

Chapter 2

Recording Business Transactions

Chapter Overview

The chapter introduces the account and the ledger, and then briefly describes specific asset, liability, and stockholders' equity accounts. The concept of double-entry bookkeeping and the rules of debit and credit for assets, liabilities, and stockholders' equity are described. The "T-account" is illustrated. The accounting equation is tied to the rules of debit and credit.

The journal is introduced and the process of recording transactions (journalizing) is illustrated. The three-step process, described for a manual system, is also completed in a computerized accounting system. The posting process is explained briefly. A series of entries are analyzed, journalized, and posted to T-accounts in the ledger. The normal balances of accounts are explained. The trial balance is defined and illustrated. A mid-chapter summary problem reviews how to journalize, post, and prepare a trial balance.

Details of journals, ledgers, and the posting process are presented, including an illustration of a 4-column ledger account with a running balance. A chart of accounts is illustrated, and the rules of debit and credit are expanded to include specific types of stockholders' equity accounts. An illustrative problem demonstrates the analyzing, journalizing, and posting of several revenue, expense, and dividend transactions, followed by the preparation of a trial balance. Some typical accounting errors revealed by a trial balance are described. Decision Guidelines are presented that assist the student in analyzing and recording transactions. The chapter concludes with a summary problem that reviews opening accounts, journalizing, posting, and preparing a trial balance.

Chapter 2: Teaching Outline

- 1) Explain accounts, journals, and ledgers as they relate to recording transactions and describe common accounts
 - a) Accounts
 - b) Ledger
 - c) Journal
 - d) Trial Balance
 - e) Assets
 - f) Liabilities
 - g) Stockholders' Equity
 - h) Chart of Accounts
 - i) Exhibit 2-1 The Ledger – Asset, Liability and Stockholders' Equity Accounts
 - j) Exhibit 2-2 Chart of Accounts – Smart Touch Learning, Inc.
- 2) Define debits, credits, and normal account balances, and use double-entry accounting and T-accounts
 - a) The T-Account
 - b) Increases and Decreases in the Accounts
 - c) Exhibit 2-3 The Accounting Equation and the Rules of Debit and Credit
 - d) Exhibit 2-4 The Accounting Equation After the First Two Transactions of Smart Touch Learning Inc.
- 3) List the steps of the transaction recording process
 - a) Posting (Copying Information) from the Journal to the Ledger
 - b) Expanding the Rules of Debit and Credit: Revenues and Expenses
 - c) The Normal Balance of an Account d) Source Documents—The Origin of the Steps
 - e) Exhibit 2-5 The Journal Page
 - f) Exhibit 2-6 Making a Journal Entry and Posting to the Ledger in T-Account Form

- g) Exhibit 2-7 The Accounting Equation Includes Revenues and Expenses
 - h) Exhibit 2-8 Complete Rules of Debit and Credit
 - i) Exhibit 2-9 Flow of Accounting Data from the Journal to the Ledger
- 4) Journalize and post sample transactions to the ledger
- a) Practice Journalizing with Specific Examples
 - b) The Ledger Accounts After Posting
 - c) Exhibit 2-10 Smart Touch Learning's Ledger Accounts After Posting April's Transactions
- 5) Prepare the trial balance from the T-accounts
- a) Correcting Trial Balance Errors b) Details of Journals and Ledgers
 - c) The Four-Column Account: An Alternative to the T-Account
 - d) Exhibit 2-11 Trial Balance
 - e) Exhibit 2-12 Details of Journalizing and Posting
 - f) Exhibit 2-13 Account in Four-Column Format

Chapter 2: Summary Handout for Students

1. Chart of accounts: a list of all the accounts with their account number
 - Assets, Liabilities, Stockholders' Equity
 - Revenues and Expenses
2. Record transactions in the journal using the rules of debit, credit, and double-entry accounting
 - Every transaction affects at least two accounts
 - Type of account determines whether it increases with a debit or a credit
 - Asset accounts increase with a debit
 - Liability accounts increase with a credit
 - Equity accounts increase with a credit
 - The normal balance of an account is on the side of an increase to the account
 - Journal entries should have:
 - Date of the transaction
 - Title of the account debited, along with the dollar amount
 - Indented title of the account credited, along with the dollar amount
 - Brief explanation of transaction
3. Post transactions from the journal to the ledger
 - See Exhibit 2-6 Making a Journal Entry and Posting to the Ledger in T-Account Form
4. Revenues and expenses affect equity
 - Revenues are increases (earned) in equity from providing goods or services to customers
 - Expenses are decreases (incurred) in equity through the operation of a business
 - Using up assets
 - Or increasing liabilities
5. The trial balance lists all the accounts in the ledger with their balances

- Total debits equal total credits

Lecture Outline Tips: Key Topics

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

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

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

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

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

Chapter 2 Assignment Grid

<u>Learning Objective</u>	<u>Short Exercises</u> <i>Easy</i>	<u>Exercises</u> <i>Moderate</i>	<u>Problems (Group A)</u> <i>Difficult</i>	<u>Problems (Group B)</u> <i>Difficult</i>
1	1	13, 14, 15	27	44
2	2, 3	15, 17, 18, 19, 20	27, 29, 35, 36	44, 52, 53
3	4	16, 17, 18, 20	28, 29, 30	45, 46
4	5, 6, 7, 8, 9	16, 17, 18, 19, 20, 21, 22, 23, 24	28, 29, 30, 31, 32, 33, 34	45, 46, 47, 48, 49, 50, 51
5	10, 11, 12	17, 18, 19, 20, 22, 24, 25, 26	29, 30, 31, 32, 33, 34, 35, 36, 37, 38, 39, 40, 41, 42, 43	46, 47, 48, 49, 50, 51, 52, 53, 54, 55, 56, 57, 58, 59, 60

Other End of Chapter Materials:

Continuing Exercise E2-61
Continuing Problem P2-62
Practice Set
Decision Case 2-1
Decision Case 2-2
Ethical Issue 2-1
Fraud Case 2-1
Financial Statement Case 2-1
Team Project 2-1
Communication Activity 2-1

End of Chapter Exercises and Problems available utilizing Accounting software:

QuickBooks 10	E2-17, P2-29A, P2-32A, P2-47B, E2-61, P2-62, Practice Set
Peachtree 10	None
Excel in Practice	E2-17, P2-29A, P2-32A, P2-47B
General Ledger	E2-16, E2-20, P2-28A, P2-30A, E2-61, P2-62, Practice Set

Sample Homework Questions in MyAccountingLab:

E2-14, E2-17, E2-18, E2-20, P2-31A, P2-32A
--

Pre-Test Questions in MyAccountingLab:

S2-3, S2-4, S2-9, E2-13

Post-Test Questions in MyAccountingLab:

P2-51B

Exercise and/or Problems used in PowerPoint slides:

S 2-1, S 2-2, S 2-5, S 2-9, SE2-10

Answer Key to Chapter 2 Quiz:

- | | |
|------|-------|
| 1. A | 6. D |
| 2. D | 7. C |
| 3. B | 8. B |
| 4. B | 9. A |
| 5. B | 10. D |

**CHAPTER 2
TEN-MINUTE QUIZ**

Circle the letter of the best response.

1. Which sequence correctly summarizes the accounting process?
 - A. Journalize transactions, post to the accounts, prepare a trial balance
 - B. Journalize transactions, prepare a trial balance, post to the accounts
 - C. Post to the accounts, journalize transactions, prepare a trial balance
 - D. Prepare a trial balance, journalize transactions, post to the accounts

2. The left side of an account is used to record which of the following?
 - A. Debit or credit, depending on the type of account
 - B. Increases
 - C. Credits
 - D. Debits

3. Suppose Hunt Corporation has Accounts receivables of \$65,000, Furniture totaling \$205,000, and Cash of \$52,000. The business has a \$109,000 Note payable and owes \$81,000 on account. How much is Hunt's stockholders' equity?
 - A. \$28,000
 - B. \$132,000
 - C. \$190,000
 - D. \$322,000

4. Your business purchased supplies of \$2,500 on account. The journal entry to record this transaction is as follows:

A.	Supplies	2,500	
	Accounts receivable		2,500
B.	Supplies	2,500	
	Accounts payable		2,500
C.	Accounts payable	2,500	
	Supplies		2,500
D.	Inventory	2,500	
	Accounts payable		2,500

5. Which journal entry records your payment for the supplies purchase described in Quick Check question 4?

A.	Accounts payable	2,500	
	Cash		2,500
B.	Accounts payable	2,500	
	Cash		2,500
C.	Cash	2,500	
	Accounts payable		2,500
D.	Cash	2,500	
	Accounts payable		2,500

6. Posting a \$2,500 purchase of supplies on account appears as follows:

A.	<u> Cash</u>	<u> Supplies</u>
	2,500	2,500
B.	<u> Supplies</u>	<u> Accounts payable</u>
	2,500	2,500
C.	<u> Supplies</u>	<u> Accounts receivable</u>
	2,500	2,500
D.	<u> Supplies</u>	<u> Accounts payable</u>
	2,500	2,500

7. The detailed record of the changes in a particular asset, liability, or stockholders' equity is called

- A. an account.
- B. a journal.
- C. a ledger.
- D. a trial balance.

8. Pixel Copies, Inc. recorded a cash collection on account by debiting Cash and crediting Accounts payable. What will the trial balance show for this error?

- A. Too much for cash
- B. Too much for liabilities
- C. Too much for expenses
- D. The trial balance will not balance

9. Timothy McGregor, Attorney, P.C., began the year with total assets of \$129,000, liabilities of \$77,000, and stockholders' equity of \$52,000. During the year, the business earned revenue of \$113,000 and paid expenses of \$34,000. The business also paid cash dividends of \$63,000. How much is the business's equity at year-end?

- A. \$68,000
- B. \$97,000
- C. \$131,000
- D. \$165,000

10. Michael Barry, Attorney, P.C. began the year with total assets of \$126,000, liabilities of \$74,000, and stockholders' equity of \$52,000. During the year, the business earned revenue of \$110,000 and paid expenses of \$33,000. The business also paid cash dividends of \$69,000. How would Michael Barry record expenses paid of \$33,000?

- | | | | |
|----|------------------|--------|--------|
| A. | Cash | 33,000 | |
| | Expenses | | 33,000 |
| B. | Accounts payable | 33,000 | |
| | Cash | | 33,000 |
| C. | Expenses | 33,000 | |
| | Accounts payable | | 33,000 |
| D. | Expenses | 33,000 | |
| | Cash | | 33,000 |

