THE RECORDING PROCESS

3

*C*ONCEPTS FOR REVIEW

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

a. What assets, liabilities, stockholders' equity, retained earnings, dividends, revenues, and expenses are. (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. 2, pp. 44–51)

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 that 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 a report. "It's the least I can do," she says.

☑ **THE NAVIGATOR**

*S*TUDY OBJECTIVES

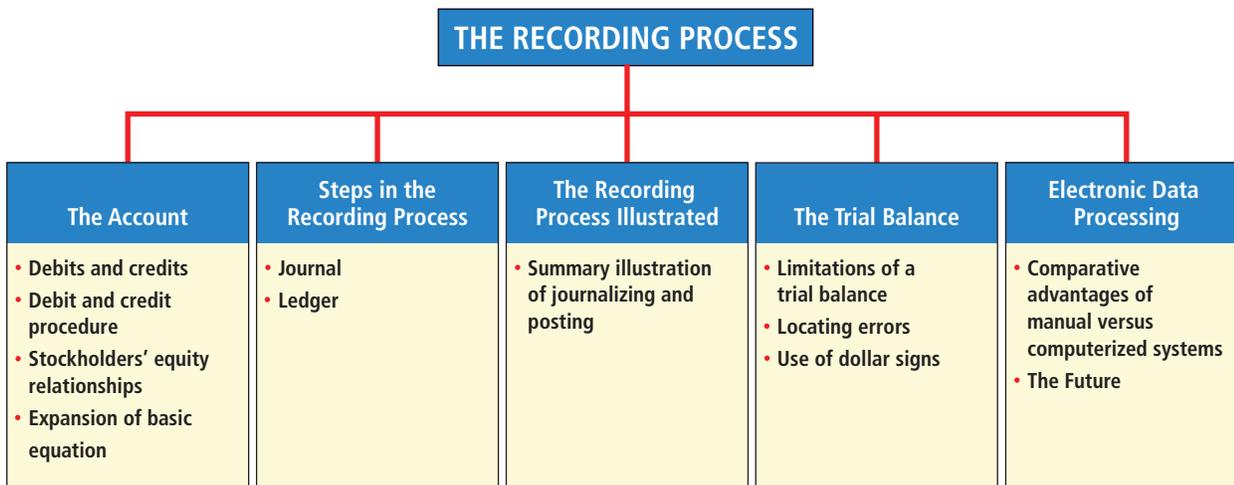**After studying this chapter, you should be able to**

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**

In Chapter 2 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, 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	Steps in the Recording Process	The Recording Process Illustrated	The Trial Balance	Electronic Data Processing
• Debits and credits • Debit and credit procedure • Stockholders' equity relationships • Expansion of basic equation	• Journal • Ledger	• Summary illustration of journalizing and posting	• Limitations of a trial balance • Locating errors • Use of dollar signs	• Comparative advantages of manual versus computerized systems • The Future

THE NAVIGATOR

THE ACCOUNT

STUDY OBJECTIVE 1

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

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 2), 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

Title of Account	
Left, or debit, side	Right, or credit, side
Debit balance	Credit balance
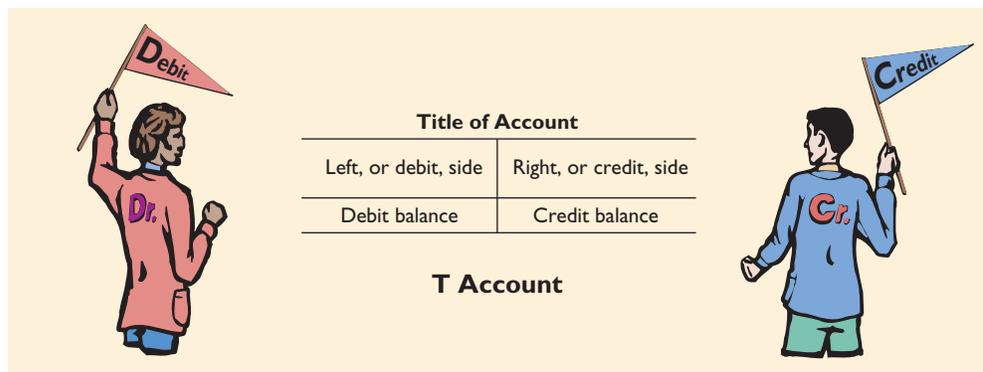
T Account

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

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 2-10.

Tabular Summary		Account Form			
Cash		**Cash**			
$15,000		**(Debits)**	15,000	**(Credits)**	7,000
−7,000			1,200		1,700
1,200			1,500		250
1,500			600		1,300
−1,700		Balance	8,050		
−250		**(Debit)**			
600					
−1,300					
$ 8,050					

Illustration 3-2

Tabular summary compared to account form

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

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 accu-

HELPFUL HINT

Debits must equal credits for each transaction.

---

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

racy 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 2. 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 (credit) side, and decreases in liabilities must be entered on the left (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
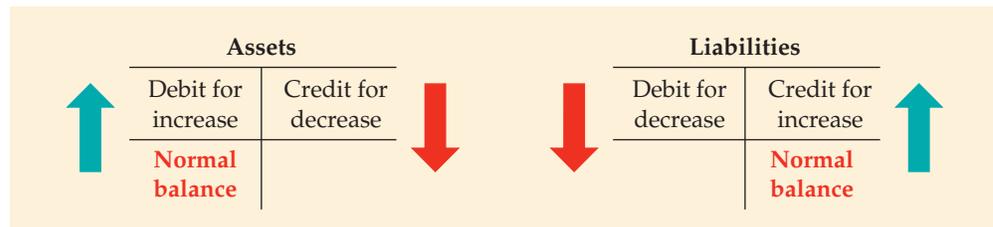
Knowing the normal balance in an account may help you to trace errors. For example, a credit balance in an asset account such as Land or a debit balance in a liability account such as Wages Payable would indicate recording errors. Occasionally, an abnormal balance may be correct. The Cash account, for 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 next.

COMMON STOCK.   **Common stock** is issued in exchange for the owners' investment paid into a 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.

Debits	Credits
Decrease common stock	Increase common stock

Illustration 3-5

Debit and credit effect—common stock

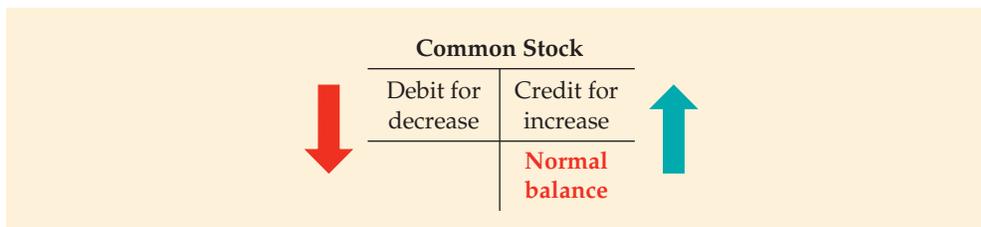The normal balance in this account may be diagrammed as shown in Illustration 3-6.

Common Stock

Debit for decrease	Credit for increase
	Normal balance

Illustration 3-6

Normal balance—common stock

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.
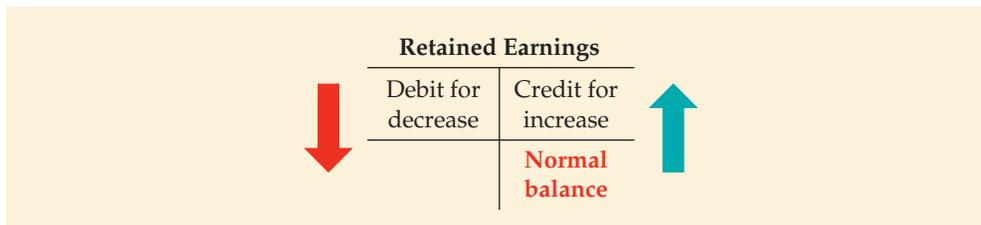
Retained Earnings

Debit for decrease	Credit for increase
	Normal balance

Illustration 3-7

Debit and credit effect and normal balance—retained earnings

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.
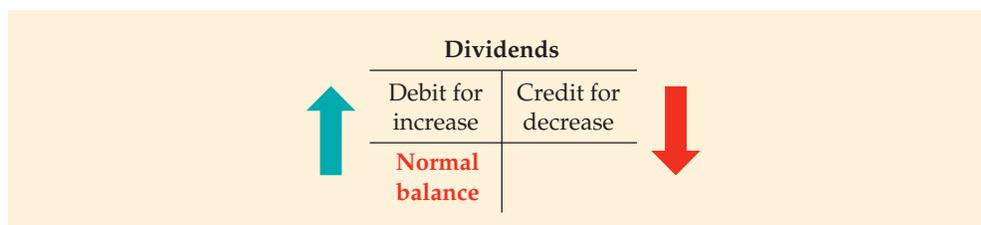
Dividends

Debit for increase	Credit for decrease
Normal balance	

Illustration 3-8

Debit and credit effect and normal balance—dividends

Revenues and Expenses

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 shown in Illustration 3-9.
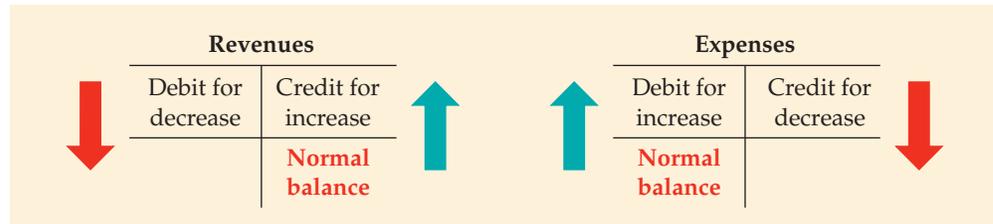
Illustration 3-9

Debit and credit effects—revenues and expenses

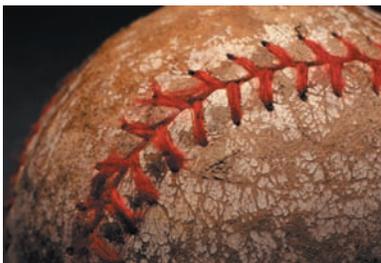| **Debits**	**Credits**
Decrease revenues	Increase revenues
Increase expenses	Decrease expenses

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				Expenses	
	Debit for decrease	Credit for increase			Debit for increase	Credit for decrease
		Normal balance			**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

Do you think that the Chicago Bears (football team) would be likely to have the same major revenue and expense accounts as the Cubs? Do you think that the Chicago-based Wrigley Company would be likely to have the same major revenue and expense accounts? Why or why not?

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.
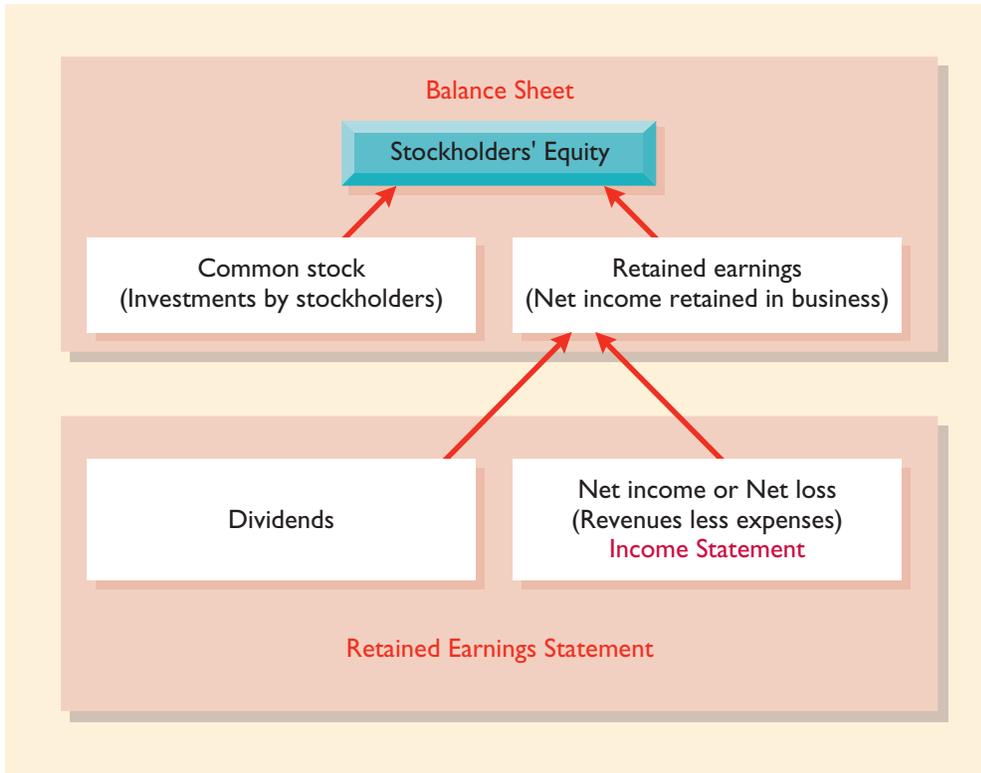

Illustration 3-11

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 to 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
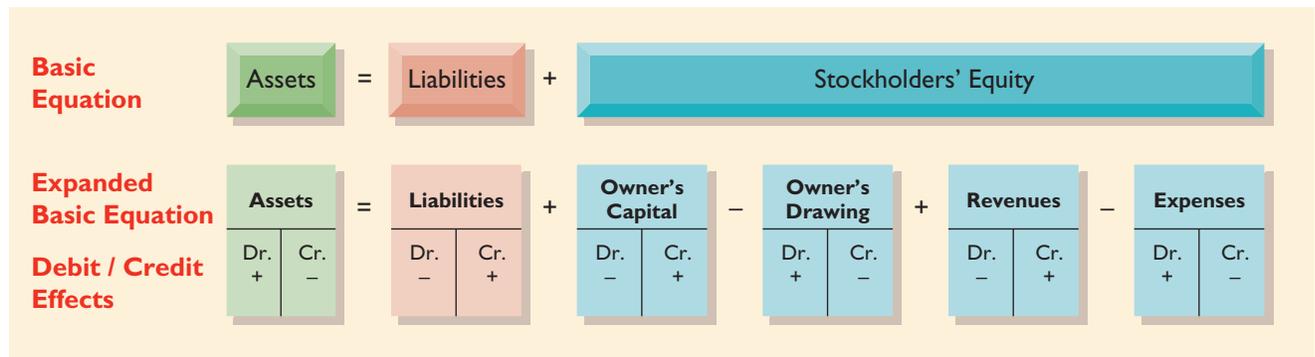
THE ACCOUNTING CYCLE

Now that we understand the accounts and how each type increases and decreases via debiting and crediting, we are ready to do "accounting." This means that we need to follow the accounting cycle. When you first learn how to drive a car,

the first step after you get into the car is to adjust your seat. Then you adjust the rearview mirror and the side mirrors. When all is fine, you turn on the engine, shift into gear, press on the gas, and so on. You would never turn on the engine, shift into gear, and then realize that you are too far from the peddles and so have to move your seat while the car is in gear. Of course, since you forgot to adjust the mirrors after you moved your seat, now you cannot see your blind spots. Refer back to Illustration 1-7, which shows the various steps in the accounting cycle beginning with a business transaction. In the remainder of this chapter until the end of Chapter 5, you will be following this cycle step-by-step. Remember, the steps are there for a reason. If you do not follow them, all your work will be wasted.

BEFORE YOU GO ON...

▶ *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 **PepsiCo's** Cash, Accounts Payable, and Interest Expense accounts?

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

Illustration 3-13

The recording process

The Recording Process

Analyze each transaction   Enter transaction in a journal   Transfer journal information to ledger accounts
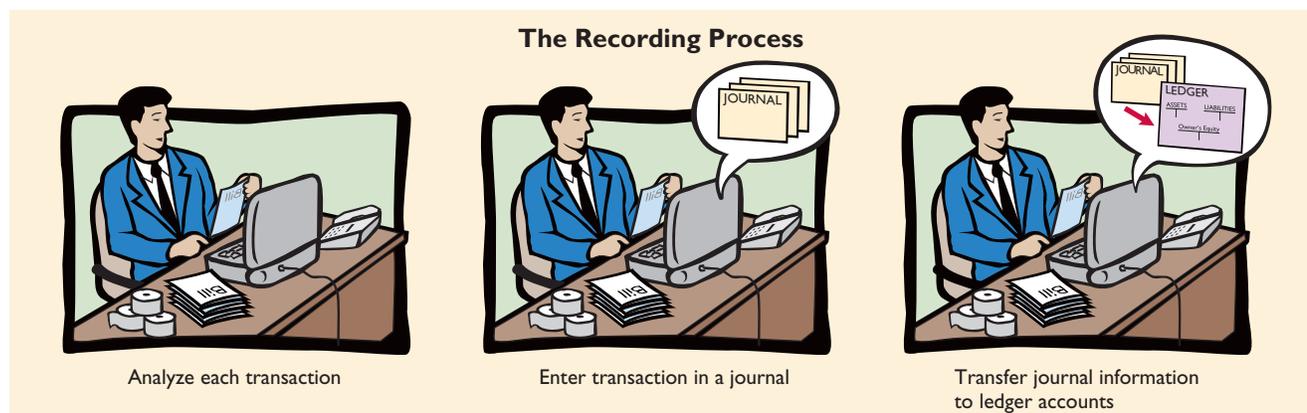
The basic steps in the recording process occur repeatedly. The analysis of transactions was illustrated in Chapter 1. Further examples will be given in this and later chapters. The other steps in the recording process are explained in the next sections.

TECHNOLOGY IN ACTION

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.
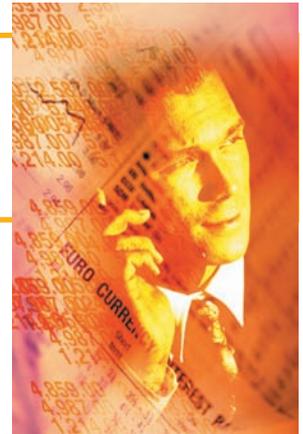
THE JOURNAL

Transactions are recorded initially 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.

STUDY OBJECTIVE 4

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

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

GENERAL JOURNAL				J1
Date	**Account Titles and Explanation**	**Ref.**	**Debit**	**Credit**
2008				
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)			

Illustration 3-14

Technique of journalizing

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.

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 (i.e., 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 purchased 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.

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.

Illustration 3-15

Compound journal entry

GENERAL JOURNAL				J1
Date	**Account Titles and Explanation**	**Ref.**	**Debit**	**Credit**
2008 July 1	Delivery Equipment Cash Accounts Payable (Purchased truck for cash with balance on account)		14,000	8,000 6,000

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.

---

[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 the content of each account. The account titles used in journalizing should not contain explanations such as Cash Paid or Cash Received.

▶ 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		

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THE LEDGER

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.

    A business can use a looseleaf binder or a 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.

STUDY OBJECTIVE 5

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

Illustration 3-16

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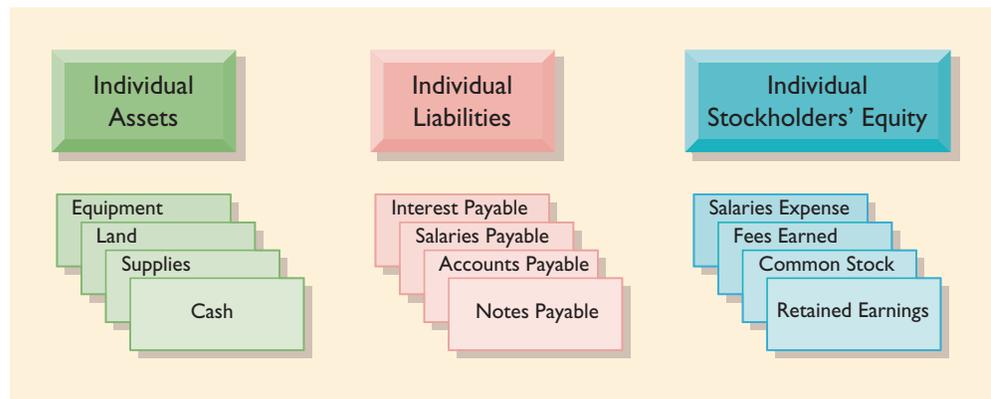
The ledger provides management with the balances in various accounts. For example, the Cash account shows the amount of cash that is available to meet current obligations. Amounts due from customers can be found by examining Accounts Receivable, and amounts owed to creditors can be found by examining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

ACCOUNTING IN ACTION *Business Insight*

In his autobiography, Sam Walton described the double-entry accounting system with which he began the **Wal-Mart** empire: "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."

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

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**
2008					
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

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, the journal page, and the 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, the journal page, and the 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.

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

STUDY OBJECTIVE 5

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

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.
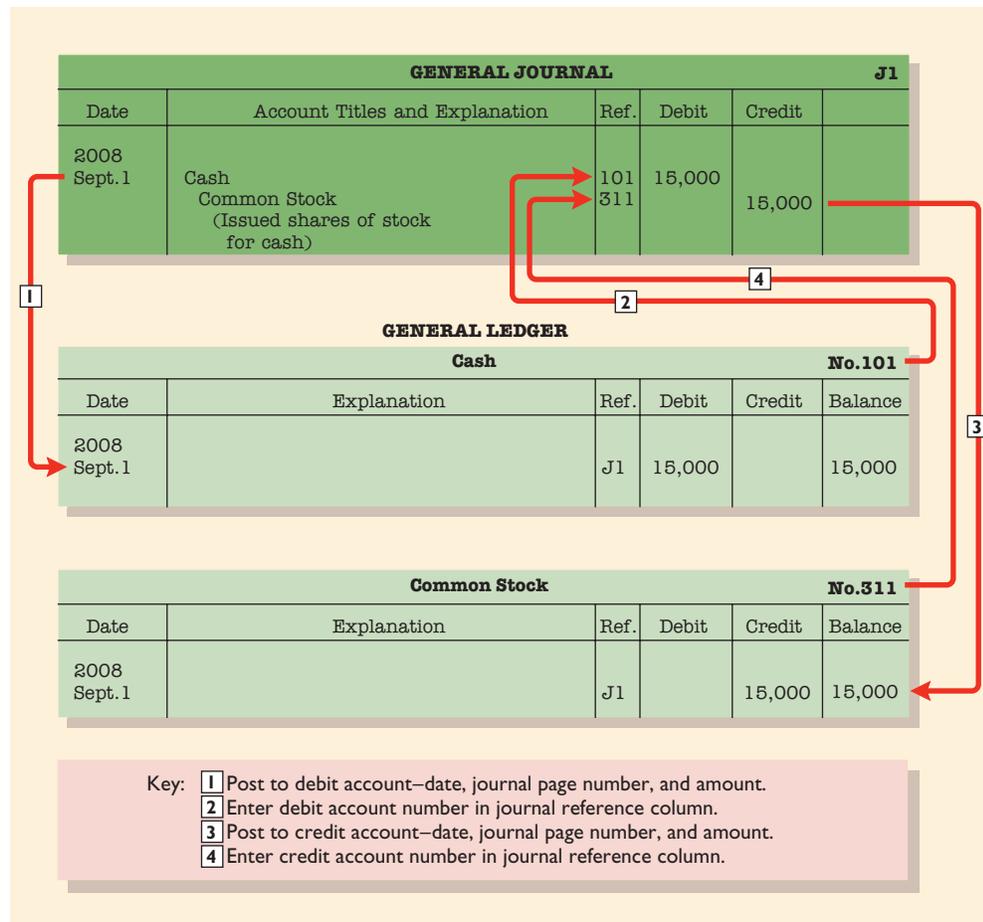
Illustration 3-18

Posting a journal entry

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.

entry. Postings should be made on a timely basis to ensure that the ledger is up to date.[3]

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.

*T*ECHNOLOGY 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 (as should be gained 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, whereas **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.

---

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

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 to understand the journal entries discussed in this chapter as well as more complex journal entries to be described in later chapters.

ACCOUNTING IN ACTION *Business Insight*

While most companies record transactions very carefully, the reality is that sometimes even the most careful companies make mistake 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.

In order to prepare and issue financial statements, these companies accounting equations (debit and credits) must have been in balance at year-end.
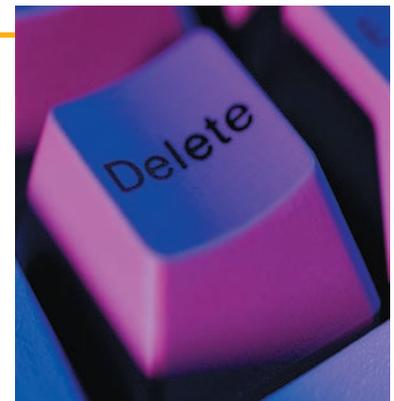
Illustration 3-20

Investment of cash by stock-holders

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		Common Stock	311
Oct. 1, 10,000				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.
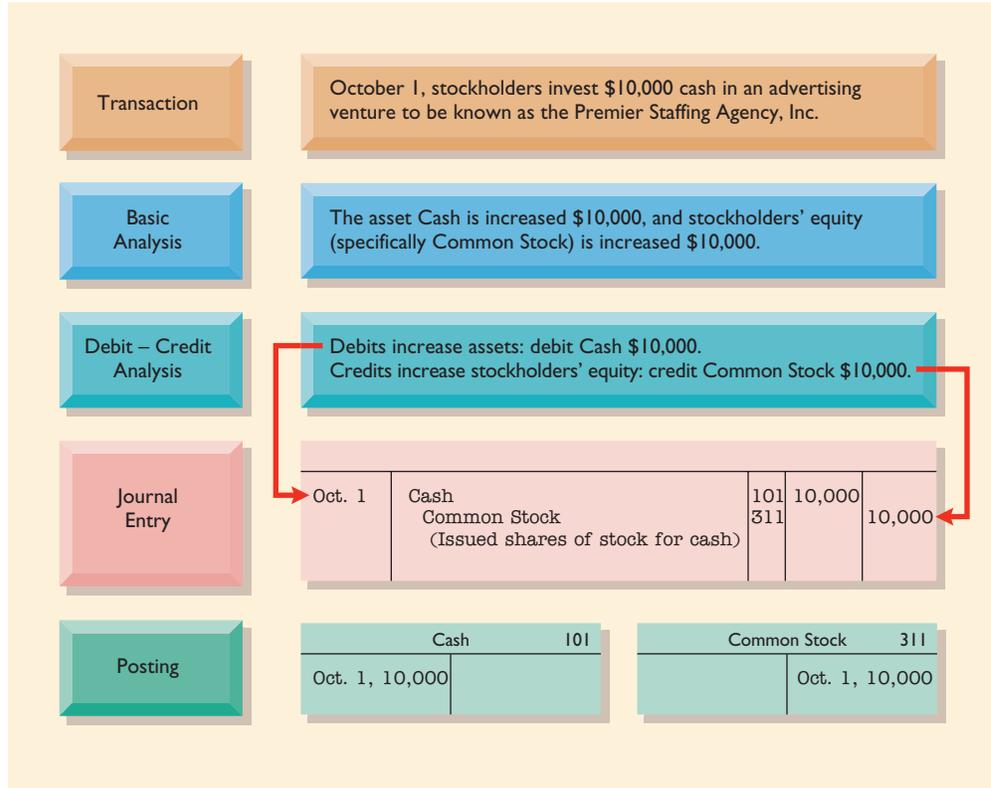
Illustration 3-21

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		Notes Payable	200
Oct. 1, 5,000				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 the 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		Prepaid Insurance		130
Oct. 1	10,000	Oct. 3	900	Oct. 4	600		
2	1,200	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		Accounts Payable		201
Oct. 5	2,500					Oct. 5	2,500

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.

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		Dividends		332
Oct. 1	10,000	Oct. 3	900	Oct. 20	500		
2	1,200	4	600				
		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			Salaries Expense		726
Oct. 1 10,000	Oct. 3	900			Oct. 26 4,000		
2 1,200	4	600					
	20	500					
	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			Service Revenue		400
Oct. 1 10,000	Oct. 3	900				Oct. 31	10,000
2 1,200	4	600					
31 10,000	20	500					
	26	4,000					

BEFORE YOU GO ON...

▶ REVIEW IT

1. How does journalizing differ from posting?
2. What is the purpose of the (a) ledger and (b) chart of accounts?
3. Why are gaps left in the chart of accounts numbering system?

▶ DO IT

Hair It Is, 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 general ledger accounts. Determine the ending balance in the cash accounts. 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		

Service Revenue

	2,280

Wages Expense

400

Utilities Expense

92

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SUMMARY ILLUSTRATION OF JOURNALIZING AND POSTING

The journal for Premier Staffing Agency, Inc., for October is shown in Illustration 3-30 on page 88. The ledger is shown in Illustration 3-31 on page 89, with all balances in color.

Illustration 3-30

General journal entries

GENERAL JOURNAL				PAGE J1
Date	**Account Titles and Explanation**	**Ref.**	**Debit**	**Credit**
2008				
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)			
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)			

*T*HE 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.

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.

Illustration 3-31

General ledger

GENERAL LEDGER											

Cash				**No. 101**		**Accounts Payable**				**No. 201**	
Date	Explanation	Ref.	Debit	Credit	Balance	Date	Explanation	Ref.	Debit	Credit	Balance
2008						2008					
Oct. 1		J1	10,000		10,000	Oct. 5		J1		2,500	**2,500**

Unearned Revenue				**No. 209**	
Date	Explanation	Ref.	Debit	Credit	Balance
2008					
Oct. 2		J1		1,200	**1,200**

Cash (continued):

Date	Explanation	Ref.	Debit	Credit	Balance
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
2008					
Oct. 5		J1	2,500		**2,500**

Common Stock				**No. 311**	
Date	Explanation	Ref.	Debit	Credit	Balance
2008					
Oct. 1		J1		10,000	**10,000**

Prepaid Insurance				**No. 130**	
Date	Explanation	Ref.	Debit	Credit	Balance
2008					
Oct. 4		J1	600		**600**

Dividends				**No. 332**	
Date	Explanation	Ref.	Debit	Credit	Balance
2008					
Oct. 20		J1	500		**500**

Office Equipment				**No. 157**	
Date	Explanation	Ref.	Debit	Credit	Balance
2008					
Oct. 1		J1	5,000		**5,000**

Service Revenue				**No. 400**	
Date	Explanation	Ref.	Debit	Credit	Balance
2008					
Oct. 31		J1		10,000	**10,000**

Notes Payable				**No. 200**	
Date	Explanation	Ref.	Debit	Credit	Balance
2008					
Oct. 1		J1		5,000	**5,000**

Salaries Expense				**No. 726**	
Date	Explanation	Ref.	Debit	Credit	Balance
2008					
Oct. 26		J1	4,000		**4,000**

Rent Expense				**No. 729**	
Date	Explanation	Ref.	Debit	Credit	Balance
2008					
Oct. 3		J1	900		**900**

The trial balance prepared from Premier Staffing's ledger is shown in Illustration 3-32. 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.

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.

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

▶ 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.

	Debit	Credit
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		

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Illustration 3-32

A trial balance

PREMIER STAFFING AGENCY, INC.
Trial Balance
October 31, 2008

	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**

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 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 (e.g., $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.

*T*ECHNOLOGY *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 undoubtedly will 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.

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

▶ *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?

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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 a property management system, and many night audit functions are now performed during the business day. 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 manual and computerized systems.

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 this 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 his or her 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, 2008. 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 a 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, 2008.

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
2008					
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)			

GENERAL LEDGER

Cash — No. 101

Date	Explanation	Ref.	Debit	Credit	Balance
2008 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

Prepaid Insurance — No. 130

Date	Explanation	Ref.	Debit	Credit	Balance
2008 Sept. 4		J1	1,200		1,200

Laundry Equipment — No. 154

Date	Explanation	Ref.	Debit	Credit	Balance
2008 Sept. 3		J1	25,000		25,000

Notes Payable — No. 200

Date	Explanation	Ref.	Debit	Credit	Balance
2008 Sept. 3		J1		15,000	15,000

Accounts Payable — No. 201

Date	Explanation	Ref.	Debit	Credit	Balance
2008 Sept. 10		J1		200	200

Common Stock — No. 311

Date	Explanation	Ref.	Debit	Credit	Balance
2008 Sept. 1		J1		20,000	20,000

Dividends — No. 332

Date	Explanation	Ref.	Debit	Credit	Balance
2008 Sept. 1		J1	700		700

Service Revenue — No. 400

Date	Explanation	Ref.	Debit	Credit	Balance
2008 Sept. 30		J1		6,200	6,200

Advertising Expense — No. 610

Date	Explanation	Ref.	Debit	Credit	Balance
2008 Sept. 10		J1	200		200

Rent Expense — No. 729

Date	Explanation	Ref.	Debit	Credit	Balance
2008 Sept. 2		J1	1,000		1,000

(c)

CAMPUS LAUNDROMAT, INC.
Trial Balance
September 30, 2008

	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 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. 68).

Application Solutions Providers (ASPs) 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. 93).

Chart of accounts A list of accounts and the account numbers that identify their location in the ledger (p. 80).

Common stock Issued in exchange for the owners' investment paid into the corporation (p. 71).

Compound entry A journal entry that involves three or more accounts (p. 76).

Credit The right side of an account (p. 69).

Debit The left side of an account (p. 69).

Dividend A distribution by a corporation to its stockholders on a pro rata (equal) basis (p. 71).

Double-entry system A system that records in appropriate accounts the dual effect of each transaction (p. 69).

General journal The most basic form of journal (p. 75).

General ledger A ledger that contains all asset, liability, and stockholders' equity accounts (p. 77).

Journal An accounting record in which transactions are initially recorded in chronological order (p. 75).

Journalizing The entering of transaction data in the journal (p. 75).

Ledger The entire group of accounts maintained by a company (p. 77).

Posting The procedure of transferring journal entries to the ledger accounts (p. 79).

Retained earnings Net income that is retained in the business (p. 71).

Simple entry A journal entry that involves only two accounts (p. 76).

T account The basic form of an account (p. 68).

Three-column form of account A form with columns for debit, credit, and balance amounts in an account (p. 79).

Trial balance A list of accounts and their balances at a given time (p. 88).

EXERCISES

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. Rooms Revenue
2. Rent Expense

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

3. Salary Payable

4. Capital

5. Food Revenue

6. Cash

3-2 Transactions for Milton's Wings and Pizza for the month of June are presented below. Identify the accounts to be debited and credited for each transaction, and journalize the transactions.

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

June 1 Milton Wolfe invests $20,000 cash in exchange for shares of common stock in a small printing corporation.

2 Buys equipment on account for $8,600.

3 Pays $1,200 to landlord for June rent.

12 Bills B. J. Chang $890 for a pizza party.

3-3 Ouro Johnson has the following transactions during August of the current year. Indicate (a) the basic analysis and (b) the debit–credit analysis illustrated on pages 82–86 of the text. Journalize the transactions.

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

Aug. 1 Opens an office as a travel agent, investing $25,000 in cash in exchange for common stock.

4 Pays insurance in advance for 6 months, $1,200.

16 Receives $5,000 from clients for arranging travel services.

27 Pays secretary $1,500 salary.

3-4 Selected transactions for Y. K. Catering 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 10	Accounts Receivable		7,200	
	Service Revenue			7,200
15	Cash		5,500	
	Accounts Receivable			5,500
20	Cash		2,500	
	Service Revenue			2,500

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)

ELIZABETH BAKERY
Trial Balance
December 31, 2008

	Debit	Credit
Cash	$33,600	
Prepaid Insurance		$4,900
Accounts Payable		7,500
Unearned Fees	5,800	
Common Stock	20,000	
Dividends		4,000
Service Revenue		29,200
Salaries Expense	17,000	
Rent Expense		3,000
	$76,400	$48,600

3-6 Selected transactions from the journal of Palm Tree Travel, Inc., are presented below.

Date	Account Titles and Explanation	Ref.	Debit	Credit
Aug. 1	Cash		10,000	
	Common Stock			10,000
	(Investment of cash for stock)			
10	Cash		3,900	
	Service Revenue			3,900
	(Received cash for services provided)			
12	Computer		4,100	
	Cash			1,500
	Notes Payable			2,600
	(Purchased computer for			
	cash and notes payable)			
25	Accounts Receivable		2,200	
	Service Revenue			2,200
	(Billed for services provided)			
31	Cash		1,800	
	Accounts Receivable			1,800
	(Receipt of cash on account)			

Instructions

(a) Post the transactions to T accounts.

(b) Prepare a trial balance at August 31, 2008.

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

	Cash		**No. 101**
4/1	15,000	4/15	900
4/12	600	4/25	1,500
4/29	1,000		
4/30	600		

	Accounts Receivable		**No. 112**
4/7	4,100	4/29	1,000

	Supplies		**No. 126**
4/4	2,500		

	Accounts Payable		**No. 201**
4/25	1,500	4/4	2,500

	Common Stock		**No. 311**
		4/1	15,000

	Service Revenue		**No. 400**
		4/7	4,100
		4/12	600
		4/30	600

	Salaries Expense		**No. 726**
4/15	900		

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, 2008.

3-8 Evergreen Campground was started on June 1 by Jolene and David Collier. The follow-ing selected events and transactions occurred during June.

June 1 Invested $150,000 cash in the business in exchange for common stock.

4 Purchased land costing $40,000 for cash.

8 Incurred advertising expense of $3,500 on account.

11 Paid salaries to employees $1,500.

12 Hired Campground manager at a salary of $5,000 per month, effective July 15.

13 Paid $2,000 for a one-year insurance policy.

20 Received $9,000 in cash for admission fees.

30 Received $5,000 in cash for admission fees.

30 Paid $1,000 on account for advertising incurred on June 8.

Evergreen uses the following accounts: Cash; Prepaid Insurance; Land; Accounts Payable; Unearned Admissions; Common Stock; 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 Alyson Clark is a licensed incorporated CPA. During the first month of operations of the business, the following events and transactions occurred:

Sept. 1 Invested $40,000 cash in exchange for common stock.

2 Hired a secretary-receptionist at a salary of $2,480 per month.

3 Purchased $1,500 of supplies on account from Ross Supply Company.

7 Paid office rent of $1,500 for the month.

11 Completed a tax assignment and billed client $1,900 for services rendered.

12 Received $7,000 advance on a management consulting engagement.

17 Received cash of $2,350 for services completed for Mutter Company.

31 Paid secretary-receptionist $2,480 salary for the month.

31 Paid 40% of balance due Ross 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 September 30, 2008.

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

3-10 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 in exchange for common stock.

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 Declared and paid $1,000 cash dividend.

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; Common Stock; Dividends; Golf Revenue; Advertising Expense; and Salaries Expense.

Instructions

Journalize the March transactions.

FINANCIAL REPORTING PROBLEM: PepsiCo

3-11   The financial statements of **PepsiCo** are presented in Appendix A. The statements contain the following selected accounts for the year ended, 2006 stated in millions of dollars.

Accounts Payable	$6,496	Income Taxes Payable	$ 90
Accounts Receivable	3,725	Interest Expense	239
Property, Plant, and Equipment	9,687	Inventory	1,926

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 acconts(s) that ordinarily would be involved when:

    (1) Interest Expense is increased.

    (2) Property, Plant, and Equipment is increased.