robbins begins business as a real estate agent with a cash investment of $20,000.
2 Hires an administrative assistant.
3 Purchases office furniture for $1,900, on account.
6 Sells a house and lot for B. Kidman; bills B. Kidman $3,200 for realty services provided.
27 Pays $700 on the balance related to the transaction of October 3.
30 Pays the administrative assistant $2,000 in salary for October.

Instructions
Prepare the debit-credit analysis for each transaction as illustrated on pages 58–62.
E2-4 Transaction data for Robbins Real Estate Agency are presented in E2-3.

**Instructions**
Journalize the transactions. (You may omit explanations.)

E2-5 Selected transactions from the journal of Roberta Mendez, investment broker, are presented below.

<table>
<thead>
<tr>
<th>Date</th>
<th>Account Titles and Explanation</th>
<th>Ref.</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Aug. 1</td>
<td>Cash</td>
<td>3,000</td>
<td>3,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Roberta Mendez, Capital</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(Owner's investment of cash in business)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>10</td>
<td>Cash</td>
<td>2,400</td>
<td></td>
<td>2,400</td>
</tr>
<tr>
<td></td>
<td>Service Revenue</td>
<td></td>
<td></td>
<td>2,400</td>
</tr>
<tr>
<td></td>
<td>(Received cash for services provided)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>12</td>
<td>Office Equipment</td>
<td>5,000</td>
<td>1,000</td>
<td>4,000</td>
</tr>
<tr>
<td></td>
<td>Cash</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Notes Payable</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(Purchased office equipment for cash and notes payable)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>25</td>
<td>Accounts Receivable</td>
<td>1,600</td>
<td></td>
<td>1,600</td>
</tr>
<tr>
<td></td>
<td>Service Revenue</td>
<td></td>
<td></td>
<td>1,600</td>
</tr>
<tr>
<td></td>
<td>(Billed for services provided)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>31</td>
<td>Cash</td>
<td>900</td>
<td></td>
<td>900</td>
</tr>
<tr>
<td></td>
<td>Accounts Receivable</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(Receipt of cash on account)</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Instructions**
(a) Prepare the complete general journal (including explanations) from which the postings to Cash were made.
(b) Prepare a trial balance at August 31, 2005.

E2-6 The T accounts below summarize the ledger of Padre Landscaping Company at the end of the first month of operations.

<table>
<thead>
<tr>
<th>Date</th>
<th>Cash No. 101</th>
<th>Unearned Revenue No. 205</th>
</tr>
</thead>
<tbody>
<tr>
<td>4/1</td>
<td>10,000</td>
<td>4/30 1,000</td>
</tr>
<tr>
<td>4/12</td>
<td>900</td>
<td>4/25 1,500</td>
</tr>
<tr>
<td>4/29</td>
<td>400</td>
<td></td>
</tr>
<tr>
<td>4/30</td>
<td>1,000</td>
<td></td>
</tr>
<tr>
<td>Accounts Receivable No. 112</td>
<td>J. Padre, Capital No. 301</td>
<td></td>
</tr>
<tr>
<td>4/7</td>
<td>3,200</td>
<td>4/1 10,000</td>
</tr>
<tr>
<td>4/29</td>
<td>400</td>
<td></td>
</tr>
<tr>
<td>Supplies No. 126</td>
<td>Service Revenue No. 400</td>
<td></td>
</tr>
<tr>
<td>4/4</td>
<td>1,800</td>
<td>4/7 3,200</td>
</tr>
<tr>
<td>4/12</td>
<td>900</td>
<td></td>
</tr>
<tr>
<td>Accounts Payable No. 201</td>
<td>Salaries Expense No. 726</td>
<td></td>
</tr>
<tr>
<td>4/25</td>
<td>1,500</td>
<td>4/15 600</td>
</tr>
<tr>
<td>4/4</td>
<td>1,800</td>
<td></td>
</tr>
</tbody>
</table>

**Instructions**
(a) Prepare the complete general journal (including explanations) from which the postings to Cash were made.
(b) Prepare a trial balance at April 30, 2005.
### E2-7
Presented below is the ledger for Maxim Co.

<table>
<thead>
<tr>
<th>Account</th>
<th>Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Cash No. 101</strong></td>
<td></td>
</tr>
<tr>
<td>10/1 5,000</td>
<td>10/4 400</td>
</tr>
<tr>
<td>10/10 650</td>
<td>10/12 1,500</td>
</tr>
<tr>
<td>10/10 3,000</td>
<td>10/15 250</td>
</tr>
<tr>
<td>10/20 500</td>
<td>10/30 300</td>
</tr>
<tr>
<td>10/25 2,000</td>
<td>10/31 500</td>
</tr>
<tr>
<td><strong>Accounts Receivable No. 112</strong></td>
<td></td>
</tr>
<tr>
<td>10/6 800</td>
<td>10/20 500</td>
</tr>
<tr>
<td>10/20 940</td>
<td></td>
</tr>
<tr>
<td><strong>Supplies No. 126</strong></td>
<td></td>
</tr>
<tr>
<td>10/4 400</td>
<td></td>
</tr>
<tr>
<td><strong>Furniture No. 149</strong></td>
<td></td>
</tr>
<tr>
<td>10/3 2,000</td>
<td></td>
</tr>
<tr>
<td><strong>Notes Payable No. 200</strong></td>
<td></td>
</tr>
<tr>
<td>10/10 3,000</td>
<td></td>
</tr>
<tr>
<td><strong>Accounts Payable No. 201</strong></td>
<td></td>
</tr>
<tr>
<td>10/12 1,500</td>
<td>10/3 2,000</td>
</tr>
<tr>
<td><strong>Maxim, Capital No. 301</strong></td>
<td></td>
</tr>
<tr>
<td>10/1 5,000</td>
<td>10/25 2,000</td>
</tr>
<tr>
<td><strong>Maxim, Drawing No. 306</strong></td>
<td>10/30 300</td>
</tr>
<tr>
<td><strong>Service Revenue No. 407</strong></td>
<td></td>
</tr>
<tr>
<td>10/6 800</td>
<td>10/10 650</td>
</tr>
<tr>
<td>10/20 940</td>
<td></td>
</tr>
<tr>
<td><strong>Store Wages Expense No. 628</strong></td>
<td></td>
</tr>
<tr>
<td>10/31 500</td>
<td></td>
</tr>
<tr>
<td><strong>Rent Expense No. 729</strong></td>
<td></td>
</tr>
<tr>
<td>10/15 250</td>
<td></td>
</tr>
</tbody>
</table>

**Instructions**

(a) Reproduce the journal entries for the transactions that occurred on October 1, 10, and 20, and provide explanations for each.

(b) Determine the October 31 balance for each of the accounts above, and prepare a trial balance at October 31, 2005.

### E2-8
Selected transactions for Neve Campbell Company during its first month in business are presented below.

Sept. 1 Invested $10,000 cash in the business.

5 Purchased equipment for $12,000 paying $6,000 in cash and the balance on account.

25 Paid $3,000 cash on balance owed for equipment.

30 Withdrew $500 cash for personal use.

Campbell’s chart of accounts shows: No. 101 Cash, No. 157 Equipment, No. 201 Accounts Payable, No. 301 Neve Campbell, Capital, No. 306 Neve Campbell, Drawing.

**Instructions**

(a) Journalize the transactions on page J1 of the journal.

(b) Post the transactions using the standard account form.
CHAPTER 2  The Recording Process

Instructions
For each error:
(a) Indicate whether the trial balance will balance.
(b) If the trial balance will not balance, indicate the amount of the difference.
(c) Indicate the trial balance column that will have the larger total.

Consider each error separately. Use the following form, in which error (1) is given as an example.

<table>
<thead>
<tr>
<th>Error (1)</th>
<th>In Balance (a)</th>
<th>Difference (b)</th>
<th>Larger Column (c)</th>
</tr>
</thead>
<tbody>
<tr>
<td>No</td>
<td></td>
<td>$400</td>
<td>debit</td>
</tr>
</tbody>
</table>

Prepare a trial balance.

P2-10 The accounts in the ledger of Speedy Delivery Service contain the following balances on July 31, 2005.

| Accounts Receivable | $10,642 | Prepaid Insurance | $1,968 |
| Accounts Payable    | 8,396   | Service Revenue   | 10,610 |
| Cash                | ?       | Repair Expense    | 961    |
| Delivery Equipment  | 49,360  | I. M. Speedy, Drawing | 700 |
| Gas and Oil Expense | 758     | I. M. Speedy, Capital | 44,636 |
| Insurance Expense   | 523     | Salaries Expense  | 4,428  |
| Notes Payable       | 26,450  | Salaries Payable  | 815    |

Instructions
Prepare a trial balance with the accounts arranged as illustrated in the chapter and fill in the missing amount for Cash.

P2-1A Surepar Miniature Golf and Driving Range was opened on March 1 by Bill Affleck. The following selected events and transactions occurred during March:

Mar. 1 Invested $60,000 cash in the business.
3 Purchased Lee's Golf Land for $38,000 cash. The price consists of land $23,000, building $9,000, and equipment $6,000. (Make one compound entry.)
5 Advertised the opening of the driving range and miniature golf course, paying advertising expenses of $1,600.
6 Paid cash $1,480 for a one-year insurance policy.
10 Purchased golf clubs and other equipment for $2,600 from Parton Company payable in 30 days.
18 Received $800 in cash for golf fees earned.
19 Sold 100 coupon books for $15 each. Each book contains 10 coupons that enable the holder to play one round of miniature golf or to hit one bucket of golf balls.
25 Withdrew $1,000 cash for personal use.
30 Paid salaries of $600.
30 Paid Parton Company in full.
31 Received $500 cash for fees earned.

Bill Affleck uses the following accounts: Cash; Prepaid Insurance; Land; Buildings; Equipment; Accounts Payable; Unearned Revenue; Bill Affleck, Capital; Bill Affleck, Drawing; Golf Revenue; Advertising Expense; and Salaries Expense.

Instructions
Journalize the March transactions.

P2-2A Judi Dench is a licensed architect. During the first month of the operation of her business, the following events and transactions occurred.

April 1 Invested $25,000 cash.
1 Hired a secretary-receptionist at a salary of $300 per week payable monthly.
2 Paid office rent for the month $800.
3 Purchased architectural supplies on account from Halo Company $1,500.
Judi uses the following chart of accounts: No. 101 Cash, No. 112 Accounts Receivable, No. 126 Supplies, No. 201 Accounts Payable, No. 205 Unearned Revenue, No. 301 Judi Dench, Capital, No. 400 Service Revenue, No. 726 Salaries Expense, and No. 729 Rent Expense.

**Instructions**

(a) Journalize the transactions.

(b) Post to the ledger accounts.

(c) Prepare a trial balance on April 30, 2005.

**P2-3A** Chambers Brokerage Services was formed on May 1, 2005. The following transactions took place during the first month.

Transactions on May 1:

1. Dennis Chambers invested $120,000 cash in the company, as its sole owner.
2. Hired two employees to work in the warehouse. They will each be paid a salary of $2,000 per month.
3. Signed a 2-year rental agreement on a warehouse; paid $36,000 cash in advance for the first year. *(Hint: The portion of the cost related to May 2005 is an expense for this month.)*
4. Purchased furniture and equipment costing $70,000. A cash payment of $20,000 was made immediately; the remainder will be paid in 6 months.
5. Paid $3,000 cash for a one-year insurance policy on the furniture and equipment. *(Hint: The portion of the cost related to May 2005 is an expense for this month.)*

Transactions during the remainder of the month:

6. Purchased basic office supplies for $1,000 cash.
7. Purchased more office supplies for $3,000 on account.
8. Total revenues earned were $30,000—$10,000 cash and $20,000 on account.
9. Paid $800 to suppliers for accounts payable due.
10. Received $5,000 from customers in payment of accounts receivable.
11. Received utility bills in the amount of $400, to be paid next month.
12. Paid the monthly salaries of the two employees, totalling $4,000.

**Instructions**

(a) Prepare journal entries to record each of the events listed.

(b) Post the journal entries to T accounts.

(c) Prepare a trial balance as of May 31, 2005.

(d) Prepare an income statement and a statement of owner’s equity for Chambers Brokerage Services for the month ended May 31, 2005, and a balance sheet as of May 31, 2005.

**P2-4A** The trial balance of Ron Salem Co. shown below does not balance.

**RON SALEM CO.**

**Trial Balance**

**June 30, 2005**

<table>
<thead>
<tr>
<th></th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>$ 3,840</td>
<td></td>
</tr>
<tr>
<td>Accounts Receivable</td>
<td></td>
<td>3,231</td>
</tr>
<tr>
<td>Supplies</td>
<td>800</td>
<td></td>
</tr>
<tr>
<td>Equipment</td>
<td>3,000</td>
<td></td>
</tr>
<tr>
<td>Accounts Payable</td>
<td>2,666</td>
<td></td>
</tr>
<tr>
<td>Uncollected Revenue</td>
<td>2,200</td>
<td>9,000</td>
</tr>
<tr>
<td>R. Salem, Capital</td>
<td>800</td>
<td>2,380</td>
</tr>
<tr>
<td>R. Salem, Drawing</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Service Revenue</td>
<td>3,400</td>
<td></td>
</tr>
<tr>
<td>Salaries Expense</td>
<td>910</td>
<td></td>
</tr>
</tbody>
</table>

**Total: $14,341**

**Total: $17,886**

The check figures you see next to Problems are also shown in the students’ text.
CHAPTER 2  The Recording Process

Each of the listed accounts has a normal balance per the general ledger. An examination of the ledger and journal reveals the following errors.

1. Cash received from a customer in payment of its account was debited for $570, and Accounts Receivable was credited for the same amount. The actual collection was for $750.
2. The purchase of a typewriter on account for $340 was recorded as a debit to Supplies for $340 and a credit to Accounts Payable for $340.
3. Services were performed on account for a client for $890. Accounts Receivable was debited for $890, and Service Revenue was credited for $89.
4. A debit posting to Salaries Expense of $367 was omitted.
5. A payment of a balance due for $309 was credited to Cash for $309 and credited to Accounts Payable for $390.
6. The withdrawal of $500 cash for Salem’s personal use was debited to Salaries Expense for $500 and credited to Cash for $500.

Instructions

Prepare a correct trial balance. (Hint: It helps to prepare the correct journal entry for the transaction described and compare it to the mistake made).

P2-5A  The Russo Theater, owned by Alan Russo, will begin operations in March. The Russo will be unique in that it will show only triple features of sequential theme movies. As of March 1, the ledger of Russo showed: No. 101 Cash $16,000; No. 140 Land $42,000; No. 145 Buildings (concession stand, projection room, ticket booth, and screen) $18,000; No. 157 Equipment $16,000; No. 201 Accounts Payable $12,000; and No. 301 A. Russo, Capital $80,000. During the month of March the following events and transactions occurred.

Mar. 2  Rented the three Star Wars movies (Star Wars, The Empire Strikes Back, and The Return of the Jedi) to be shown for the first 3 weeks of March. The film rental was $9,000; $3,000 was paid in cash and $6,000 will be paid on March 10.
3  Ordered the first three Star Trek movies to be shown the last 10 days of March. It will cost $300 per night.
9  Received $6,500 cash from admissions.
10  Paid balance due on Star Wars movies rental and $3,000 on March 1 accounts payable.
11  Russo Theater contracted with M. Brewer Company to operate the concession stand. Brewer is to pay 10% of gross concession receipts (payable monthly) for the right to operate the concession stand.
12  Paid advertising expenses $800.
20  Received $7,200 cash from customers for admissions.
20  Received the Star Trek movies and paid the rental fee of $3,000.
31  Paid salaries of $4,800.
31  Received statement from M. Brewer showing gross receipts from concessions of $8,000 and the balance due to Russo Theater of $800 ($8,000 × 10%) for March. Brewer paid one-half the balance due and will remit the remainder on April 5.
31  Received $12,000 cash from customers for admissions.

In addition to the accounts identified above, the chart of accounts includes: No. 112 Accounts Receivable, No. 405 Admission Revenue, No. 406 Concession Revenue, No. 610 Advertising Expense, No. 632 Film Rental Expense, and No. 726 Salaries Expense.

Instructions

(a) Enter the beginning balances in the ledger. Insert a check mark (✓) in the reference column of the ledger for the beginning balance.
(b) Journalize the March transactions.
(c) Post the March journal entries to the ledger. Assume that all entries are posted from page 1 of the journal.
(d) Prepare a trial balance on March 31, 2005.

Trial balance totals $115,500
PROBLEMS: SET B

P2-1B Frontier Park was started on April 1 by C. J. Amaro. The following selected events and transactions occurred during April.

Apr. 1 Amaro invested $50,000 cash in the business.
4 Purchased land costing $30,000 for cash.
8 Incurred advertising expense of $1,800 on account.
11 Paid salaries to employees $1,500.
12 Hired park manager at a salary of $4,000 per month, effective May 1.
13 Paid $1,500 cash for a one-year insurance policy.
17 Withdrew $600 cash for personal use.
20 Received $5,700 in cash for admission fees.
25 Sold 100 coupon books for $25 each. Each book contains 10 coupons that entitle the holder to one admission to the park.
30 Withdrew $600 cash for personal use.
30 Paid $900 on balance owed for advertising incurred on April 8.

Amaro uses the following accounts: Cash; Prepaid Insurance; Land; Accounts Payable; Unearned Admission Revenue; C. J. Amaro, Capital; C. J. Amaro, Drawing; Admission Revenue; Advertising Expense; and Salaries Expense.

Instructions
Journalize the April transactions.

P2-2B Kara Shin is a licensed CPA. During the first month of operations of her business, the following events and transactions occurred.

May 1 Shin invested $20,000 cash.
2 Hired a secretary-receptionist at a salary of $1,000 per month.
3 Purchased $1,500 of supplies on account from Read Supply Company.
7 Paid office rent of $900 cash for the month.
11 Completed a tax assignment and billed client $2,100 for services provided.
12 Received $3,500 advance on a management consulting engagement.
17 Received cash of $1,200 for services completed for H. Arnold Co.
31 Paid secretary-receptionist $1,000 salary for the month.
31 Paid 40% of balance due Read Supply Company.

Kara uses the following chart of accounts: No. 101 Cash, No. 112 Accounts Receivable, No. 126 Supplies, No. 201 Accounts Payable, No. 205 Unearned Revenue, No. 301 Kara Shin, Capital, No. 400 Service Revenue, No. 726 Salaries Expense, and No. 729 Rent Expense.

Instructions
(a) Journalize the transactions.
(b) Post to the ledger accounts.
(c) Prepare a trial balance on May 31, 2005.

P2-3B Mark Hockenberry owns and manages a computer repair service, which had the following trial balance on December 31, 2004 (the end of its fiscal year).

BYTE REPAIR SERVICE
Trial Balance
December 31, 2004

<table>
<thead>
<tr>
<th>Account</th>
<th>Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>$ 8,000</td>
</tr>
<tr>
<td>Accounts Receivable</td>
<td>15,000</td>
</tr>
<tr>
<td>Parts Inventory</td>
<td>13,000</td>
</tr>
<tr>
<td>Prepaid Rent</td>
<td>3,000</td>
</tr>
<tr>
<td>Shop Equipment</td>
<td>21,000</td>
</tr>
<tr>
<td>Accounts Payable</td>
<td>$19,000</td>
</tr>
<tr>
<td>Mark Hockenberry, Capital</td>
<td>41,000</td>
</tr>
</tbody>
</table>

$60,000 $60,000

Journalize a series of transactions.

Journalize transactions, post, and prepare a trial balance.

Journalize and post transactions, prepare a trial balance, and determine elements of financial statements.
Summarized transactions for January 2005 were as follows:

1. Advertising costs, paid in cash, $1,000.
2. Additional repair parts inventory acquired on account $4,000.
3. Miscellaneous expenses, paid in cash, $2,000.
4. Cash collected from customers in payment of accounts receivable $13,000.
5. Cash paid to creditors for accounts payable due $15,000.
6. Repair parts used during January $4,000. (Hint: Debit this to Repair Parts Expense.)
7. Repair services performed during January: for cash $5,000; on account $9,000.
8. Wages for January, paid in cash, $3,000.
9. Rent expense for January recorded. However, no cash was paid out for rent during January. A rent payment had been made for 4 months, in advance, on December 1, 2004, in the amount of $4,000.
10. Mark’s drawings during January were $2,000.

Instructions
(a) Explain why the December 31, 2004, balance in the Prepaid Rent account is $3,000. (Refer to the Trial Balance and item (9) above.)
(b) Open T accounts for each of the accounts listed in the trial balance, and enter the opening balances for 2005.
(c) Prepare journal entries to record each of the January transactions.
(d) Post the journal entries to the accounts in the ledger. (Add accounts as needed.)
(e) Prepare a trial balance as of January 31, 2005.
(f) Determine the total assets as of January 31, 2005. (It is not necessary to prepare a balance sheet. Simply list the relevant amounts from the trial balance and calculate the total.)
(g) Determine the net income or loss for the month of January 2005. (It is not necessary to prepare an income statement. Simply list the relevant amounts from the trial balance, and calculate the amount of the net income or loss.)

The trial balance of the Garland Company shown below does not balance.

GARLAND COMPANY
Trial Balance
May 31, 2005

<table>
<thead>
<tr>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>$3,850</td>
</tr>
<tr>
<td>Accounts Receivable</td>
<td>$2,750</td>
</tr>
<tr>
<td>Prepaid Insurance</td>
<td>700</td>
</tr>
<tr>
<td>Equipment</td>
<td>12,000</td>
</tr>
<tr>
<td>Accounts Payable</td>
<td>560</td>
</tr>
<tr>
<td>Property Taxes Payable</td>
<td>4,500</td>
</tr>
<tr>
<td>M. Garland, Capital</td>
<td>11,700</td>
</tr>
<tr>
<td>Service Revenue</td>
<td>8,690</td>
</tr>
<tr>
<td>Salaries Expense</td>
<td>4,200</td>
</tr>
<tr>
<td>Advertising Expense</td>
<td>1,100</td>
</tr>
<tr>
<td>Property Tax Expense</td>
<td>800</td>
</tr>
<tr>
<td></td>
<td>$30,800</td>
</tr>
<tr>
<td></td>
<td>$20,050</td>
</tr>
</tbody>
</table>

Your review of the ledger reveals that each account has a normal balance. You also discover the following errors.

1. The totals of the debit sides of Prepaid Insurance, Accounts Payable, and Property Tax Expense were each understated $100.
2. Transposition errors were made in Accounts Receivable and Service Revenue. Based on postings made, the correct balances were $2,570 and $8,960, respectively.
3. A debit posting to Salaries Expense of $200 was omitted.
4. A $1,000 cash drawing by the owner was debited to M. Garland, Capital for $1,000 and credited to Cash for $1,000.
5. A $520 purchase of supplies on account was debited to Equipment for $520 and credited to Cash for $520.
6. A cash payment of $450 for advertising was debited to Advertising Expense for $45 and credited to Cash for $45.
7. A collection from a customer for $420 was debited to Cash for $420 and credited to Accounts Payable for $420.

### Instructions
Prepare a correct trial balance. Note that the chart of accounts includes the following: M. Garland, Drawing, and Supplies. (Hint: It helps to prepare the correct journal entry for the transaction described and compare it to the mistake made.)

**P2-5B** The Lake Theater is owned by Alvin Wasicko. All facilities were completed on March 31. At this time, the ledger showed: No. 101 Cash $6,000; No. 140 Land $10,000; No. 145 Buildings (concession stand, projection room, ticket booth, and screen) $8,000; No. 157 Equipment $6,000; No. 201 Accounts Payable $2,000; No. 275 Mortgage Payable $8,000; and No. 301 Alvin Wasicko, Capital $20,000. During April, the following events and transactions occurred.

**Apr. 2** Paid film rental of $800 on first movie.
3 Ordered two additional films at $1,000 each.
9 Received $1,800 cash from admissions.
10 Made $2,000 payment on mortgage and $1,000 for accounts payable due.
11 Lake Theater contracted with R. Zarle Company to operate the concession stand. Zarle is to pay 17% of gross concession receipts (payable monthly) for the right to operate the concession stand.
12 Paid advertising expenses $300.
20 Received one of the films ordered on April 3 and was billed $1,000. The film will be shown in April.
25 Received $5,200 cash from admissions.
29 Paid salaries $1,600.
30 Received statement from R. Zarle showing gross concession receipts of $1,000 and the balance due to The Lake Theater of $170 ($1,000 / 17%) for April. Zarle paid one-half of the balance due and will remit the remainder on May 5.
30 Prepaid $900 rental on special film to be run in May.

In addition to the accounts identified above, the chart of accounts shows: No. 112 Accounts Receivable, No. 136 Prepaid Rentals, No. 405 Admission Revenue, No. 406 Concession Revenue, No. 610 Advertising Expense, No. 632 Film Rental Expense, and No. 726 Salaries Expense.

### Instructions
(a) Enter the beginning balances in the ledger as of April 1. Insert a check mark (✓) in the reference column of the ledger for the beginning balance.
(b) Journalize the April transactions.
(c) Post the April journal entries to the ledger. Assume that all entries are posted from page 1 of the journal.
(d) Prepare a trial balance on April 30, 2005.

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**BROADENING YOUR PERSPECTIVE**

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**Financial Reporting and Analysis**

**FINANCIAL REPORTING PROBLEM: PepsiCo**

**BYP2-1** The financial statements of PepsiCo are presented in Appendix A. The notes accompanying the statements contain the following selected accounts, stated in millions of dollars.

<table>
<thead>
<tr>
<th>Account</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounts Payable</td>
<td>$4,998</td>
</tr>
<tr>
<td>Accounts Receivable</td>
<td>2,531</td>
</tr>
<tr>
<td>Property, Plant, and Equipment</td>
<td>7,390</td>
</tr>
<tr>
<td>Income Taxes Payable</td>
<td>$ 492</td>
</tr>
<tr>
<td>Interest Expense</td>
<td>178</td>
</tr>
<tr>
<td>Inventory</td>
<td>1,342</td>
</tr>
</tbody>
</table>
CHAPTER 2  The Recording Process

Instructions
(a) Answer the following questions.
(1) What is the increase and decrease side for each account?
(2) What is the normal balance for each account?
(b) Identify the probable other account in the transaction and the effect on that account when:
(1) Accounts Receivable is decreased.
(2) Accounts Payable is decreased.
(3) Inventory is increased.
(c) Identify the other account(s) that ordinarily would be involved when:
(1) Interest Expense is increased.
(2) Property, Plant, and Equipment is increased.

■ COMPARATIVE ANALYSIS PROBLEM: PepsiCo vs. Coca-Cola

BYP2-2 PepsiCo’s financial statements are presented in Appendix A. Coca-Cola’s financial statements are presented in Appendix B.

Instructions
(a) Based on the information contained in the financial statements, determine the normal balance of the listed accounts for each company.

<table>
<thead>
<tr>
<th>PepsiCo</th>
<th>Coca-Cola</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Inventory</td>
<td>1. Accounts Receivable</td>
</tr>
<tr>
<td>2. Property, Plant, and Equipment</td>
<td>2. Cash and Cash Equivalents</td>
</tr>
<tr>
<td>4. Interest Expense</td>
<td>4. Sales (revenue)</td>
</tr>
</tbody>
</table>

(b) Identify the other account ordinarily involved when:
(1) Accounts Receivable is increased.
(2) Wages Payable is decreased.
(3) Property, Plant, and Equipment is increased.
(4) Interest Expense is increased.

■ INTERPRETING FINANCIAL STATEMENTS: A Global Focus

BYP2-3 Doman Industries Ltd., whose products are sold in 30 countries worldwide, is an integrated Canadian forest products company.

Doman sells the majority of its lumber products in the United States and a significant amount of its pulp products in Asia. Doman also has loans from other countries. For example, the Company borrowed US$160 million at an annual interest rate of 12%. Doman must repay this loan, and interest, in U.S. dollars.

One of the challenges global companies face is to make themselves attractive to investors from other countries. This is difficult to do when different accounting rules in different countries blur the real impact of earnings. For example, in 1998 Doman reported a loss of $2.3 million, using Canadian accounting rules. Had it reported under U.S. accounting rules, its loss would have been $12.1 million.

Many companies that want to be more easily compared with U.S. and other global competitors have switched to U.S. accounting principles. Canadian National Railway, Corel, Cott, Inco, and the Thomson Corporation are but a few examples of large Canadian companies whose financial statements are now presented in U.S. dollars, which adhere to U.S. GAAP, or are reconciled to U.S. GAAP.

Instructions
(a) Identify advantages and disadvantages that companies should consider when switching to U.S. reporting standards.
(b) Suppose you wish to compare Doman Industries to a U.S.-based competitor. Do you believe the use of country-specific accounting policies would hinder your comparison? If so, explain how.
(c) Suppose you wish to compare Doman Industries to a Canadian-based competitor. If the companies chose to apply generally acceptable Canadian accounting policies differently, how could this affect your comparison of their financial results?
(d) Do you see any significant distinction between comparing statements prepared using generally accepted accounting principles of different countries and comparing statements pre-
pared using generally accepted accounting principles of the same country (e.g., U.S.) but that apply the principles differently?

EXPLORING THE WEB

BYP2-4 Much information about specific companies is available on the World Wide Web. Such information includes basic descriptions of the company’s location, activities, industry, financial health, and financial performance.

Address: biz.yahoo.com/i, or go to www.wiley.com/college/weygandt

Steps
1. Type in a company name, or use index to find company name.
2. Choose Profile. Perform instructions (a)–(c) below.
3. Click on the company’s specific industry to identify competitors. Perform instructions (d)–(g) below.

Instructions
Answer the following questions.

(a) What is the company’s industry?
(b) What was the company’s total sales?
(c) What was the company’s net income?
(d) What are the names of four of the company’s competitors?
(e) Choose one of these competitors.
(f) What is this competitor’s name? What were its sales? What was its net income?
(g) Which of these two companies is larger by size of sales? Which one reported higher net income?

Critical Thinking

GROUP DECISION CASE

BYP2-5 Amy Torbert operates Hollins Riding Academy. The academy’s primary sources of revenue are riding fees and lesson fees, which are paid on a cash basis. Amy also boards horses for owners, who are billed monthly for boarding fees. In a few cases, boarders pay in advance of expected use. For its revenue transactions, the academy maintains the following accounts: No. 1 Cash, No. 5 Boarding Accounts Receivable, No. 27 Unearned Boarding Revenue, No. 51 Riding Revenue, No. 52 Lesson Revenue, and No. 53 Boarding Revenue.

The academy owns 10 horses, a stable, a riding corral, riding equipment, and office equipment. These assets are accounted for in accounts No. 11 Horses, No. 12 Building No. 13 Riding Corral, No. 14 Riding Equipment, and No. 15 Office Equipment.

For its expenses, the academy maintains the following accounts: No. 6 Hay and Feed Supplies, No. 7 Prepaid Insurance, No. 21 Accounts Payable, No. 60 Salaries Expense, No. 61 Advertising Expense, No. 62 Utilities Expense, No. 63 Veterinary Expense, No. 64 Hay and Feed Expense, and No. 65 Insurance Expense.

Amy makes periodic withdrawals of cash for personal living expenses. To record Amy’s equity in the business and her drawings, two accounts are maintained: No. 50 Amy Torbert, Capital, and No. 51 Amy Torbert, Drawing.

During the first month of operations an inexperienced bookkeeper was employed. Amy Torbert asks you to review the following eight entries of the 50 entries made during the month. In each case, the explanation for the entry is correct.

May 1 Cash 18,000
Amy Torbert, Capital 18,000
(Invested $18,000 cash in business)
18,000 18,000

5 Cash 250
Riding Revenue 250
(Received $250 cash for lessons provided)
250 250

7 Cash 500
Boarding Revenue 500
(Received $500 for boarding of horses beginning June 1)
### Instructions
With the class divided into groups, answer the following.

(a) Identify each journal entry that is correct. For each journal entry that is incorrect, prepare the entry that should have been made by the bookkeeper.

(b) Which of the incorrect entries would prevent the trial balance from balancing?

(c) What was the correct net income for May, assuming the bookkeeper reported net income of $4,500 after posting all 50 entries?

(d) What was the correct cash balance at May 31, assuming the bookkeeper reported a balance of $12,475 after posting all 50 entries (and the only errors occurred in the items listed above)?

---

### COMMUNICATION ACTIVITY

**BYP2-6** Shandler’s Maid Company offers home cleaning service. Two recurring transactions for the company are billing customers for services rendered and paying employee salaries. For example, on March 15, bills totaling $5,000 were sent to customers and $2,000 was paid in salaries to employees.

**Instructions**
Write a memo to your instructor that explains and illustrates the steps in the recording process for each of the March 15 transactions. Use the format illustrated in the text under the heading, “The Recording Process Illustrated” (p. 57).

### ETHICS CASE

**BYP2-7** Sara Rankin is the assistant chief accountant at Hokey Company, a manufacturer of computer chips and cellular phones. The company presently has total sales of $20 million. It is the end of the first quarter. Sara is hurriedly trying to prepare a general ledger trial balance so that quarterly financial statements can be prepared and released to management and the regulatory agencies. The total credits on the trial balance exceed the debits by $1,000. In order to meet the 4 p.m. deadline, Sara decides to force the debits and credits into balance by adding the amount of the difference to the Equipment account. She chose Equipment because it is one of the larger account balances; percentage-wise, it will be the least misstated. Sara “plugs” the difference! She believes that the difference will not affect anyone’s decisions. She wishes that she had another few days to find the error but realizes that the financial statements are already late.

**Instructions**

(a) Who are the stakeholders in this situation?

(b) What are the ethical issues involved in this case?

(c) What are Sara’s alternatives?
Answers to Self-Study Questions
1. b  2. c  3. d  4. d  5. b  6. a  7. c  8. d  9. a  10. c

Answer to PepsiCo Review It Question 4, p. 50
Normal balances for PepsiCo (or any company) are: Cash—debit; Accounts Payable—credit; Interest Expense—debit.

REMEmber to go back to the Navigator box on the chapter-opening page and check off your completed work.