Recording Business Transactions

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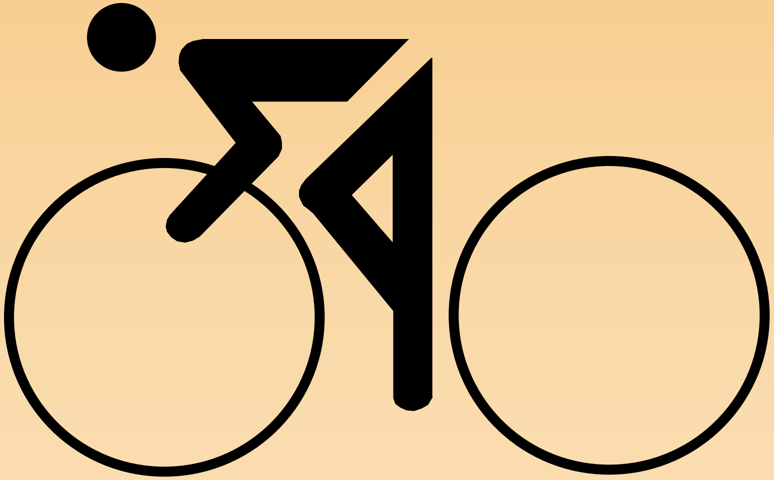
Tools of The Recording Process

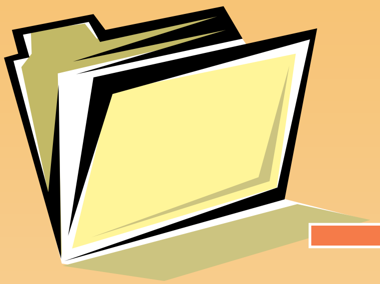
- Debits and Credits
- Journal Entries
- Ledger Accounts

First, however, let's look at...



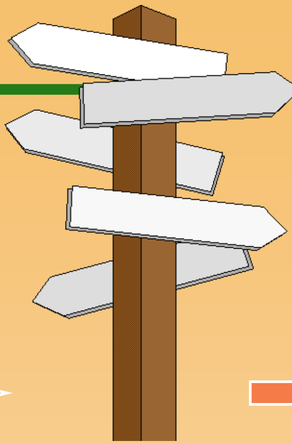
The Accounting Cycle

Steps in The Accounting Cycle



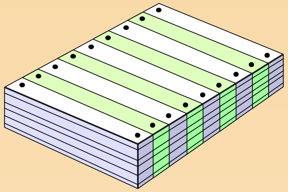
Analyze source documents.

Journalize transactions in the general journal.



Post entries to the accounts in the general ledger.

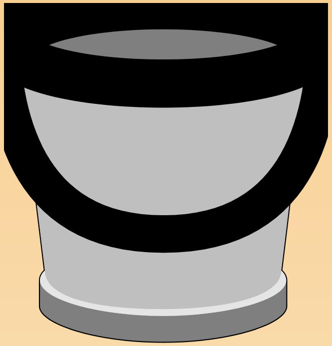
Prepare a trial balance.



Prepare financial statements.

Let's start with The General Ledger Account

A ledger account is a tool used for classifying and summarizing information about increases, decreases, and balances of financial statements items.



- **Think of it as a storage container like a bucket.**
- **Dollars, which are used to measure economic transactions, are "poured" into and out of the container.**

Two General Ledger Account Formats

❶ **Three-Amount Column Format (Debit, Credit, Balance)**

- Used in general ledgers in the business world

❷ **T-Account Format**

- Used primarily for teaching and analysis of complex transactions

General Ledger Account
Three-Amount Column Format

ACCOUNT NAME: **ACCOUNT No.**

Date	Description	PR	Debit (1)	Credit (2)	Balance (3)

General Ledger Account
T-Account Format

For the sake of simplicity, we often use this format in teaching accounting even though it is no longer used in practice.

Account Name	
Debit	Credit

The T-Account

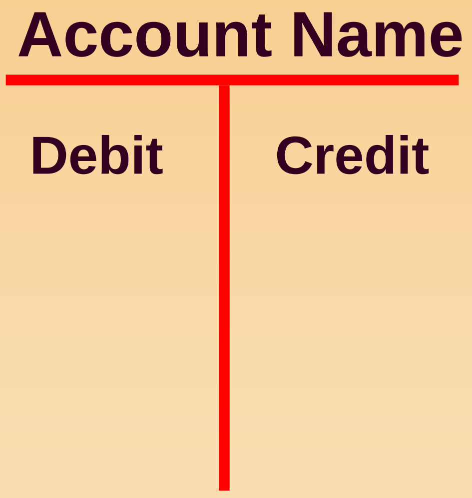
Increases to the T-account are recorded on one side of the T-account, and decreases are recorded on the other side.

Account Name

Debit	Credit

The T-Account

The side which increases and the side which decreases is determined by the <u>type</u> of account.



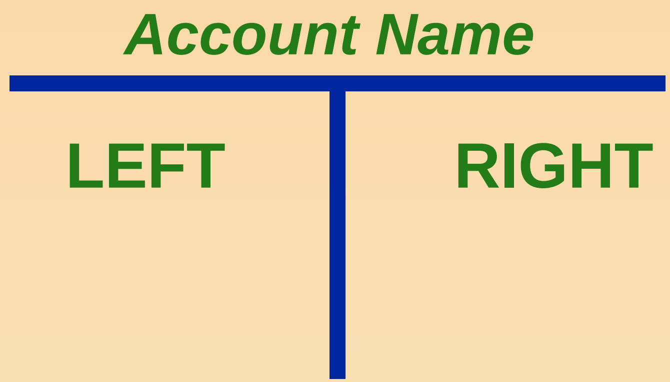
What Are Debits and Credits?

- Tools used for recording transactions
  - Debit (DR)
  - Credit (CR)
- Debit refers to the **LEFT** and Credit to the **RIGHT** side of the T-Account.
- Debit and Credit are neutral terms and do not connote value judgments. Neither is “good” or “bad”!

What Are Debits and Credits?

- Tools used for recording transactions
  - Debit (DR)
  - Credit (CR)

- Debit refers to the **LEFT** and Credit to the **RIGHT** side of the T-Account



What Are Debits and Credits?

- **Tools used for recording transactions**
  - Debit (DR)
  - Credit (CR)

- **Debit refers to the LEFT and Credit to the RIGHT side of the T-Account**

Account Name

LEFT	RIGHT
DEBIT SIDE	**CREDIT SIDE**

Used as Adjectives:

What Are Debits and Credits?

- Tools used for recording transactions
  - Debit (DR)
  - Credit (CR)

- Debit refers to the **LEFT** and Credit to the **RIGHT** side of the T-Account

Account Name

LEFT	RIGHT
DEBIT	CREDIT

Used as Verbs:

Synonym for Debit?

Names of Ledger Accounts

- There are no "magic" names for many accounts
  - e.g., either "Heat, Light & Power" or "Utilities Expense" could be used for an account name.
- Other accounts have names which <u>must</u> be used
  - e.g., "Cash", "Accounts Receivable" and "Accounts Payable".

Types of Ledger Accounts

Let's see how debits and credits affect the different types of accounts.

Account Name

Debit	Credit

Types of Ledger Accounts

1. Assets
2. Liabilities
3. Stockholders' Equity
4. Revenues
5. Expenses

Using Debits and Credits

- Again, debits and credits are used to increase or decrease account balances.
- Determining whether to use a debit or credit to record an increase or decrease depends on the type of account in question.
- The Balance Sheet equation is the basis for the determination.

Balance Sheet Model (Revisited)

$$A \quad = \quad L \quad + \quad SE$$

Balance Sheet Model (Revisited)

Assign a T-Account to each element of the Balance Sheet Model

A = L + SE

Account Name		*Account Name*		*Account Name*	
Debit	Credit	Debit	Credit	Debit	Credit

Balance Sheet Model (Revisited)

Debits and credits affect the Balance Sheet Model as follows:

A = L + SE

Account Name		*Account Name*		*Account Name*	
Debit	Credit	Debit	Credit	Debit	Credit

Balance Sheet Model (Revisited)

Debits and credits affect the Balance Sheet Model as follows:

A = L + SE

ASSETS	
Debit for Increase	Credit for Decrease

Account Name	
Debit	Credit

Account Name	
Debit	Credit

Balance Sheet Model (Revisited)

Debits and credits affect the Balance Sheet Model as follows:

A = L + SE

ASSETS

Debit for Increase	Credit for Decrease

LIABILITIES

Debit for Decrease	Credit for Increase

Account Name

Debit	Credit

Balance Sheet Model (Revisited)

Debits and credits affect the Balance Sheet Model as follows:

A = L + SE

ASSETS		LIABILITIES		EQUITIES	
Debit for Increase	Credit for Decrease	Debit for Decrease	Credit for Increase	Debit for Decrease	Credit for Increase

Stockholders’ Equity
A Closer Look

Recall that Stockholders’ Equity consists of the following components:

Capital Stock + Retained Earnings

C/S + R/E

Stockholders' Equity
A Closer Look

Therefore, the **Capital Stock and Retained Earnings** accounts are affected in the following manner by debits and credits because they are part of Stockholders' Equity:

CAPITAL STOCK	
Debit for Decrease	Credit for Increase

RET. EARNINGS	
Debit for Decrease	Credit for Increase

Stockholders’ Equity
A Closer Look

Also, because **Revenue** accounts increase Stockholders’ Equity, they are affected by debits and credits as follows:

REVENUES

Debit for Decrease	Credit for Increase

Stockholders' Equity
A Closer Look

And because **Expense** accounts <u>decrease</u> Stockholders' Equity, they are affected by debits and credits as follows:

EXPENSES	
Debit for Increase	Credit for Decrease

Normal Balances

Each of the 5 account types also has a normal balance side. It is always the side which is used to record <u>increases</u> in the account.

Normal Balances

The normal balances for each of the **FIVE** types of accounts are as follows:

Account Name

Debit Balance	Credit Balance
Assets	**Liabilities**
Expenses	**Stockholders' Equity**
	Revenues

Three Alternative Approaches For Learning Debits and Credits

- **Alternative #1**
  - The textbook approach on p. 59
- **Alternative #2**
  - Expanded Accounting Equation
  - This is Rice's preferred approach
- **Alternative #3**
  - "A L O R E" acronym

Alternative Approach #2
Expanded Accounting Equation

ASSETS + EXP. = LIAB. + S/H EQUITY + REV.

A + E = L + S/E + R

Dr.	Cr.
+	-
Bal.	

Dr.	Cr.
-	+
	Bal.

Alternative Approach #3
"A L O R E" Acronym

	Debit	Credit
A (ssets)	+	-
L (iabilities)	-	+
O (wners' equity)	-	+
R (evenues)	-	+
E (xpenses)	+	-

Debits and Credits
Question 1

Which of the following accounts would normally be expected to have a debit (or left-side) balance?

a. Accounts Payable
b. Buildings
c. Interest Revenue
d. Capital Stock

Debits and Credits
Solution 1

Which of the following accounts would normally be expected to have a debit (or left-side) balance?

a. Accounts Payable
b. **Buildings**
c. Interest Revenue
d. Capital Stock

BUILDINGS is an asset account and normally has a DEBIT balance.

The other three accounts normally have CREDIT balances.

Debits and Credits
Question 2

Which of the following accounts would normally be expected to have a credit (or right-side) balance?

a. Accounts Receivable
b. Salary Expense
c. Salary Payable
d. Land

Debits and Credits
Solution 2

Which of the following accounts would normally be expected to have a credit (or right-side) balance?

a. Accounts Receivable
b. Salary Expense
c. **Salary Payable**
d. Land

Debits and Credits
Solution 2

Which of the following accounts would normally be expected to have a credit (or right-side) balance?

a. Accounts Recei
b. Salary Expense
c. Salary Payable
d. Land

SALARY PAYABLE is a liability account and normally has a CREDIT balance.

The other three accounts normally have DEBIT balances.

Debits and Credits
Example

If the balance in Accounts Receivable (an asset) is $750 (debit side balance),

Accounts Receivable	
750	

Debits and Credits
Example

If the balance in Accounts Receivable (an asset) is $750 (debit side balance),

Accounts Receivable	
750	

What would we do to increase the account by $200?

Debits and Credits
Example

If the balance in Accounts Receivable (an asset) is $750 (debit side balance),

Accounts Receivable	
750	
200	

What would we do to increase the account by $200?

Debits and Credits
Example

If the balance in Accounts Receivable (an asset) is $750 (debit side balance),

Accounts Receivable	
750	
200	

What would we do to increase the account by $200?

What would we do to decrease the account by $350?

Debits and Credits
Example

If the balance in Accounts Receivable (an asset) is $750 (debit side balance),

Accounts Receivable

750	350
200	

What would we do to increase the account by $200?

What would we do to decrease the account by $350?

Debits and Credits
Example

Accounts Receivable

750	350
200	

Note the lack of $. It is understood that the yardstick is dollars.

It is not “money”!

Balancing The T-Account

To get the balance of the T-Account . . .

Accounts Receivable	
750	350
200	

. . . net the totals on the two sides against each other. Place the residual amount on the appropriate side.

Balancing The T-Account

To get the balance of the T-Account . . .

Accounts Receivable

750	350
200	
600	

. . . net the totals on the two sides against each other. Place the residual amount on the appropriate side.

Balancing The T-Account

To get the balance of the T-Account . . .

Accounts Receivable

750	350
200	
600	

(Can use the either the approach above to show the balance, the text's approach or Rice's approach)

Three Alternative Approaches to Balancing The T-Account

Using the example at the bottom of p. 57

Approach on Previous slide

Cash

(1)	10,000	(4)	600
(2)	5,000	(5)	2,000
(3)	1,000		
	13,400		

Text Approach

Cash

(1)	10,000	(4)	600
(2)	5,000	(5)	2,000
(3)	1,000		
	16,000		2,600
bal	13,400		

Rice's Approach

Cash

(1)	10,000	(4)	600
(2)	5,000	(5)	2,000
(3)	1,000		
	13,400		

ALL 3 are O.K.!

Debits and Credits
Question 3

The Cash account has three entries: a debit for $1,200, a credit for $300, and another credit for $400. What is the balance in the Cash account?

a. $ 1,900 Debit.
b. $ 500 Credit.
c. $ 700 Credit.
d. $ 500 Debit.

Debits and Credits
Question 3

The Cash account has three entries: a debit for $1,200, a credit for $300, and another credit for $400. What is the balance in the Cash account?

a. $ 1,900 Debit.
b. $ 500 Credit.
c. $ 700 Credit.
d. $ 500 Debit.

Cash	
$1,200	$ 300
	$ 400
$ 500	

Implications Of Debits And Credits

Debits and Credits are used to indicate that something happened to an account.

Interpreting the implications requires an analysis of the entire journal entry.

Implications
Question 1

If the company made a Credit entry to Notes Payable, would the account increase or decrease?

Implications
Question 1

If the company made a Credit entry to Notes Payable, would the account increase or decrease?

ANSWER:

Notes Payable would increase.

Implications Question 2

Notes Payable is the account where we record long-term borrowings. What event would cause us to record an increase in our long-term borrowings?

Implications Question 2

Notes Payable is the account where we record long-term borrowings. What event would cause us to record an increase in our long-term borrowings?

ANSWER:

Such an increase could imply that the company borrowed money.

Implications
Question 3

If the company borrowed money, which account would also be affected and in what way?

Implications Question 3

If the company borrowed money, which account would also be affected and in what way?

ANSWER:

There would also be an equal-sized increase in the Cash account.

Implications Question 4

Suppose instead of an increase to Cash, you find an increase to the Land account. How do you interpret the increase in Notes Payable?

Implications
Question 4

Suppose instead of an increase to Cash, you find an increase to the Land account. How do you interpret the increase in Notes Payable?

ANSWER:

The company acquired land and gave a note that promised to pay for the land in the future.

Recording Transactions

- Initially, all transactions are recorded in the **General** **<u>Journal</u>**.

Recording Transactions

- **Initially, all transactions are recorded in the General Journal.**
- **Each transaction always affects at least two different accounts.**
  - **One account has a debit effect.**
  - **The second account has a credit effect.**
- **This methodology was named “double entry” accounting by whom?**

Pacioli

General Journal Page

GENERAL JOURNAL

Page: ______

Date	Description	PR	Debit	Credit

Journal Entries
Example 1

On January 1, 19X7, Caldwell Company borrows $10,000 from the bank.

Prepare the appropriate general journal entry for the above transaction.

Journal Entries
Solution 1

- Two accounts are affected:
  - Cash is increased by $10,000.
  - Notes Payable is increased by $10,000.

Journal Entries
Solution 1

- **Two accounts are affected:**
  - Cash is increased by $10,000.
  - Notes Payable is increased by $10,000.

GENERAL JOURNAL

Page: 1

Date	Description	PR	Debit	Credit

Journal Entries
Solution 1

- **Two accounts are affected:**
  - **Cash is increased by $10,000.**
  - **Notes Payable is increased by $10,000.**

GENERAL JOURNAL

Page: 1

Date	Description	PR	Debit	Credit
1-Jan	Cash	100	10,000	
	Notes Payable	201		10,000
	to record loan from bank			

Journal Entries
Solution 1

Typically, accounts are numbered. The account numbers are used as references for posting to the General Ledger. More on account numbers will come later.

ected:

$10,000.

eased by $10,000.

URNAL

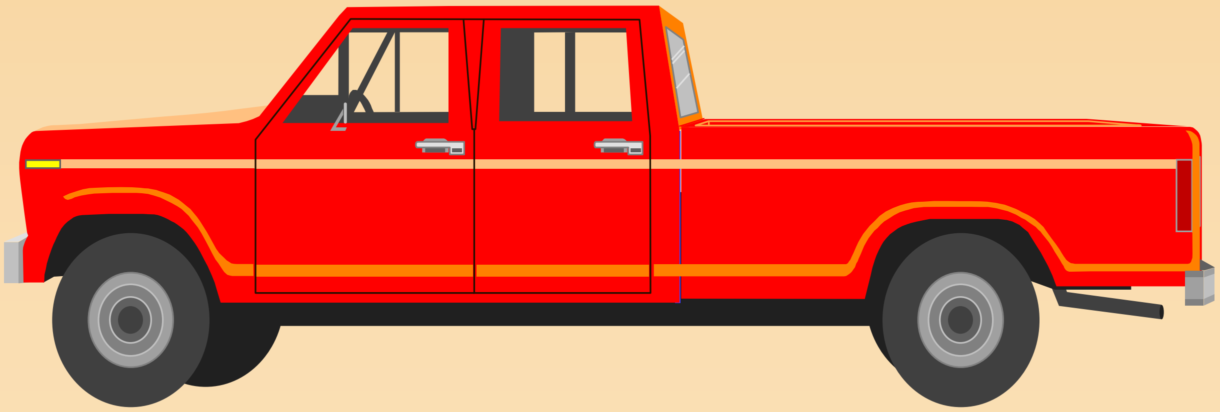
Page: 1

	PR	Debit	Credit
	100	10,000	
	201		10,000

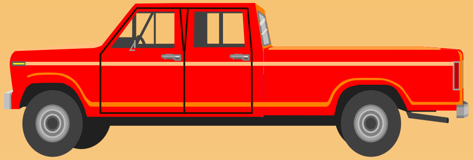
Journal Entries
Example 2

On January 15, 19X7, Caldwell Company purchases a truck for $19,500 cash.

Prepare the appropriate journal entry for the above transaction.

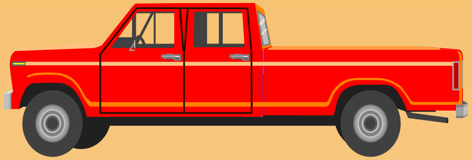


Journal Entries
Solution 2



- **Two accounts are affected:**
  - **Trucks is increased by $19,500.**
  - **Cash is decreased by $19,500.**

Journal Entries
Solution 2



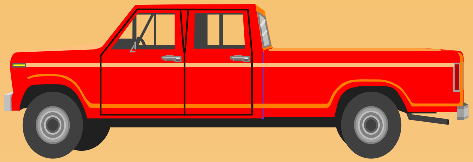
- **Two accounts are affected:**
  - **Trucks is increased by $19,500.**
  - **Cash is decreased by $19,500.**

GENERAL JOURNAL

Page: 1

Date	Description	PR	Debit	Credit

Journal Entries
Solution 2



- **Two accounts are affected:**
  - **Trucks is increased by $19,500.**
  - **Cash is decreased by $19,500.**

GENERAL JOURNAL

Page: 1

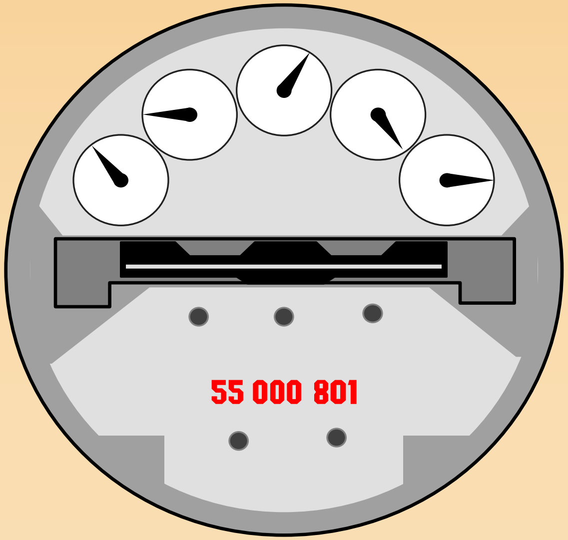
Date	Description	PR	Debit	Credit
15-Jan	**Trucks**	**150**	**19,500**	
	Cash	**100**		**19,500**
	to record purchase of truck			

Journal Entries

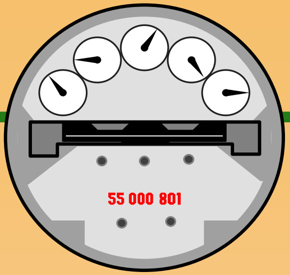
Example 3

On January 20, 19X7, Caldwell Co. pays the $400 electric bill for January.

Prepare the appropriate journal entry for the above transaction.

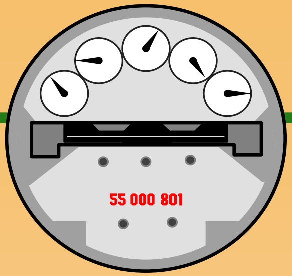


Journal Entries
Solution 3



- **Two accounts are affected:**
  - **Utility Expense is increased by $400.**
  - **Cash is decreased by $400.**

Journal Entries
Solution 3



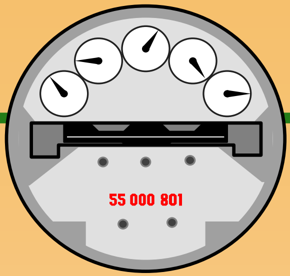
- **Two accounts are affected:**
  - **Utility Expense is increased by $400.**
  - **Cash is decreased by $400.**

GENERAL JOURNAL

Page: 1

Date	Description	PR	Debit	Credit

Journal Entries
Solution 3



- Two accounts are affected:
  - Utility Expense is increased by $400.
  - Cash is decreased by $400.

GENERAL JOURNAL

Page: 1

Date	Description	PR	Debit	Credit
20-Jan	Utility Expense	511	400	
	Cash	100		400
	to record payment of January			
	electric bill			

More About The General Ledger

- It is a complete collection of all the accounts of a company
- Accounts are individually numbered for easy reference
- It is used to collect the information about all of the transactions affecting a specific account
- A cumulative, running balance is maintained when using the 3-column type

Categories of General Ledger Accounts

The five types of accounts fall into one of two categories

Real Accounts

Nominal Accounts

Real Accounts

- This category includes Assets, Liabilities, and Stockholders' Equities (i.e., Balance Sheet accounts)
- Accounts are permanent.
- Account balances are carried forward from one fiscal year to the next.

Nominal Accounts

- Nominal accounts include revenues and expenses.
- Nominal accounts are temporary.
- Nominal account balances are closed out to zero at the end of the fiscal year.
  - Closing Entries will be discussed in Chapter 4.

Numbering Accounts

The listing of all accounts and their account numbers is called the **chart of accounts**.

Numbering Accounts

The listing of all accounts and their account numbers is called the **chart of accounts**.

A typical account numbering scheme might appear as follows:

Assets	100-199	Revenues	400-499
Liabilities	200-299	Expenses	500-599
Equities	300-399		

(See page 63 and inside back cover)

Posting to the GL Example

GENERAL JOURNAL

Page: 1

Date	Description	PR	Debit	Credit
1-Jan	Cash		10,000	
	Notes Payable			10,000
	to record loan from bank			

Start with the journal entry from the General Journal.

Posting to the GL Example

Next, find the appropriate page in the General Ledger for Cash.

1

Date				Credit
1-Jan	Cash		10,000	
	Notes Payable			10,000
	to record loan from bank			

ACCOUNT NAME: CASH **ACCOUNT No. 100**

Date	Description	PR	Debit	Credit	Balance
	Beginning Balance		0		0

Posting to the GL Example

Post the account reference number.

Date	Description	PR	Debit	Credit
1-Jan	Cash	100	10,000	
	Notes Payable			10,000
	to record loan from bank			

ACCOUNT NAME: CASH **ACCOUNT No. 100**

Date	Description	PR	Debit	Credit	Balance
	Beginning Balance		0		0

Posting to the GL Example

GENERAL JOURNAL

Page: 1

Date	Description	PR	Debit	Credit
1-Jan	Cash	100	10,000	
	Notes Payable			10,000
	to record loan from bank			

ACCOUNT NAME: CASH **ACCOUNT No. 100**

Date	Description	PR	Debit	Credit	Balance
	Beginning Balance		0		0
1-Jan	Loan	G1	10,000		

Post the transaction info to the GL.

Posting to the GL Example

GENERAL JOURNAL

Page: 1

Date	Description	PR	Debit	Credit
1-Jan	Cash	100	10,000	
	Notes Payable			10,000
	to record loan from bank			

ACCOUNT NAME: CASH **ACCOUNT No. 100**

Date	Description	PR	Debit	Credit	Balance
	Beginning Balance		0		0
1-Jan	Loan	G1	10,000		10,000

Update the General Ledger balance.

Posting to the GL Example

Next, find the Notes Payable page in the General Ledger.

1

Date				redit
1-Jan				
	Notes Payable			10,000
	to record loan from bank			

ACCOUNT NAME: Notes Payable **ACCOUNT No. 201**

Date	Description	PR	Debit	Credit	Balance
	Beginning Balance			0	0

Posting to the GL Example

Post the account reference number.

Date	Description	PR	Debit	Credit
1-Jan	Cash	100	10,000	
	Notes Payable	201		10,000
	to record loan from bank			

ACCOUNT NAME: Notes Payable **ACCOUNT No. 201**

Date	Description	PR	Debit	Credit	Balance
	Beginning Balance			0	0

Posting to the GL Example

GENERAL JOURNAL

Page: 1

Date	Description	PR	Debit	Credit
1-Jan	Cash	100	10,000	
	Notes Payable	201		10,000
	to record loan from bank			

ACCOUNT NAME: Notes Payable **ACCOUNT No. 201**

Date	Description	PR	Debit	Credit	Balance
	Beginning Balance			0	0
1-Jan	Loan	G1		10,000	

Post the transaction info to the GL.

Posting to the GL Example

GENERAL JOURNAL

Page: 1

Date	Description	PR	Debit	Credit
1-Jan	Cash	100	10,000	
	Notes Payable	201		10,000
	to record loan from bank			

ACCOUNT NAME: Notes Payable **ACCOUNT No. 201**

Date	Description	PR	Debit	Credit	Balance
	Beginning Balance			0	0
1-Jan	Loan	G1		10,000	10,000

Update the General Ledger balance.

Posting to the GL Example

Examine the next journal entry.

Date	Description	PR	Debit	Credit
15-Jan	Trucks		9,500	
	Cash			9,500
	to record purchase of truck			

ACCOUNT NAME: CASH **ACCOUNT No. 100**

Date	Description	PR	Debit	Credit	Balance
	Beginning Balance		0		0
1-Jan	Loan from bank	G1	10,000		10,000

Posting to the GL Example

Record the account reference.

Date	Description	PR	Debit	Credit
15-Jan	Trucks		9,500	
	Cash	100		9,500
	to record purchase of truck			

ACCOUNT NAME: CASH **ACCOUNT No. 100**

Date	Description	PR	Debit	Credit	Balance
	Beginning Balance		0		0
1-Jan	Loan from bank	G1	10,000		10,000

Posting to the GL Example

GENERAL JOURNAL

Page: 3

Date	Description	PR	Debit	Credit
15-Jan	Trucks		9,500	
	Cash	100		9,500
	to record purchase of truck			

ACCOUNT NAME: CASH — **ACCOUNT No. 100**

Date	Description	PR	Debit	Credit	Balance
	Beginning Balance		0		0
1-Jan	Loan from bank	G1	10,000		10,000
15-Jan	Purchase of truck	G3		9,500	

Post the entry to the GL.

Posting to the GL Example

GENERAL JOURNAL

Page: 3

Date	Description	PR	Debit	Credit
15-Jan	Trucks		9,500	
	Cash	100		9,500
	to record purchase of truck			

ACCOUNT NAME: CASH **ACCOUNT No. 100**

Date	Description	PR	Debit	Credit	Balance
	Beginning Balance		0		0
1-Jan	Loan from bank	G1	10,000		10,000
15-Jan	Purchase of truck	G3		9,500	500

Update the General Ledger balance.

TRIAL BALANCE

- Used to periodically test whether the General Ledger is in balance.

- Consists of a listing of each account with its balance as of a specific date.
  - All Debit balances are in one column.
  - All Credit balances are in another column.

Trial Balance Illustration (Text example is on p. 79)

First Company
Trial Balance
12/31/X8

	Debits	Credits
Cash	$ 500	
Accounts Receivable	1,200	
Equipment	3,800	
Accounts Payable		$ 700
Notes Payable		1,450
Capital Stock		3,000
Retained Earnings - 1/1/X8		-
Dividends	250	
Revenues		11,000
Salary Expense	5,000	
Utility Expense	3,000	
Rent Expense	2,400	
	$16,150	$16,150

Trial Balance Illustration
(Text example is on p. 79)

First Company
Trial Balance
12/31/X8

Notice that Total Debits are equal to Total Credits.

	Debits	Credits
	$ 500	
	1,200	
	3,800	
		$ 700
		1,450
		3,000
/X8		-
Dividends	250	
Revenues		11,000
Salary Expense	5,000	
Utility Expense	3,000	
Rent Expense	2,400	
	$16,150	$ 16,150

Dividends Account

The **Dividends** account is a contra account to Retained Earnings. Therefore, it is affected by debits and credits as follows:

DIVIDENDS	
Debit for Increase	Credit for Decrease