THE RECORDING PROCESS

3

THE NAVIGATOR ✓

- Understand *Concepts for Review* ❑
- Read *Feature Story* ❑
- Scan *Study Objectives* ❑
- Read *Preview* ❑
- Read text and answer *Before You Go On*
  p. 81 ❑ *p.* 85 ❑ *p.* 97 ❑ *p.* 99 ❑
- Work *Demonstration Problem* ❑
- Review *Summary of Study Objectives* ❑
- Complete *Assignments* ❑

CONCEPTS FOR REVIEW

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

a. What are assets, liabilities, stockholders' equity, retained earnings, dividends, revenues, and expenses. (Ch. 1, pp. 11–12)

b. Why assets equal liabilities plus stockholders' equity. (Ch. 1, p. 11)

c. What transactions are and how they affect the basic accounting equation. (Ch. 1, pp. 14–20)

THE NAVIGATOR

FEATURE STORY

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.

THE NAVIGATOR

STUDY OBJECTIVES

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.
8. Identify the advantages of manual and computerized accounting systems.

THE NAVIGATOR

PREVIEW OF CHAPTER 3

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 Best Caterers, Inc. 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 3 are as follows.

THE RECORDING PROCESS

The Account
- Debits and credits
- Debit and credit procedure
- Stockholders' equity relationships
- Expansion of basic equation

Steps in the Recording Process
- Journal
- Ledger

The Recording Process Illustrated
- Summary illustration of journalizing and posting

The Trial Balance
- Limitations of a trial balance
- Locating errors
- Use of dollar signs

Electronic Data Processing
- Comparative advantages of manual versus computerized systems
- The Future

THE NAVIGATOR

STUDY OBJECTIVE 1

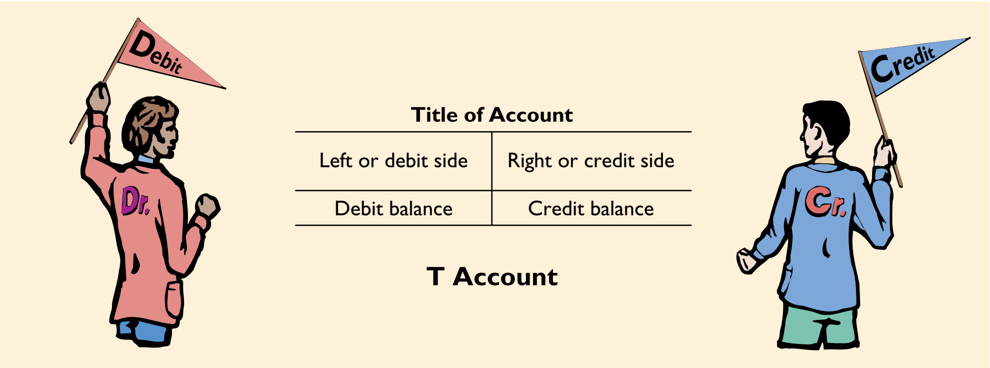
Explain what an account is and how it helps in the recording process.

THE ACCOUNT

An **account** is an individual accounting record of increases and decreases in a specific asset, liability, or stockholders' equity item. For example, Best Caterers, Inc. (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 3-1.

Illustration 3-1

Basic form of account



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

STUDY OBJECTIVE 2

Define debits and credits and explain how they are used to record business transactions.

The term **debit** means left, and **credit** means right. They are commonly abbreviated as Dr. for debit and Cr. for credit.[1] These terms are directional signals: They indicate on which side of a T account a number will be recorded. 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 3-2 for the cash transactions of Best Caterers, Inc. The data are taken from the cash column of the tabular summary in Illustration 1-9.

Illustration 3-2

Tabular summary compared to account form

Tabular Summary

Cash
$15,000
−7,000
1,200
1,500
−1,700
−250
600
−1,300
$ 8,050

Account Form

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

HELPFUL HINT
At this point, don't think about increases and decreases in relation to debits and credits. As you'll soon learn, the effects of debits and credits depend on the type of account involved.

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 Best Caterers, Inc. has had $8,050 more increases than decreases in cash.

DEBIT AND CREDIT PROCEDURES

HELPFUL HINT
Debits must equal credits for each transaction.

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 method for recording transactions. It also offers a means of proving the

[1]These terms and their abbreviations come from the Latin words *debere* (Dr.) and *credere* (Cr.).

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 stockholders' 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 (Assets = Liabilities + Stockholders' Equity) must be equal. It follows that increases and decreases in assets and liabilities must be recorded opposite from each other. In Illustration 3-2, 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 in Illustration 3-3.

Illustration 3-3

Debit and credit effects—assets and liabilities

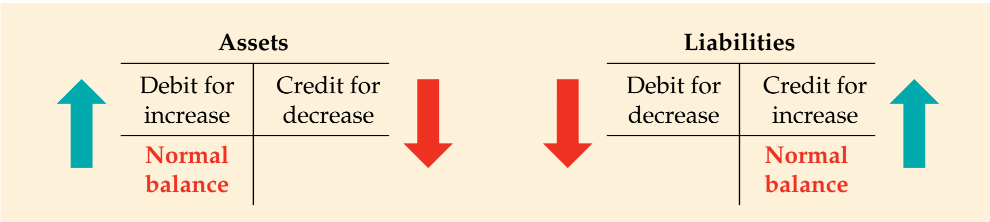
Debits	Credits
Increase assets	Decrease assets
Decrease liabilities	Increase liabilities

HELPFUL HINT
The normal balance for an account is always the same as the increase side.

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. Illustration 3-4 shows how the normal balances can be diagrammed.

Illustration 3-4

Normal balances—assets and liabilities



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).

Stockholders' Equity

As indicated in Chapter 1, there are five subdivisions of stockholders' equity: common stock, retained earnings, dividends, revenues, and expenses. In a double-entry system, accounts are kept for each of these subdivisions, as explained below.

COMMON STOCK. **Common stock** is issued in exchange for the owners' investment paid into the corporation. The Common Stock account is increased by credits and decreased by debits. When cash is invested in the business in exchange for shares of the corporation's stock, Cash is debited and Common Stock is credited.

The rules of debit and credit for the Common Stock account are stated in Illustration 3-5.

Illustration 3-5
Debit and credit effect—common stock

Debits	Credits
Decrease common stock	Increase common stock

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

Illustration 3-6
Normal balance—common stock

Common Stock	
Debit for decrease	Credit for increase
	Normal balance

HELPFUL HINT
The rules for debit and credit and the normal balance of common stock are the same as for liabilities.

RETAINED EARNINGS. **Retained earnings** is net income that is retained in the business. It represents the portion of stockholders' equity that has been accumulated through the profitable operation of the business. Retained earnings is increased by credits (net income) and decreased by debits (dividends or net losses), as shown in Illustration 3-7.

Illustration 3-7
Debit and credit effect and normal balance—retained earnings

Retained Earnings	
Debit for decrease	Credit for increase
	Normal balance

DIVIDENDS. A **dividend** is a distribution by a corporation to its stockholders on a pro rata (equal) basis. The most common form of a distribution is a **cash dividend**. Dividends can be declared (authorized) only by the board of directors. They are a reduction of the stockholders' claims on retained earnings. The Dividends account is increased by debits and decreased by credits, with a normal debit balance as shown in Illustration 3-8.

Illustration 3-8
Debit and credit effect and normal balance—dividends

Dividends	
Debit for increase	Credit for decrease
Normal balance	

Revenues and Expenses

HELPFUL HINT
Because revenues increase stockholders' equity, a revenue account has the same debit and credit rules as does the common stock account. Conversely, expenses have the opposite effect.

Remember that the ultimate purpose of earning revenues is to benefit the stockholders of the business. When revenues are earned, stockholders' equity is increased. Revenues are a subdivision of stockholders' equity that provides information as to *why* stockholders' equity increased. Revenue accounts are increased by credits and decreased by debits. Accordingly, **the effect of debits and credits on revenue accounts is identical to their effect on stockholders' equity**.

Expenses have the opposite effect: expenses decrease stockholders' 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 may be stated as follows.

Illustration 3-9
Debit and credit effects—revenues and expenses

Debits	Credits
Decrease revenues	Increase revenues
Increase expenses	Decrease expenses

Credits to revenue accounts should exceed the debits, and debits to expense accounts should exceed credits. Thus, revenue accounts normally show credit balances, and expense accounts normally show debit balances. Illustration 3-10 diagrams the normal balances.

Illustration 3-10
Normal balances—revenues and expenses

Revenues	
Debit for decrease	Credit for increase
	Normal balance

Expenses	
Debit for increase	Credit for decrease
Normal balance	

ACCOUNTING IN ACTION *Business Insight*

The Chicago Cubs baseball team has the following major revenue and expense accounts.

Revenues	Expenses
Admissions (ticket sales)	Players' salaries
Concessions	Administrative salaries
Television and radio	Travel
Advertising	Ballpark maintenance

STOCKHOLDERS' EQUITY RELATIONSHIPS

As indicated in Chapter 1, common stock and retained earnings are reported in the stockholders' equity section of the balance sheet. Dividends are reported on the retained earnings statement. Revenues and expenses are reported on the income statement. Dividends, revenues, and expenses are eventually transferred to retained earnings at the end of the period. As a result, a change in any one of these three items affects stockholders' equity. The relationships related to stockholders' equity are shown in Illustration 3-11.

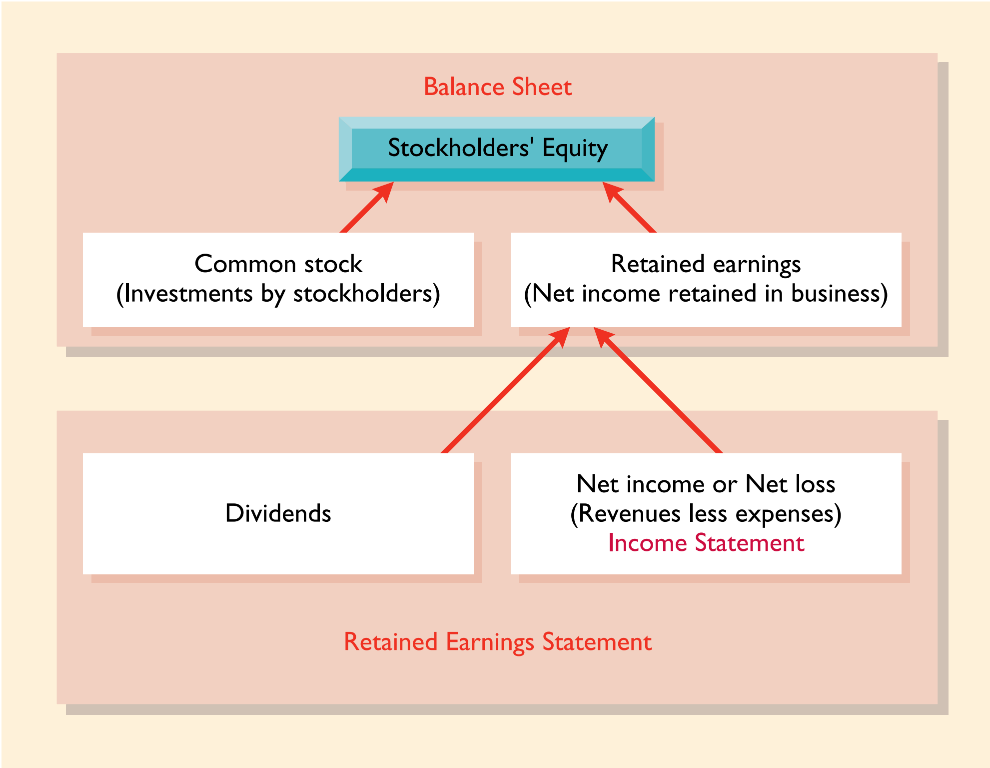
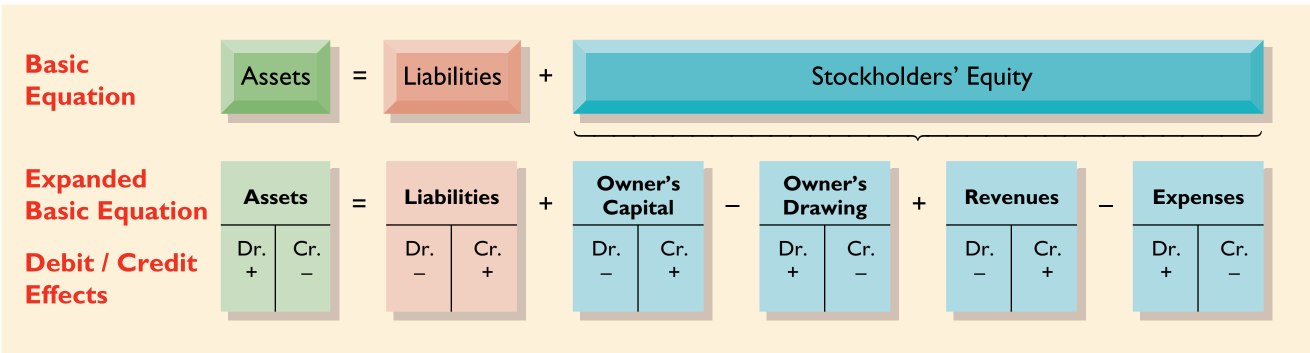


Illustration 3-11
Stockholders' equity relationships

EXPANSION OF THE BASIC EQUATION

You have already learned the basic accounting equation. Illustration 3-12 expands this equation to show the accounts that compose stockholders' 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).

Illustration 3-12
Expanded basic equation and debit/credit rules and effects



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

REVIEW IT

1. What do the terms *debit* and *credit* mean?
2. What are the debit and credit effects on assets, liabilities, and stockholders' equity?
3. What are the debit and credit effects on revenues, expenses, and dividends?
4. What are the normal balances for **Hilton's** Cash, Accounts Payable, and Interest Expense accounts? The answers to this question are provided on page 108.

Image rights not available

DO IT

Kate Browne, president of Raisin Buns, Inc. has just rented space in a shopping mall in which she will open and operate a beauty salon. Long before opening day and before purchasing equipment, hiring assistants, and remodeling the space, Kate has been advised to set up a double-entry set of accounting records in which to record all of her business transactions.

Identify the balance sheet accounts that Raisin Buns, Inc. will likely need to record the transactions needed to establish and open the business. Also, indicate whether the normal balance of each account is a debit or a credit.

ACTION PLAN

- Determine the types of accounts needed: Kate will need asset accounts for each type of asset she invests in the business, and liability accounts for any debts she incurs.
- Understand the types of stockholders' equity accounts: Only Common Stock will be needed when Kate begins the business. Other stockholders' equity accounts will be needed later.

SOLUTION: Raisin Buns, Inc. would likely need the following accounts to record the transactions needed to ready the beauty salon for opening day: Cash (debit balance); Equipment (debit balance); Supplies (debit balance); Accounts Payable (credit balance); Notes Payable (credit balance), if the business borrows money; and Common Stock (credit balance).

Related exercise material: 3-1 and 3-2.

THE NAVIGATOR

STEPS IN THE RECORDING PROCESS

STUDY OBJECTIVE 3

Identify the basic steps in the recording process.

In practically every business, there are three basic steps in the recording process:

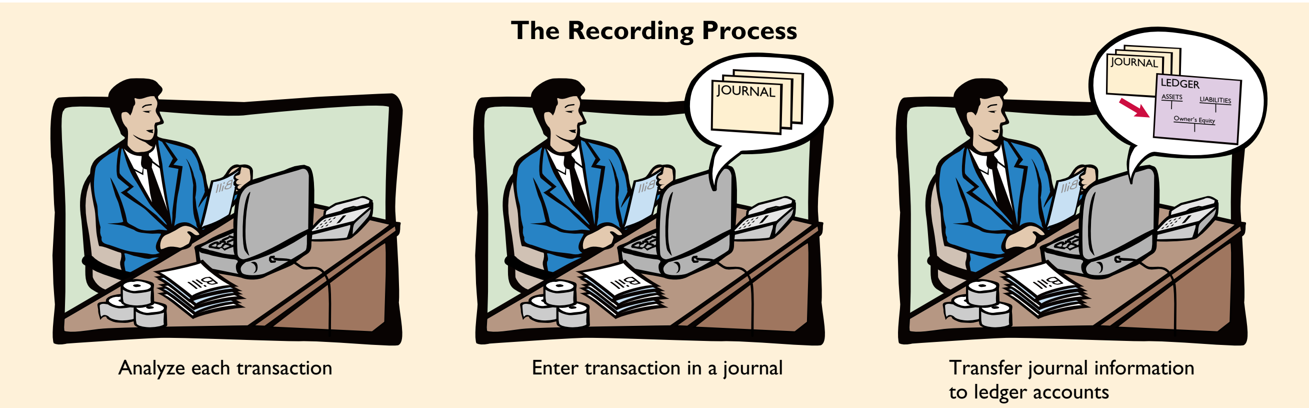
1. Analyze each transaction for its effects on the accounts.
2. Enter the transaction information in a journal (book of original entry).
3. Transfer the journal information to the appropriate accounts in the ledger (book of accounts).

Although it is possible to enter transaction information directly into the accounts without using a journal, 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 journal. Finally, the journal entry is transferred to the designated accounts

Illustration 3-13

The recording process



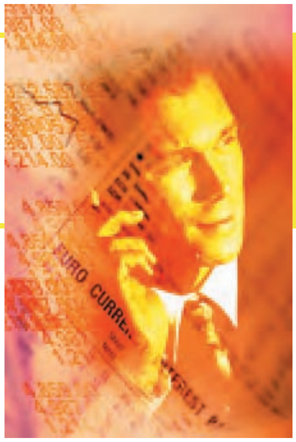
in the ledger. The sequence of events in the recording process is shown in Illustration 3-13.

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.

Technology in Action examples show how computer technology is used in accounting and business.

TECHNOLOGY IN ACTION

Computerized and manual accounting systems basically parallel one another. Most of the procedures are handled by electronic circuitry in computerized systems. They seem to occur invisibly. But, to fully comprehend how computerized systems operate, you need to understand manual approaches for processing accounting data.



THE JOURNAL

STUDY OBJECTIVE 4

Explain what a journal is and how it helps in the recording process.

Transactions are initially recorded in chronological order in a **journal** 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. 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.

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 3-14 shows the technique of journalizing, using the first two transactions of Best Caterers, Inc. These transactions were: September 1, stockholders invested $15,000 cash in the corporation in exchange for shares of stock, and computer equipment was purchased for $7,000 cash. The number J1 indicates that these two entries are recorded on the first page of the general journal.

Illustration 3-14

Technique of journalizing

GENERAL JOURNAL — J1

Date		Account Titles and Explanation	Ref.	Debit	Credit
2002					
Sept.	1	Cash		15,000	
		Common Stock			15,000
		(Issued shares of stock for cash)			
	1	Computer Equipment		7,000	
		Cash			7,000
		(Purchased equipment for cash)			

The standard form and content of journal entries are as follows:

- The date of the transaction is entered in the Date column. The date recorded should include the year, month, and day of the transaction.
- 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.
- The credit account title (i.e., 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.
- A brief explanation of the transaction is given on the line below the credit account title.
- A space is left between journal entries. The blank space separates individual journal entries and makes the entire journal easier to read.
- 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 journalizing. 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 Special Events 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 shown in Illustration 3-15.

Illustration 3-15

Compound journal entry

GENERAL JOURNAL J1

Date		Account Titles and Explanation	Ref.	Debit	Credit
2004					
July	1	Delivery Equipment		14,000	
		Cash			8,000
		Accounts Payable			6,000
		(Purchased truck for cash with balance on account)			

HELPFUL HINT

Assume you find this compound entry:

Wages Expense	700	
Cash		1,200
Rent Expense	400	

(Paid cash for wages and rent)

Is the entry correct? No. It is incorrect in form because both debits should be listed before the credit. It is incorrect in content because the debit amounts do not equal the credit amount.

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.

[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.

BEFORE YOU GO ON...

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, Raisin Buns, Inc., Kate Browne as president and sole stockholder engaged in the following activities.

1. Opened a bank account in the name of Raisin Buns, Inc. and deposited $20,000 of her own money in this account in exchange for shares of common stock.
2. Purchased equipment on account (to be paid in 30 days) for a total cost of $4,800.
3. Interviewed three applicants for the position of stylists.

In what form (type of record) should Raisin Buns, Inc. 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 stockholders' equity accounts.

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

1. Cash	20,000	
Common Stock		20,000
(Issued shares of stock for cash)		
2. Equipment	4,800	
Acounts Payable		4,800
(Purchased equipment on account)		
3. No entry because no transaction has occurred		

Related exercise material: 3-3 and 3-7.

THE LEDGER

STUDY OBJECTIVE 5

Explain what a ledger is and how it helps in the recording process.

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 stockholders' equity accounts, as shown in Illustration 3-16.

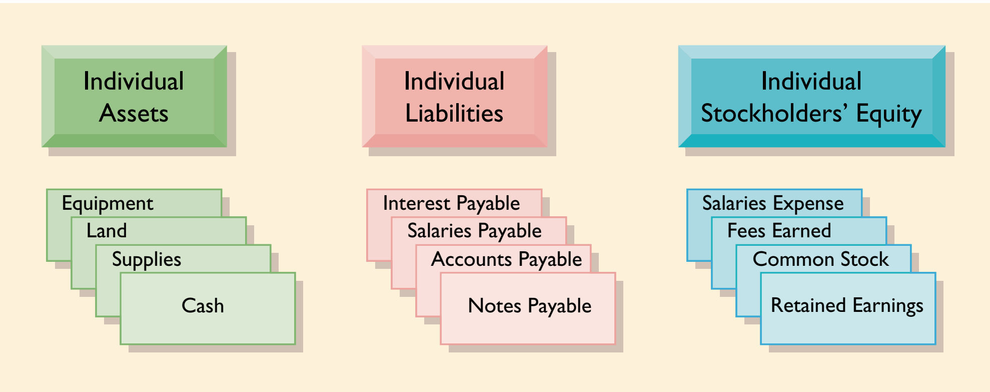


Illustration 3-16

The general ledger

A business can use a looseleaf binder or card file for the ledger. Each account is kept on a separate sheet or card. Whenever the term *ledger* is used in this textbook without a modifying adjective, it means 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, stockholders' equity accounts, 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.

ACCOUNTING IN ACTION *Business Insight*

In his autobiography Sam Walton described the double-entry accounting system he began the **Wal-Mart** 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."

SOURCE: Sam Walton, *Made in America* (New York: Doubleday, 1992), p. 53.

Standard Form of Account

The simple T-account form used in accounting textbooks is often useful for illustration purposes. However, in practice, the account forms used in ledgers are much more structured. A widely used form is shown in Illustration 3-17, using assumed data from a cash account.

Illustration 3-17

Three-column form of account

CASH					No. 101
Date	**Explanation**	**Ref.**	**Debit**	**Credit**	**Balance**
2004					
June 1			25,000		25,000
2				8,000	17,000
3			4,200		21,200
9			7,500		28,700
17				11,700	17,000
20				250	16,750
30				7,300	9,450

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

STUDY OBJECTIVE 6

Explain what posting is and how it helps in the recording process.

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 3-18 using the first journal entry of Best Caterers, Inc. The boxed numbers indicate the sequence of the steps.

Illustration 3-18

Posting a journal entry

GENERAL JOURNAL J1

Date	Account Titles and Explanation	Ref.	Debit	Credit
2004 Sept. 1	Cash	101	15,000	
	Common Stock	311		15,000
	(Issued shares of stock for cash)			

GENERAL LEDGER

Cash No. 101

Date	Explanation	Ref.	Debit	Credit	Balance
2004 Sept. 1		J1	15,000		15,000

Common Stock No. 311

Date	Explanation	Ref.	Debit	Credit	Balance
2004 Sept. 1		J1		15,000	15,000

Key:
1 Post to debit account–date, journal page number, and amount.
2 Enter debit account number in journal reference column.
3 Post to credit account–date, journal page number, and amount.
4 Enter credit account number in journal reference column.

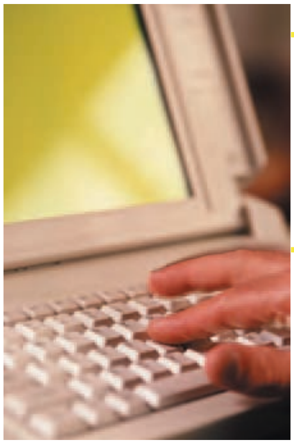
Posting should be performed in chronological order. That is, all the debits and credits of one journal entry should be posted before proceeding to the next journal entry. Postings should be made on a timely basis to ensure that the ledger is up to date.[3]

HELPFUL HINT
How can one tell whether all postings have been completed? Answer: Scan the reference column of the journal to see whether there are any blanks opposite account titles. If there are no blanks, all postings have been made.

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

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 infrequently because an explanation already appears in the journal. It generally is used only when detailed analysis of account activity is required.



TECHNOLOGY IN ACTION

Determining what to record is the most critical (and for most businesses the most expensive) point in the accounting process. In computerized systems, after this phase is completed, the input and all further processing just boil down to merging files and generating reports. Programmers and management information system types with good accounting backgrounds (such as they should gain from a good principles textbook) are better able to develop effective computerized systems.

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 small corporation like Best Caterers, Inc. will have fewer accounts than a corporate giant like **General Mills**. Best Caterers, Inc. may be able to manage and report its activities in twenty to thirty accounts, while **General Mills** 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 Premier Staffing Agency Inc. (a service enterprise). Accounts 101–199 indicate asset accounts; 200–299 indicate liabilities; 300–350 indicate stockholders' equity accounts; 400–499, revenues; 601–799, expenses; 800–899, other revenues; and 900–999, other expenses.

The chart of accounts for Premier Staffing Agency Inc. is shown in Illustration 3-19. 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 Premier Staffing Agency Inc. Gaps are left to permit the insertion of new accounts as needed during the life of the business.

Illustration 3-19

Chart of accounts for Premier Staffing Agency Inc.

CHART OF ACCOUNTS
Premier Staffing Agency Inc.

Assets	Stockholders' Equity
101 Cash	**311 Common Stock**
112 Accounts Receivable	320 Retained Earnings
129 Supplies	**332 Dividends**
130 Prepaid Insurance	350 Income Summary
157 Office Equipment	
158 Accumulated Depreciation—Office Equipment	**Revenues**
	400 Service Revenue
Liabilities	**Expenses**
200 Notes Payable	611 Advertising Supplies Expense
201 Accounts Payable	711 Depreciation Expense
209 Unearned Revenue	722 Insurance Expense
212 Salaries Payable	**726 Salaries Expense**
230 Interest Payable	**729 Rent Expense**
	905 Interest Expense

THE RECORDING PROCESS ILLUSTRATED

Illustrations 3-20 through 3-29 show the basic steps in the recording process, using the October transactions of the Premier Staffing Agency Inc. 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 3-20 through 3-29 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, stockholders' equity, revenues, or expenses. By becoming skilled at transaction analysis, you will be able to recognize quickly the impact of any transaction on these five items.

Illustration 3-20

Investment of cash by stockholders

Transaction

October 1, stockholders invest $10,000 cash in an advertising venture to be known as the Premier Staffing Agency Inc.

Basic Analysis

The asset Cash is increased $10,000, and stockholders' equity (specifically Common Stock) is increased $10,000.

Debit – Credit Analysis

Debits increase assets: debit Cash $10,000.
Credits increase stockholders' equity: credit Common Stock $10,000.

Journal Entry

Oct. 1	Cash	101	10,000	
	Common Stock	311		10,000
	(Issued shares of stock for cash)			

Posting

Cash	101
Oct. 1, 10,000	

Common Stock	311
	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.
First: Determine what type of account is involved.
Second: Determine what items increased or decreased and by how much.
Third: Translate the increases and decreases into debits and credits.

Illustration 3-21

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	Office Equipment	157	5,000	
	Notes Payable	200		5,000
	(Issued 3-month, 12% note for office equipment)			

Posting

Office Equipment	157
Oct. 1, 5,000	

Notes Payable	200
	Oct. 1, 5,000

Illustration 3-22

Receipt of cash for future service

Transaction

October 2, a $1,200 cash advance is received from R. Knox, a client, for staffing services that are expected to be completed by December 31.

Basic Analysis

The asset Cash is increased $1,200; the liability Unearned Revenue is increased $1,200 because the service has not been rendered 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.

Debit – Credit Analysis

Debits increase assets: debit Cash $1,200.
Credits increase liabilities: credit Unearned Revenue $1,200.

Journal Entry

Oct. 2	Cash	101	1,200	
	Unearned Revenue	209		1,200
	(Received cash from R. Knox for future service)			

Posting

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

Unearned Revenue		209
	Oct. 2	1,200

HELPFUL HINT

When the revenue is earned, the Unearned Revenue account is debited (decreased), and a revenue account is credited (increased).

Illustration 3-23

Payment of monthly rent

Transaction

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

Basic Analysis

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

Debit – Credit Analysis

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

Journal Entry

Oct. 3	Rent Expense	729	900	
	Cash	101		900
	(Paid October rent)			

Posting

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

Rent Expense		729
Oct. 3	900	

Illustration 3-24

Payment for insurance

Transaction

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

Basic Analysis

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.

Debit – Credit Analysis

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

Journal Entry

Oct. 4	Prepaid Insurance	130	600	
	Cash	101		600
	(Paid one-year policy; effective date October 1)			

Posting

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

Prepaid Insurance			130
Oct. 4	600		

Illustration 3-25

Purchase of supplies on credit

Transaction

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

Basic Analysis

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

Debit – Credit Analysis

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

Journal Entry

Oct. 5	Supplies	129	2,500	
	Accounts Payable	201		2,500
	(Purchased supplies on account from Aero Supply)			

Posting

Supplies			129
Oct. 5	2,500		

Accounts Payable			201
		Oct. 5	2,500

Illustration 3-26

Hiring of employees

Transaction	October 9, hire four employees to begin work on October 15. Each employee is to receive a weekly salary of $500 for a 5-day work week, payable every 2 weeks—first payment made on October 26.
Basic Analysis	A business transaction has not occurred. 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.)

Illustration 3-27

Declaration and payment of dividend by corporation

Transaction	October 20, the board of directors declares and pays a $500 cash dividend to stockholders.
Basic Analysis	The dividends account is increased $500; the asset Cash is decreased $500.
Debit – Credit Analysis	Debits increase dividends: debit Dividends $500. Credits decrease assets: credit Cash $500.

Journal Entry

Oct. 20	Dividends	332	500	
	Cash	101		500
	(Declared and paid a cash dividend)			

Posting

Cash			101
Oct. 1	10,000	Oct. 3	900
2	1,200	4	600
		20	500

Dividends			332
Oct. 20	500		

Illustration 3-28

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

Oct. 26	Salaries Expense	726	4,000	
	Cash	101		4,000
	(Paid salaries to date)			

Posting

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

Salaries Expense			726
Oct. 26	4,000		

Illustration 3-29

Receipt of cash for services provided

Transaction
October 31, received $10,000 in cash from Copa Company for staffing 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

Oct. 31	Cash	101	10,000	
	Service Revenue	400		10,000
	(Received cash for services provided)			

Posting

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

Service Revenue			400
		Oct. 31	10,000

ACCOUNTING IN ACTION e-Business Insight

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 internally accepted framework called the Extensible Business Reporting Language (XBRL). The organization comprises 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.

The journal for Premier Staffing Agency Inc. for October is shown in Illustration 3-30. The ledger is shown in Illustration 3-31, on page 96, with all balances in color.

Illustration 3-30

General journal entries

General Journal				Page J1
Date	**Account Titles and Explanation**	**Ref.**	**Debit**	**Credit**
2004				
Oct. 1	Cash	101	10,000	
	Common Stock	311		10,000
	(Issued shares of stock for cash)			
1	Office Equipment	157	5,000	
	Notes Payable	200		5,000
	(Issued 3-month, 12% note for office equipment)			
2	Cash	101	1,200	
	Unearned Revenue	209		1,200
	(Received cash from R. Knox for future services)			
3	Rent Expense	729	900	
	Cash	101		900
	(Paid October rent)			
4	Prepaid Insurance	130	600	
	Cash	101		600
	(Paid one-year policy; effective date October 1)			
5	Supplies	129	2,500	
	Accounts Payable	201		2,500
	(Purchased supplies on account from Aero Supply)			

Illustration 3-30
Continued

GENERAL JOURNAL **PAGE J1**

Date	Account Titles and Explanation	Ref.	Debit	Credit
20	Dividends	332	500	
	Cash	101		500
	(Declared and paid a cash dividend)			
26	Salaries Expense	726	4,000	
	Cash	101		4,000
	(Paid salaries to date)			
31	Cash	101	10,000	
	Service Revenue	400		10,000
	(Received cash for services provided)			

Illustration 3-31
General ledger

GENERAL LEDGER

Cash **No. 101**

Date	Explanation	Ref.	Debit	Credit	Balance
2004					
Oct. 1		J1	10,000		10,000
2		J1	1,200		11,200
3		J1		900	10,300
4		J1		600	9,700
20		J1		500	9,200
26		J1		4,000	5,200
31		J1	10,000		**15,200**

Supplies **No. 129**

Date	Explanation	Ref.	Debit	Credit	Balance
2004					
Oct. 5		J1	2,500		**2,500**

Prepaid Insurance **No. 130**

Date	Explanation	Ref.	Debit	Credit	Balance
2004					
Oct. 4		J1	600		**600**

Office Equipment **No. 157**

Date	Explanation	Ref.	Debit	Credit	Balance
2004					
Oct. 1		J1	5,000		**5,000**

Notes Payable **No. 200**

Date	Explanation	Ref.	Debit	Credit	Balance
2004					
Oct. 1		J1		5,000	**5,000**

Accounts Payable **No. 201**

Date	Explanation	Ref.	Debit	Credit	Balance
2004					
Oct. 5		J1		2,500	**2,500**

Unearned Revenue **No. 209**

Date	Explanation	Ref.	Debit	Credit	Balance
2004					
Oct. 2		J1		1,200	**1,200**

Common Stock **No. 311**

Date	Explanation	Ref.	Debit	Credit	Balance
2004					
Oct. 1		J1		10,000	**10,000**

Dividends **No. 332**

Date	Explanation	Ref.	Debit	Credit	Balance
2004					
Oct. 20		J1	500		**500**

Service Revenue **No. 400**

Date	Explanation	Ref.	Debit	Credit	Balance
2004					
Oct. 31		J1		10,000	**10,000**

Salaries Expense **No. 726**

Date	Explanation	Ref.	Debit	Credit	Balance
2004					
Oct. 26		J1	4,000		**4,000**

Rent Expense **No. 729**

Date	Explanation	Ref.	Debit	Credit	Balance
2004					
Oct. 3		J1	900		**900**

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

Raisin Buns, Inc. recorded the following transactions in a general journal during the month of March.

Cash	2,280	
Service Revenue		2,280
Wages Expense	400	
Cash		400
Utilities Expense	92	
Cash		92

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

Cash

3/1	600	400
	2,280	92
3/31 Bal.	2,388	

Related exercise material: 3-4 and 3-6.

THE NAVIGATOR

THE TRIAL BALANCE

STUDY OBJECTIVE 7

Prepare a trial balance and explain its purposes.

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.

There are three steps for preparing a trial balance:

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 Premier Staffing's ledger is shown in Illustration 3-32.

Illustration 3-32

A trial balance

PREMIER STAFFING AGENCY INC.
Trial Balance
October 31, 2004

	Debit	Credit
Cash	$15,200	
Supplies	2,500	
Prepaid Insurance	600	
Office Equipment	5,000	
Notes Payable		$ 5,000
Accounts Payable		2,500
Unearned Revenue		1,200
Common Stock		10,000
Dividends	500	
Service Revenue		10,000
Salaries Expense	4,000	
Rent Expense	900	
	$28,700	**$28,700**

HELPFUL HINT
To sum a column of figures is sometimes referred to as *to foot* the column. The column is then said to be *footed.*

HELPFUL HINT
A trial balance is so named because it is a test to see if the sum of the debit balances equals the sum of the credit balances.

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.

ETHICS NOTE
Auditors are required to differentiate *errors* from *irregularities* when evaluating the accounting system. An error is the result of an unintentional mistake; as such, it is neither ethical nor unethical. An irregularity, on the other hand, is an intentional misstatement, which is viewed as unethical.

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 recompute 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.

TECHNOLOGY IN ACTION

In a computerized system, the trial balance is often only one column (no debit or credit columns), and the accounts have plus and minus signs associated with them. The final balance therefore is zero. Any errors that develop in a computerized system will undoubtedly involve the initial recording rather than some error in the posting or preparation of a trial balance.

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.

HELPFUL HINT
We have avoided the use of cents in the text to save you time and effort.

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?

ELECTRONIC DATA PROCESSING

In accounting offices, calculators, eighteen-column pads, and tapes have moved aside for spreadsheet programs and software applications. In a theme park restaurant, cash registers gave way to point-of-sales systems, which total sales figures and produce managerial reports. In a hotel, the manual folio system was replaced by property management system, and many night audit functions are now performed during the business day. The use of the Internet brings yet another dimension to the hospitality industry.

COMPARATIVE ADVANTAGES OF MANUAL VERSUS COMPUTERIZED SYSTEMS

Are computerized systems better? Well, it depends. With regard to speed, the computerized system wins. In today's business world there is a need to act daily, not monthly, making speed and efficiency the name of the game. However, in accounting there is a need for both the manual and computerized system.

Comprehension and Usage

To really understand accounting and use it effectively, you need to learn it manually first. You need to know the steps involved in the accounting cycle—accounts, types, normal balances, and debits and credits—before determining if an event is a business transaction. Only then do you begin the recording process. First come the journal and the ledger, then the trial balance, and later the adjustments. With a good knowledge of the ins and outs of a manual system, if you make a mistake somewhere, it is quite easy to backtrack and make corrections. If you only know how to enter numbers to input data and do not know why and how the numbers are being compiled, a $10 mistake can easily be compounded into a $200 mistake on the books.

Speed and Efficiency

A computerized system obviously has the advantage over the manual system in this regard. A touch of a few buttons and a short amount of time are all that is needed to generate reports that otherwise take hours. When you enter a debit and a credit into an accounting software, the balances are posted directly into the appropriate accounts in the general ledger. The data are then added and subtracted and a new balance is calculated. This balance is automatically transferred to the correct line item on a trial balance. This all happens in a matter of seconds.

Accuracy

Humans do make errors. If a computer system is programmed correctly, there should not be any errors in the output. The time needed to detect and correct errors can be saved if the system is in full operation. However, if a human error occurs in data entry, the results will still be incorrect.

Timeliness of Information

One advantage of a computerized system is having updated information at your fingertips. As soon as data are entered, the new and updated information is available. Once raw data are gathered, analyzing them is a matter of programming in spreadsheet formulas. A lot of time is saved and information, therefore, is timely. No longer will a manager have to wait two weeks after a month-end closing to find out how much profit and loss were realized in the past month.

A LOOK INTO THE FUTURE

Computerization and technology hold vast potential for the hospitality industry. Personal computers are more efficient than ever, and personal data assistants are part of a businessperson's wardrobe. Touch screens now replace bulky point-of-sales systems in foodservice outlets. Handheld ordering devices for servers are here already. Billing and invoices for a group's hotel stay can be sent via e-mail directly from the property management system. **Application solutions providers (ASPs)** are the fastest growing segment of the technology industry. These firms are targeting the club industry as they provide all technical system components at a secure remote site. Thus, club managers can concentrate their time on membership and operations issues while qualified personnel monitor the technology. Club managers no longer need to worry about shopping for systems, training, hardware and software installation, incremental upgrades, connectivity, and access issues. ASPs are also looking into the hotel industry. Some companies, such as **Meristar Hotels and Resorts**, are their own ASP, providing the remote control and data storing and crunching functions for their general managers.

Technology also touches the restaurant industry. In 1996, **Long John Silver's** revamped its accounting procedures to use computerization in all general ledger, accounts payable and receivable, asset management, store-level reporting, and activity management. Small chain restaurants such as **Pasta Pomodoro** in San Francisco have begun using the Internet for purchasing and business analysis. Let's face it, technology and accounting data go hand in hand.

A LOOK BACK AT OUR FEATURE STORY

Refer back to the Feature Story about **The Mug and Musket** at the beginning of the chapter, and answer the following questions.

1. What accounting entries would Tanis likely make to record (a) the receipt of cash from a customer in payment of their bill, (b) payment of a utility bill, and (c) payment of wages for the waiters?

2. How did Tanis's job as Director of Finance help in her studies as she finished her business administration degree?

SOLUTION

1. Tanis would likely make the following entries.

(a) Cash
  Food Sales Revenue
   (Receipt of payment for foodservices)

(b) Utility Expense
  Cash
   (Payment of electric bill)

(c) Salaries (or Wages) Expense
  Cash
   (Paid waiters' wages)

2. As a result of her accounting position, Tanis was able to relate the subject matter as well as much of the assignment material in her business courses to a real-world context. From her job, she knew how bills were paid, how supplies were determined, and how employees were hired, managed, evaluated, and paid.

THE NAVIGATOR

DEMONSTRATION PROBLEM

Bob Sample and other student investors opened the Campus Laundromat Inc. on September 1, 2004. During the first month of operations the following transactions occurred.

Sept.	1	Stockholders 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	Declared and paid a cash dividend to stockholders $700.
	30	Determined that cash receipts for laundry fees for the month were $6,200.

The chart of accounts for the company is the same as for Premier Staffing Agency Inc. 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, 2004.

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 J1

Date	Account Titles and Explanation	Ref.	Debit	Credit
2004				
Sept. 1	Cash	101	20,000	
	Common Stock	311		20,000
	(Stockholders invested cash in business)			
2	Rent Expense	729	1,000	
	Cash	101		1,000
	(Paid September rent)			
3	Laundry Equipment	154	25,000	
	Cash	101		10,000
	Notes Payable	200		15,000
	(Purchased laundry equipment for cash and 6-month, 12% note payable)			
4	Prepaid Insurance	130	1,200	
	Cash	101		1,200
	(Paid one-year insurance policy)			
10	Advertising Expense	610	200	
	Accounts Payable	201		200
	(Received bill from *Daily News* for advertising)			
20	Dividends	332	700	
	Cash	101		700
	(Declared and paid a cash dividend)			
30	Cash	101	6,200	
	Service Revenue	400		6,200
	(Received cash for laundry fees earned)			

(b) GENERAL LEDGER

Cash No. 101

Date	Explanation	Ref.	Debit	Credit	Balance
2004					
Sept. 1		J1	20,000		20,000
2		J1		1,000	19,000
3		J1		10,000	9,000
4		J1		1,200	7,800
20		J1		700	7,100
30		J1	6,200		13,300

Laundry Equipment No. 154

Date	Explanation	Ref.	Debit	Credit	Balance
2004					
Sept. 3		J1	25,000		25,000

Notes Payable No. 200

Date	Explanation	Ref.	Debit	Credit	Balance
2004					
Sept. 3		J1		15,000	15,000

Prepaid Insurance No. 130

Date	Explanation	Ref.	Debit	Credit	Balance
2004					
Sept. 4		J1	1,200		1,200

Accounts Payable No. 201

Date	Explanation	Ref.	Debit	Credit	Balance
2004					
Sept. 10		J1		200	200

Accounts Payable **No. 201**

Date	Explanation	Ref.	Debit	Credit	Balance
2004					
Sept. 10		J1		200	200

Common Stock **No. 311**

Date	Explanation	Ref.	Debit	Credit	Balance
2004					
Sept. 1		J1		20,000	20,000

Dividends **No. 332**

Date	Explanation	Ref.	Debit	Credit	Balance
2004					
Sept. 1		J1	700		700

Service Revenue **No. 400**

Date	Explanation	Ref.	Debit	Credit	Balance
2004					
Sept. 30		J1		6,200	6,200

Advertising Expense **No. 610**

Date	Explanation	Ref.	Debit	Credit	Balance
2004					
Sept. 10		J1	200		200

Rent Expense **No. 729**

Date	Explanation	Ref.	Debit	Credit	Balance
2004					
Sept. 2		J1	1,000		1,000

(c)

CAMPUS LAUNDROMAT INC.
Trial Balance
September 30, 2004

	Debit	Credit
Cash	$13,300	
Prepaid Insurance	1,200	
Laundry Equipment	25,000	
Notes Payable		$15,000
Accounts Payable		200
Common Stock		20,000
Dividends	700	
Service Revenue		6,200
Advertising Expense	200	
Rent Expense	1,000	
	$41,400	$41,400

THE NAVIGATOR

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 stockholders' 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, dividends, and expenses are increased by debits and decreased by credits. Liabilities, common stock, retained earnings, 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.

8. ***Identify the advantages of both the manual and computerized accounting systems.*** A manual accounting system is advantageous when one is learning accounting. Learning the system manually provides users with a better comprehension of accounting and its logic. A computerized system does have the advantages of speed, efficiency, accuracy, and timeliness of information. However, the data compiled are only as good and as accurate as the data being entered. Thus, manual and computerized accounting systems do complement each other.

THE NAVIGATOR

GLOSSARY

Account A record of increases and decreases in specific asset, liability, or stockholders' equity items (p. 76).

Application Solutions Providers Companies that provide application solutions directly to the end-users in the industry. The end-users purchase application solutions via the Internet rather than the software (p. 100).

Chart of accounts A list of accounts and the account numbers that identify their location in the ledger (p. 88).

Common stock Issued in exchange for the owners' investment paid in to the corporation (p. 79).

Compound entry A journal entry that involves three or more accounts (p. 84).

Credit The right side of an account (p. 77).

Debit The left side of an account (p. 77).

Dividend A distribution by a corporation to its stockholders on a pro rata (equal) basis (p. 79).

Double-entry system A system that records in appropriate accounts the dual effect of each transaction (p. 77).

General journal The most basic form of journal (p. 83).

General ledger A ledger that contains all asset, liability, and stockholders' equity accounts (p. 85).

Journal An accounting record in which transactions are initially recorded in chronological order (p. 83).

Journalizing The entering of transaction data in the journal (p. 83).

Ledger The entire group of accounts maintained by a company (p. 85).

Posting The procedure of transferring journal entries to the ledger accounts (p. 87).

Retained earnings Net income that is retained in the business (p. 79).

Simple entry A journal entry that involves only two accounts (p. 84).

T account The basic form of an account (p. 76).

Three-column form of account A form with columns for debit, credit, and balance amounts in an account (p. 86).

Trial balance A list of accounts and their balances at a given time (p. 97).

EXERCISES

Indicate debit and credit effects and normal balance.
(SO 2)

3-1 For each of the following accounts indicate (a) the effect of a debit or a credit on the account and (b) the normal balance.

1. Accounts Payable
2. Advertising Expense
3. Service Revenue
4. Accounts Receivable
5. Common Stock
6. Dividends

Identify accounts to be debited and credited.
(SO 2)

3-2 Transactions for Doris Wang Company for the month of June are presented below. Identify the accounts to be debited and credited for each transaction, and journalize the transactions.

June	1	Doris Wang invests $12,000 cash in exchange for shares of common stock in a small printing corporation.
	2	Buys equipment on account for $7,500.
	3	Pays $800 to landlord for June rent.
	12	Bills B. J. Chang $400 for printing work done.

Indicate basic and debit–credit analysis.
(SO 4)

3-3 Jim Carrey Corporation has the following transactions during August of the current year. Indicate (a) the basic analysis and (b) the debit–credit analysis illustrated on pages 90–93 of the text. Journalize the transactions.

Aug.	1	Opens an office as a financial advisor, investing $15,000 in cash in exchange for common stock.
	4	Pays insurance in advance for 6 months, $2,100.
	16	Receives $1,000 from clients for services rendered.
	27	Pays secretary $900 salary.

3-4 Selected transactions for Fernholz Company are presented in journal form below. Post the transactions to T accounts.

Post journal entries to T accounts.
(SO 6)

J1

Date	Account Titles and Explanation	Ref.	Debit	Credit
May 5	Accounts Receivable		6,800	
	Service Revenue			6,800
12	Cash		4,100	
	Accounts Receivable			4,100
15	Cash		3,000	
	Service Revenue			3,000

3-5 An inexperienced bookkeeper prepared the following trial balance that does not balance. Prepare a correct trial balance, assuming all account balances are normal.

Prepare a correct trial balance.
(SO 7)

ARMARO COMPANY
Trial Balance
December 31, 2004

	Debit	Credit
Cash	$31,600	
Prepaid Insurance		$ 3,900
Accounts Payable		7,500
Unearned Fees	5,800	
Common Stock		20,000
Dividends		5,000
Service Revenue		29,200
Salaries Expense	19,000	
Rent Expense		3,000
	$56,400	$68,600

3-6 Selected transactions from the journal of Tiger Woods Inc., investment brokerage firm, are presented below.

Post journal entries and prepare a trial balance.
(SO 6, 7)

Date	Account Titles and Explanation	Ref.	Debit	Credit
Aug. 1	Cash		9,600	
	Common Stock			9,600
	(Investment of cash for stock)			
10	Cash		2,800	
	Service Revenue			2,800
	(Received cash for services provided)			
12	Office Equipment		4,500	
	Cash			2,000
	Notes Payable			2,500
	(Purchased office equipment for cash and notes payable)			
25	Accounts Receivable		1,650	
	Service Revenue			1,650
	(Billed for services provided)			
31	Cash		1,200	
	Accounts Receivable			1,200
	(Receipt of cash on account)			

Instructions

(a) Post the transactions to T accounts.
(b) Prepare a trial balance at August 31, 2004.

Journalize transactions from account data, and prepare a trial balance.
(SO 4, 7)

3-7 The T accounts below summarize the ledger of Quick Response Catering Corporation at the end of the first month of operations:

Cash — No. 101

4/1	10,000	4/15	450
4/12	600	4/25	1,100
4/29	900		
4/30	600		

Unearned Revenue — No. 209

		4/30	600

Accounts Receivable — No. 112

4/7	3,200	4/29	900

Common Stock — No. 311

		4/1	10,000

Supplies — No. 126

4/4	1,800		

Service Revenue — No. 400

		4/7	3,200
		4/12	600

Accounts Payable — No. 201

4/25	1,100	4/4	1,800

Salaries Expense — No. 726

4/15	450		

Instructions

(a) Prepare the complete general journal entries (including explanations) from which the postings to Cash were made.

(b) Prepare a trial balance at April 30, 2004.

Journalize a series of transactions.
(SO 2, 4)

3-8 Evergreen Park Corp. was started on April 1 by Susan and Bill Helms. The following selected events and transactions occurred during April.

Apr.	1	Invested $100,000 cash in the business in exchange for common stock.
	4	Purchased land costing $35,000 for cash.
	8	Incurred advertising expense of $2,100 on account.
	11	Paid salaries to employees $1,200.
	12	Hired park manager at a salary of $4,500 per month, effective May 1.
	13	Paid $1,800 for a one-year insurance policy.
	17	Declared and paid a $900 cash dividend.
	20	Received $7,200 in cash for admission fees.
	25	Sold 100 coupon books for $30 each. Each book contains six coupons that entitle the holder to one admission to the park.
	30	Received $6,200 in cash admission fees.
	30	Paid $900 on account for advertising incurred on April 8.

Evergreen uses the following accounts: Cash; Prepaid Insurance; Land; Accounts Payable; Unearned Admissions; Common Stock; Dividends; Admission Revenue; Advertising Expense; and Salaries Expense.

Instructions

Journalize the April transactions.

Journalize transactions, post, and prepare a trial balance.
(SO 2, 4, 6, 7)

3-9 Lauren Kim-Bae is a licensed incorporated CPA. During the first month of operations of the business, the following events and transactions occurred.

May	1	Invested $39,000 cash in exchange for common stock.
	2	Hired a secretary-receptionist at a salary of $1,800 per month.
	3	Purchased $900 of supplies on account from Frost Supply Company.
	7	Paid office rent of $1,200 for the month.
	11	Completed a tax assignment and billed client $1,700 for services rendered.
	12	Received $5,000 advance on a management consulting engagement.
	17	Received cash of $1,500 for services completed for Mutter Company.
	31	Paid secretary-receptionist $1,800 salary for the month.
	31	Paid 40% of balance due Frost Supply Company.

The company 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. 311 Common Stock, 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, 2004.

Journalize transactions, post, and prepare a trial balance.
(SO 2, 4, 6, 7)

3-10 JarJar Theater Inc. opened on April 1. All facilities were completed on March 31. At this time, the ledger showed: No. 101 Cash $10,000; 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 $9,000; and No. 311 Common Stock $23,000. During April, the following events and transactions occurred.

Apr.	2	Paid film rental of $1,000 on first movie.
	3	Ordered two additional films at $500 each.
	9	Received $2,100 cash from admissions.
	10	Made $3,000 payment on mortgage and $500 on accounts payable.
	11	Hired Tim Rowe to operate concession stand. Tim Rowe to pay JarJar Theater 16 percent of gross receipts payable monthly.
	12	Paid advertising expenses $600.
	20	Received one of the films ordered on April 3 and was billed $500. The film will be shown in April.
	25	Received $4,600 cash from admissions.
	29	Paid salaries $1,900.
	30	Received statement from Tim Rowe showing gross receipts of $1,500 and the balance due to JarJar Theater of $240 for April. Tim Rowe paid one-half of the balance due and will remit the remainder on May 5.
	30	Prepaid $800 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, 2004.

FINANCIAL REPORTING PROBLEM: Hilton Hotels Corporation

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3-11 The financial statements of **Hilton** are presented in the Appendix. The statements contain the following selected accounts, stated in millions of dollars, for 2001.

Accounts Payable	$ 533	Income Taxes Payable	$ 4
Accounts Receivable	291	Interest Expense	385
Property, Plant, and Equipment	3,911	Inventory	148

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.

EXPLORING THE WEB

3-12 Much information about specific companies is available on the World Wide Web. This information includes basic descriptions of the company's location, activities, industry, financial health, and financial performance.

Address: **http://biz.yahoo.com/i**

Steps

1. Type in a company name, or use an 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 was the company's net income?
(b) What was the company's total sales?
(c) What is the company's industry?
(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?

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Answer to Hilton Review It Question 4, p. 81

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.