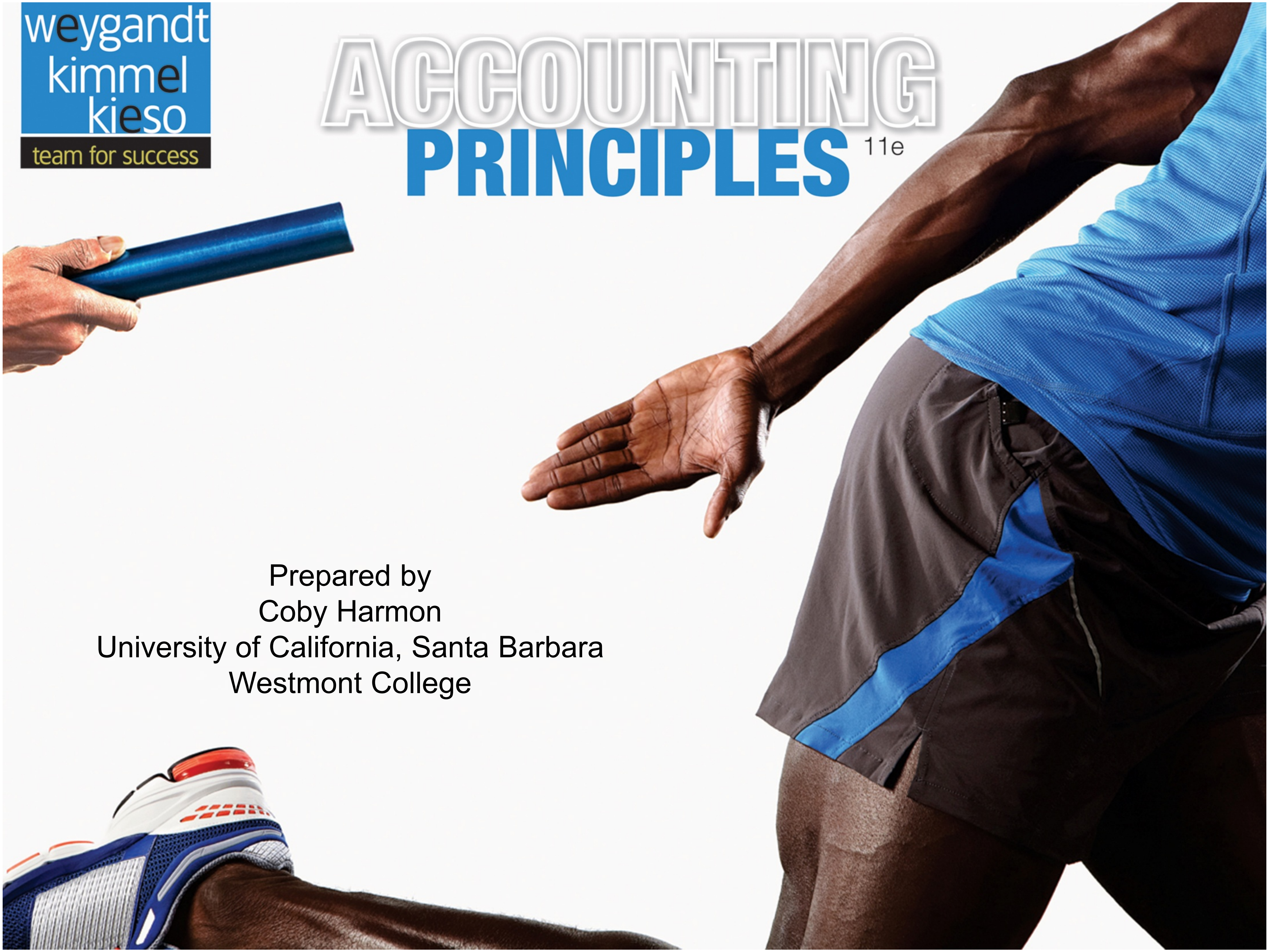


weygandt
kimmel
kieso
team for success

ACCOUNTING PRINCIPLES 11e

Prepared by
Coby Harmon
University of California, Santa Barbara
Westmont College

2 The Recording Process

Learning 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 their use in recording 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.

Preview of Chapter 2

THE RECORDING PROCESS

The Account	Steps in the Recording Process	The Trial Balance
• Debits and credits • Owner's equity relationships • Summary of debit/credit rules	• Journal • Ledger • Posting • Chart of accounts • The recording process illustrated	• Limitations of a trial balance • Locating errors • Use of dollar signs

The Account

Account

- Record of increases and decreases in a specific asset, liability, equity, revenue, or expense item.
- Debit = “Left”
- Credit = “Right”

An account can be illustrated in a T-account form.

Account Name

Debit / Dr.	**Credit / Cr.**

LO 1 Explain what an account is and how it helps in the recording process.

The Account

Debits and Credits

Double-entry system

- Each transaction must affect two or more accounts to keep the basic accounting equation in balance.
- Recording done by debiting at least one account and crediting another.
- **DEBITS must equal CREDITS**.

LO 2 Define debits and credits and explain their use in recording business transactions.

Debits and Credits

If Debit amounts are greater than Credit amounts, the account will have a debit balance.

Account Name

	Debit / Dr.	Credit / Cr.	
Transaction #1	$10,000	$3,000	Transaction #2
Transaction #3	8,000		
Balance	$15,000		

LO 2 Define debits and credits and explain their use in recording business transactions.

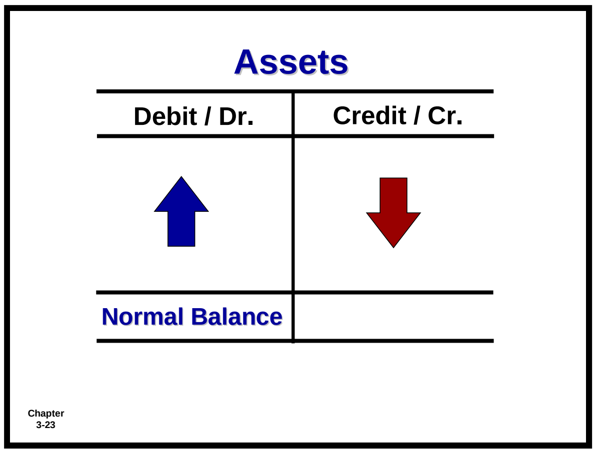
Debits and Credits

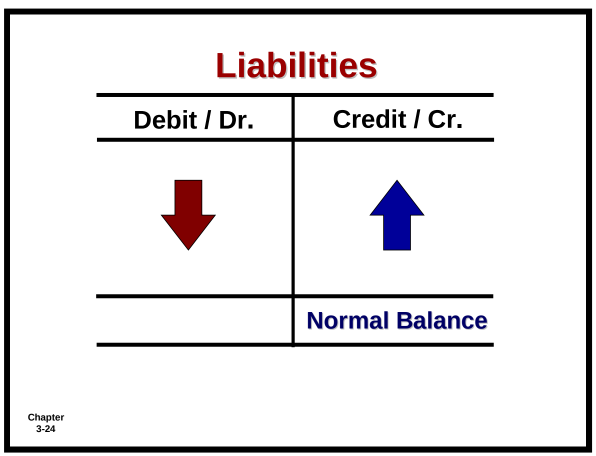
If Debit amounts are less than Credit amounts, the account will have a credit balance.

	Account Name		
	Debit / Dr.	**Credit / Cr.**	
Transaction #1	**$10,000**	**$3,000**	**Transaction #2**
		8,000	**Transaction #3**
Balance		**$1,000**	

LO 2 Define debits and credits and explain their use in recording business transactions.

Debits and Credits

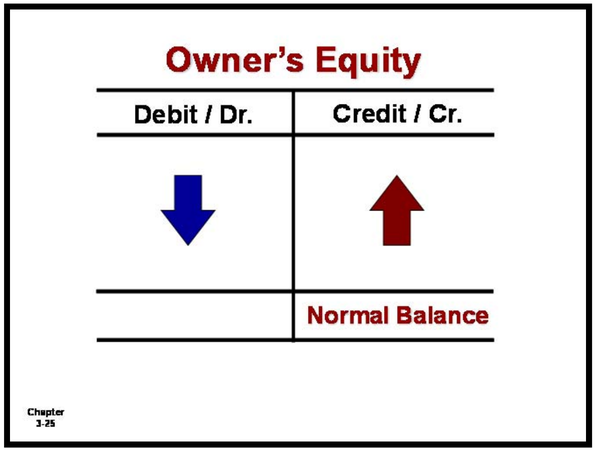




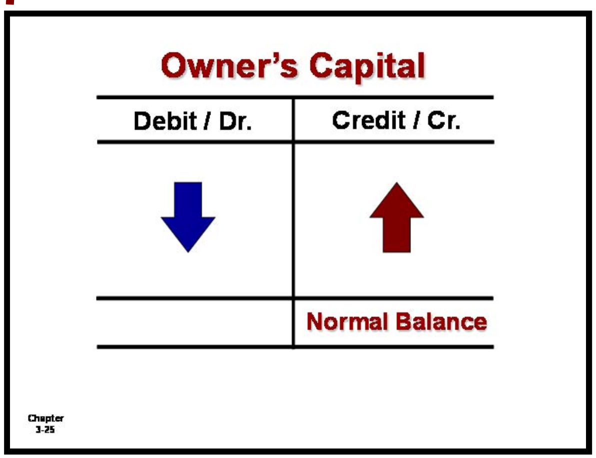
- **Assets** - Debits should exceed credits.
- **Liabilities** – Credits should exceed debits.
- **Normal balance** is on the increase side.

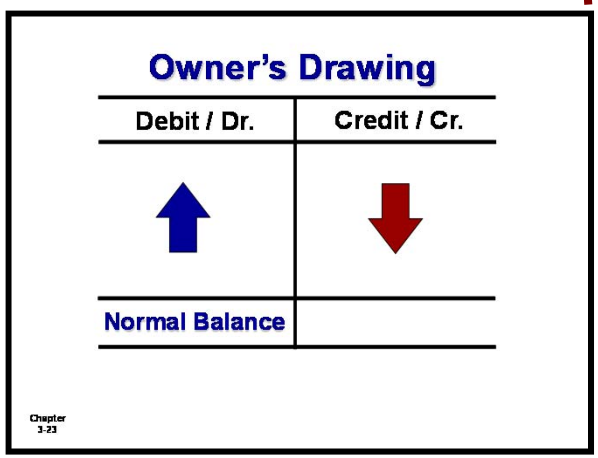
LO 2 Define debits and credits and explain their use in recording business transactions.

Debits and Credits



- **Owner's investments** and **revenues** increase owner's equity (credit).
- **Owner's drawings** and **expenses** decrease owner's equity (debit).

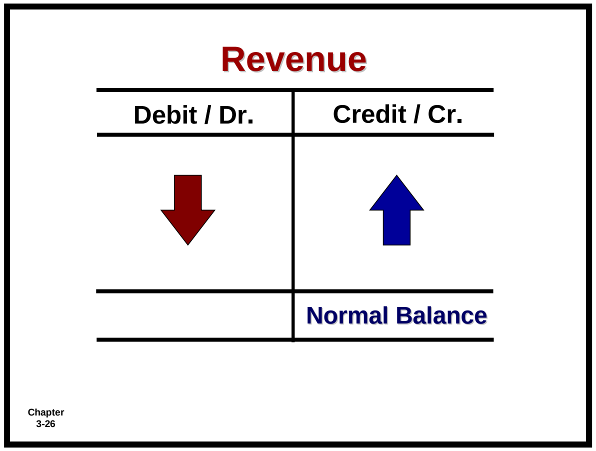


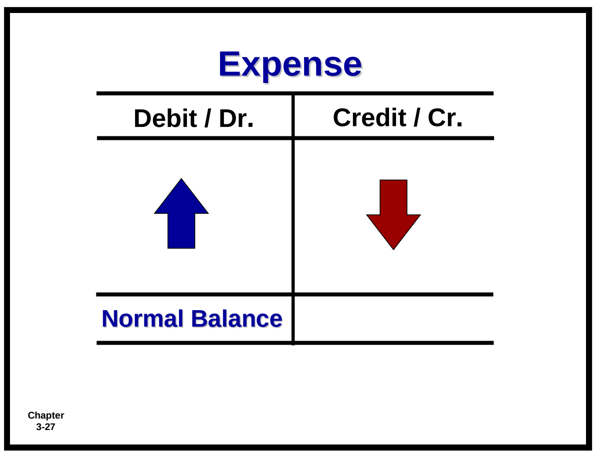


Helpful Hint Because revenues increase owner's equity, a revenue account has the same debit/credit rules as the Owner's Capital account. Expenses have the opposite effect.

LO 2

Debits and Credits



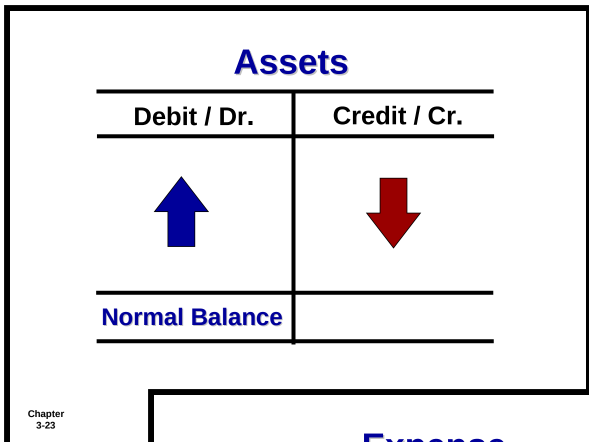


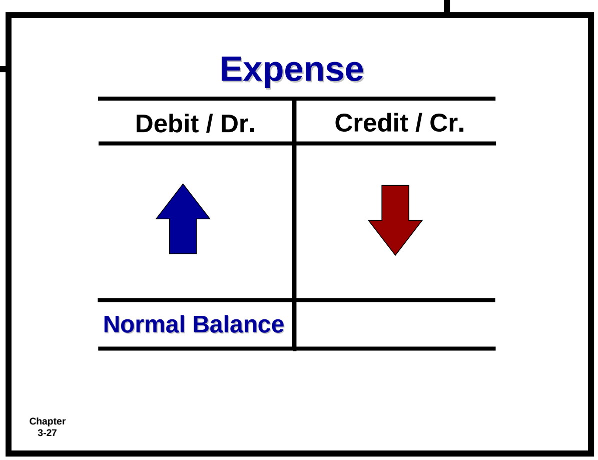
- The purpose of earning **revenues** is to benefit the owner(s).
- The effect of debits and credits on revenue accounts is the **same as** their effect on Owner's Capital.
- **Expenses** have the opposite effect: expenses decrease owner's equity.

LO 2 Define debits and credits and explain their use in recording business transactions.

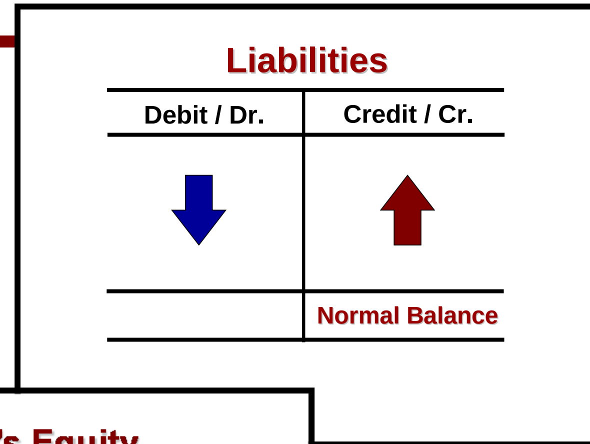
Debits/Credits Rules

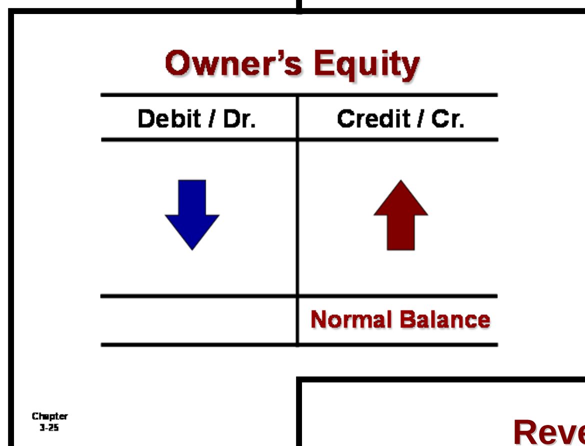
Normal Balance **Debit**

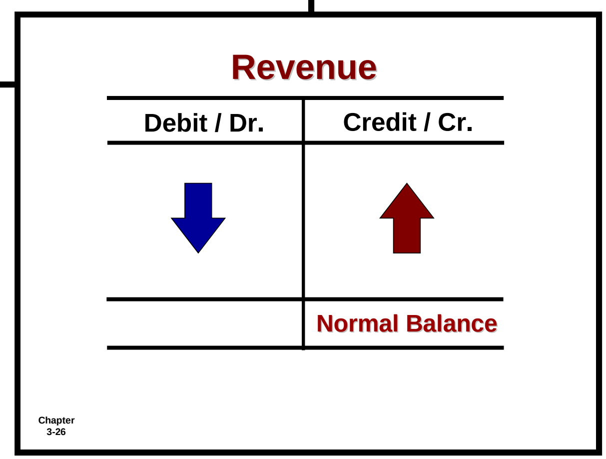




Normal Balance **Credit**







Debits/Credits Rules

	Balance Sheet			Income Statement	
	Asset =	Liability +	Equity	Revenue -	Expense
Debit	↑	↓	↓	↓	↑
Credit	↓	↑	↑	↑	↓

LO 2 Define debits and credits and explain their use in recording business transactions.

Debits/Credits Rules

Question

Debits:

a. increase both assets and liabilities.

b. decrease both assets and liabilities.

c. increase assets and decrease liabilities.

d. decrease assets and increase liabilities.

LO 2 Define debits and credits and explain their use in recording business transactions.

Debits/Credits Rules

Question

Accounts that normally have debit balances are:

a. assets, expenses, and revenues.

b. assets, expenses, and equity.

c. assets, liabilities, and owner's drawing.

d. assets, owner's drawing, and expenses.

LO 2 Define debits and credits and explain their use in recording business transactions.

INVESTOR INSIGHT

Keeping Score

The Chicago Cubs baseball team has these 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? (See page 95.)

Summary of Debits/Credits Rules

Relationship among the assets, liabilities and owner's equity of a business:

Illustration 2-11

Basic Equation

Assets = Liabilities + Owner's Equity

Expanded Basic Equation

Assets		=	Liabilities		+	Owner's Capital		−	Owner's Drawing		+	Revenues		−	Expenses	
Dr.	Cr.		Dr.	Cr.		Dr.	Cr.		Dr.	Cr.		Dr.	Cr.		Dr.	Cr.
+	−		−	+		−	+		+	−		−	+		+	−

The equation must be in balance after every transaction.
For every **Debit** there must be a **Credit**.

LO 2 Define debits and credits and explain their use in recording business transactions.

DO IT!

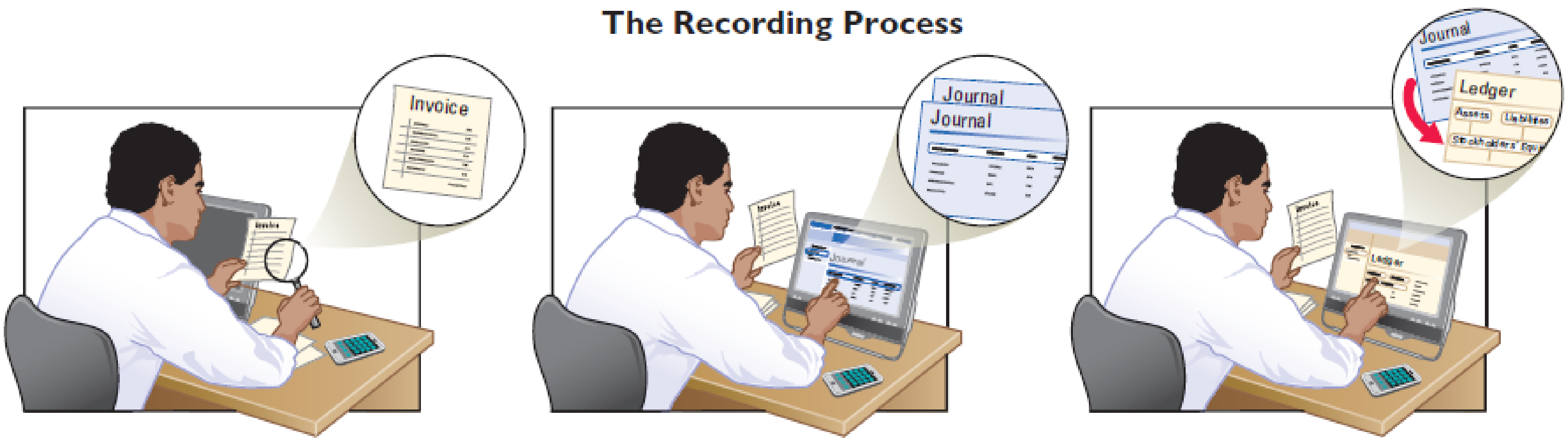
Kate Browne has just rented space in a shopping mall. In this space, she will open a hair salon to be called “Hair It Is.” A friend has advised Kate to set up a double-entry set of accounting records in which to record all of her business transactions. Identify the balance sheet accounts that Kate will likely need to record the transactions needed to open her business. Indicate whether the normal balance of each account is a debit or a credit.

Assets	Liabilities	Equity
Cash (debit)	Notes payable (credit)	Owner’s Capital (credit)
Supplies (debit)	Accounts payable (credit)	
Equipment (debit)		

LO 2 Define debits and credits and explain their use in recording business transactions.

Steps in the Recording Process

Illustration 2-12



Analyze each transaction | **Enter transaction in a journal** | **Transfer journal information to ledger accounts**

Business documents, such as a sales slip, a check, a bill, or a cash register tape, provide evidence of the transaction.

LO 3 Identify the basic steps in the recording process.

Steps in the Recording Process

The Journal

- Book of original entry.
- Transactions recorded in chronological order.
- Contributions to the recording process:
  1. Discloses the **complete effects of a transaction**.
  2. Provides a **chronological record** of transactions.
  3. Helps to **prevent or locate errors** because the debit and credit amounts can be easily compared.

LO 4 Explain what a journal is and how it helps in the recording process.

Steps in the Recording Process

Journalizing - Entering transaction data in the journal.

Illustration: On September 1, Ray Neal invested $15,000 cash in the business, and Softbyte purchased computer equipment for $7,000 cash.

Illustration 2-13

General Journal

Date	Account Title	Ref.	Debit	Credit
Sept. 1	Cash		15,000	
	Owner's Capital			15,000
	Equipment		7,000	
	Cash			7,000

LO 4 Explain what a journal is and how it helps in the recording process.

Steps in the Recording Process

Simple and Compound Entries

Illustration: On July 1, Butler Company purchases a delivery truck costing $14,000. It pays $8,000 cash now and agrees to pay the remaining $6,000 on account.

Illustration 2-14

General Journal

Date	Account Title	Ref.	Debit	Credit
July 1	Equipment		14,000	
	Cash			8,000
	Accounts payable			6,000

LO 4 Explain what a journal is and how it helps in the recording process.

ACCOUNTING ACROSS THE ORGANIZATION

Boosting Microsoft's Profits

At one time, Microsoft's Home and Entertainment Division lost over $4 billion, mostly due to losses on the original Xbox videogame console. With the Xbox 360 videogame console, the division's head of finance, Bryan Lee, hoped the division would become profitable. He set strict goals for sales, revenue, and profit. "A manager seeking to spend more on a feature such as a disk drive has to find allies in the group to cut spending elsewhere, or identify new revenue to offset the increase," he explained.

For example, Microsoft originally designed the Xbox 360 to have 256 megabytes of memory. But the design department said that amount of memory wouldn't support the best special effects. The purchasing department said that adding more memory would cost $30—which was 10% of the estimated selling price of $300. The marketing department, however, "determined that adding the memory would let Microsoft reduce marketing costs and attract more game developers, boosting royalty revenue. It would also extend the life of the console, generating more sales." As a result, Microsoft doubled the memory to 512 megabytes. Today, the division enjoys great success.

Source: Robert A. Guth, "New Xbox Aim for Microsoft: Profitability," *Wall Street Journal* (May 24, 2005), p. C1.

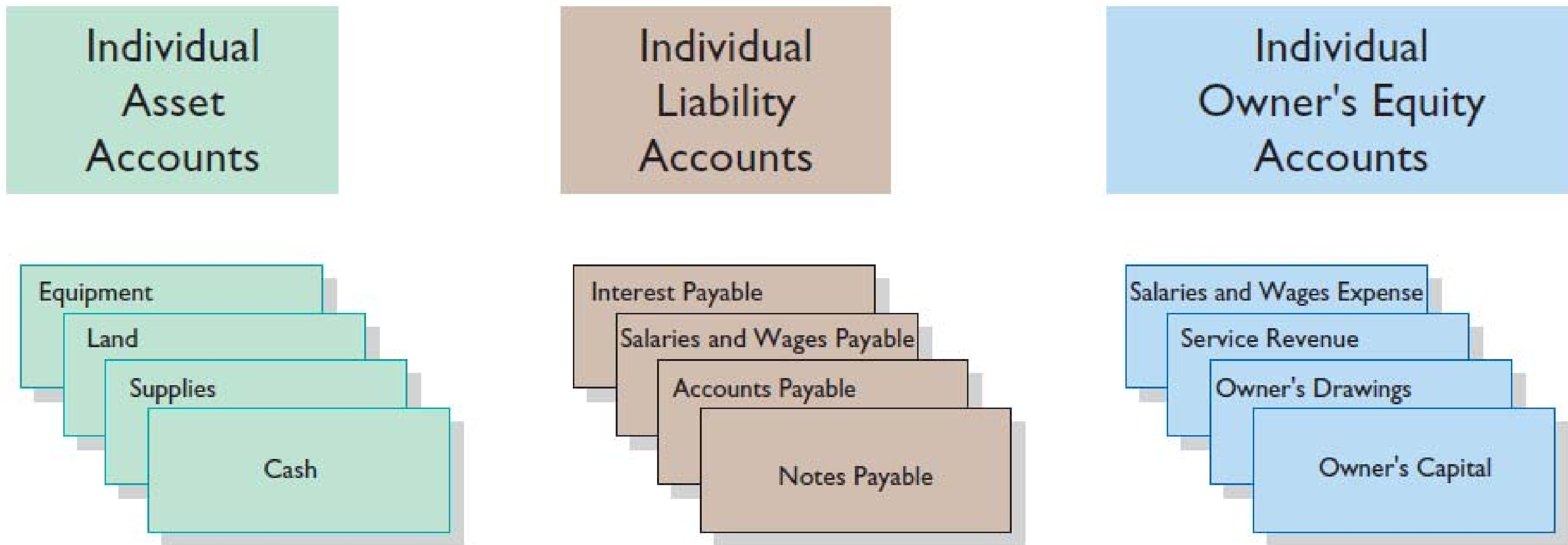
? In what ways is this Microsoft division using accounting to assist in its effort to become more profitable? (See page 95.)

Steps in the Recording Process

The Ledger

- **General Ledger** contains the entire group of accounts maintained by a company.

Illustration 2-15



LO 5 Explain what a ledger is and how it helps in the recording process.

ETHICS INSIGHT

A Convenient Overstatement

Sometimes a company's investment securities suffer a permanent decline in value below their original cost. When this occurs, the company is supposed to reduce the recorded value of the securities on its balance sheet ("write-them down" in common financial lingo) and record a loss. It appears, however, that during the financial crisis, employees at some financial institutions chose to look the other way as the value of their investments skidded. A number of Wall Street traders that worked for the investment bank Credit Suisse Group were charged with intentionally overstating the value of securities that had suffered declines of approximately $2.85 billion. One reason that they may have been reluctant to record the losses is out of fear that the company's shareholders and clients would panic if they saw the magnitude of the losses. However, personal self-interest might have been equally to blame—the bonuses of the traders were tied to the value of the investment securities.

Source: S. Pulliam, J. Eaglesham, and M. Siconolfi, "U.S. Plans Changes on Bond Fraud," *Wall Street Journal Online* (February 1, 2012).

? What incentives might employees have had to overstate the value of these investment securities on the company's financial statements? (See page 95.)

Steps in the Recording Process

Standard Form of Account

Illustration 2-16

Cash					No. 101
Date	**Explanation**	**Ref.**	**Debit**	**Credit**	**Balance**
2014					
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

LO 5 Explain what a ledger is and how it helps in the recording process.

Steps

Posting – process of transferring amounts from the journal to the ledger accounts.

GENERAL JOURNAL J1

Date	Account Titles and Explanation	Ref.	Debit	Credit
2014 Sept. 1	Cash	101	15,000	
	Owner's Capital	301		15,000
	(Owner's investment of cash in business)			

GENERAL LEDGER

Cash No. 101

Date	Explanation	Ref.	Debit	Credit	Balance
2014 Sept. 1		J1	15,000		15,000

Owner's Capital No. 301

Date	Explanation	Ref.	Debit	Credit	Balance
2014 Sept. 1		J1		15,000	15,000

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

Illustration 2-17

LO 6 Explain what posting is and how it helps in the recording process.

Posting

Question

Posting:

a. normally occurs before journalizing.

b. transfers ledger transaction data to the journal.

c. is an optional step in the recording process.

d. transfers journal entries to ledger accounts.

Chart of Accounts

Accounts and account numbers arranged in sequence in which they are presented in the financial statements.

Illustration 2-18

PIONEER ADVERTISING AGENCY
Chart of Accounts

Assets	Owner's Equity
101 Cash	301 Owner's Capital
112 Accounts Receivable	306 Owner's Drawings
126 Supplies	350 Income Summary
130 Prepaid Insurance	
157 Equipment	**Revenues**
158 Accumulated Depreciation—Equipment	400 Service Revenue
Liabilities	**Expenses**
200 Notes Payable	631 Supplies Expense
201 Accounts Payable	711 Depreciation Expense
209 Unearned Service Revenue	722 Insurance Expense
212 Salaries and Wages Payable	726 Salaries and Wages Expense
230 Interest Payable	729 Rent Expense
	732 Utilities Expense
	905 Interest Expense

LO 6 Explain what posting is and how it helps in the recording process.

The Recording Process Illustrated

Follow these steps:

1. Determine what type of account is involved.
2. Determine what items increased or decreased and by how much.
3. Translate the increases and decreases into debits and credits.

Transaction: On October 1, C. R. Byrd invests $10,000 cash in an advertising company called Pioneer Advertising Agency.

Basic Analysis: The asset Cash increases $10,000, and owner's equity (specifically, Owner's Capital) increases $10,000.

Equation Analysis:

Assets	=	Liabilities	+	Owner's Equity
Cash	=			Owner's Capital
+10,000				+10,000

Debit–Credit Analysis: Debits increase assets: debit Cash $10,000. Credits increase owner's equity: credit Owner's Capital $10,000.

Journal Entry:

Oct. 1	Cash	101	10,000	
	Owner's Capital	301		10,000
	(Owner's investment of cash in business)			

Posting:

Cash		101
Oct. 1	10,000	

Owner's Capital		301
	Oct. 1	10,000

Illustration 2-19

LO 6

The Recording Process Illustrated

Illustration 2-20

Transaction	On October 1, Pioneer purchases office equipment costing $5,000 by signing a 3-month, 12%, $5,000 note payable.
Basic Analysis	The asset Equipment increases $5,000, and the liability Notes Payable increases $5,000.
Equation Analysis	**Assets** = **Liabilities** + **Owner's Equity** Equipment = Notes Payable +5,000 = +5,000
Debit–Credit Analysis	Debits increase assets: debit Equipment $5,000. Credits increase liabilities: credit Notes Payable $5,000.

Journal Entry

Oct. 1	Equipment	157	5,000	
	Notes Payable	200		5,000
	(Issued 3-month, 12% note for office equipment)			

Posting

Equipment	157
Oct. 1 5,000	

Notes Payable	200
	Oct. 1 5,000

LO 6

The Recording Process Illustrated

Illustration 2-21

Transaction	On October 2, Pioneer receives a $1,200 cash advance from R. Knox, a client, for advertising services that are expected to be completed by December 31.
Basic Analysis	The asset Cash increases $1,200; the liability Unearned Service Revenue increases $1,200 because the service has not been provided yet. That is, when Pioneer receives an advance payment, it should record an unearned revenue (a liability) 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.
Equation Analysis	see equation table below
Debit–Credit Analysis	Debits increase assets: debit Cash $1,200. Credits increase liabilities: credit Unearned Service Revenue $1,200.

Equation Analysis:

Assets	=	**Liabilities**	+	**Owner's Equity**
Cash	=	Unearned Service Revenue		
+1,200		+1,200		

Journal Entry:

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

Posting:

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

Unearned Service Revenue			209
		Oct. 2	1,200

LO 6

The Recording Process Illustrated

Illustration 2-22

Transaction

On October 3, Pioneer pays office rent for October in cash, $900.

Basic Analysis

The expense account Rent Expense increases $900 because the payment pertains only to the current month; the asset Cash decreases $900.

Equation Analysis

Assets	=	**Liabilities**	+	**Owner's Equity**
Cash	=			Rent Expense
-900				-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		

The Recording Process Illustrated

Illustration 2-23

Transaction	On October 4, Pioneer pays $600 for a one-year insurance policy that will expire next year on September 30.
Basic Analysis	The asset Prepaid Insurance increases $600 because the payment extends to more than the current month; the asset Cash decreases $600. Payments of expenses that will benefit more than one accounting period are prepaid expenses or prepayments. When a company makes a payment, it debits an asset account in order to show the service or benefit that will be received in the future.
Equation Analysis	**Assets** = **Liabilities** + **Owner's Equity** Cash + Prepaid Insurance -600 +600
Debit–Credit Analysis	Debits increase assets: debit Prepaid Insurance $600. Credits decrease assets: credit Cash $600.

Journal Entry

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

Posting

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

Prepaid Insurance			130
Oct. 4	600		

LO 6

The Recording Process Illustrated

Illustration 2-24

Transaction	On October 5, Pioneer purchases an estimated 3-month supply of advertising materials on account from Aero Supply for $2,500.
Basic Analysis	The asset Supplies increases $2,500; the liability Accounts Payable increases $2,500.
Equation Analysis	see below
Debit–Credit Analysis	Debits increase assets: debit Supplies $2,500. Credits increase liabilities: credit Accounts Payable $2,500.
Journal Entry	see below
Posting	see below

Equation Analysis

Assets	=	**Liabilities**	+	**Owner's Equity**
Supplies	=	Accounts Payable		
+2,500		+2,500		

Journal Entry

Oct. 5	Supplies	126	2,500	
	Accounts Payable	201		2,500
	(Purchased supplies on account from Aero Supply)			

Posting

Supplies			126
Oct. 5	2,500		

Accounts Payable			201
		Oct. 5	2,500

The Recording Process Illustrated

Illustration 2-25

Event	On October 9, Pioneer hires 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.)

The Recording Process Illustrated

Illustration 2-26

Transaction	On October 20, C. R. Byrd withdraws $500 cash for personal use.
Basic Analysis	The owner's equity account Owner's Drawings increases $500; the asset Cash decreases $500.
Equation Analysis	**Assets** = **Liabilities** + **Owner's Equity** Cash = Owner's Drawings -500 -500
Debit–Credit Analysis	Debits increase drawings: debit Owner's Drawings $500. Credits decrease assets: credit Cash $500.

Journal Entry

Oct. 20	Owner's Drawings	306	500	
	Cash	101		500
	(Withdrew cash for personal use)			

Posting

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

Owner's Drawings			306
Oct. 20	500		

LO 6

The Recording Process Illustrated

Illustration 2-27

Transaction	On October 26, Pioneer owes employee salaries of $4,000 and pays them in cash. (See October 9 transaction.)
Basic Analysis	The expense account Salaries and Wages Expense increases $4,000; the asset Cash decreases $4,000.
Equation Analysis	see below
Debit–Credit Analysis	Debits increase expenses: debit Salaries and Wages Expense $4,000. Credits decrease assets: credit Cash $4,000.

Equation Analysis

Assets	=	**Liabilities**	+	**Owner's Equity**
Cash	=			Salaries and Wages Expense
-4,000				-4,000

Journal Entry

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

Posting

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

Salaries and Wages Expense		726
Oct. 26	4,000	

LO 6

The Recording Process Illustrated

Illustration 2-28

Transaction	On October 31, Pioneer receives $10,000 in cash from Copa Company for advertising services provided in October.
Basic Analysis	The asset Cash increases $10,000; the revenue account Service Revenue increases $10,000.
Equation Analysis	**Assets** = **Liabilities** + **Owner's Equity** Cash = Service Revenue +10,000 +10,000
Debit–Credit Analysis	Debits increase assets: debit Cash $10,000. Credits increase revenues: credit Service Revenue $10,000.

Journal Entry

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

Posting

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

Service Revenue			400
		Oct. 31	10,000

LO 6

> DO IT!

Kate Brown recorded the following transactions in a general journal during the month of March. Post these entries to the Cash account.

Mar. 4	Cash	2,280	
	Service Revenue		2,280
Mar. 15	Salaries and Wages Expense	400	
	Cash		400
Mar. 19	Utilities Expense	92	
	Cash		92

Cash

3/1	600		

LO 6

Summary of Journalizing and Posting

GENERAL JOURNAL				PAGE J1
Date	**Account Titles and Explanation**	**Ref.**	**Debit**	**Credit**
2014				
Oct. 1	Cash	101	10,000	
	Owner's Capital	301		10,000
	(Owner's investment of cash in business)			
1	Equipment	157	5,000	
	Notes Payable	200		5,000
	(Issued 3-month, 12% note for office equipment)			
2	Cash	101	1,200	
	Unearned Service Revenue	209		1,200
	(Received cash from R. Knox for future service)			
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	126	2,500	
	Accounts Payable	201		2,500
	(Purchased supplies on account from Aero Supply)			
20	Owner's Drawings	306	500	
	Cash	101		500
	(Withdrew cash for personal use)			
26	Salaries and Wages 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 performed)			

Illustration 2-29

LO 6

General Ledger

Cash No. 101

Date	Explanation	Ref.	Debit	Credit	Balance
2014					
Oct. 1		J1	10,000		10,000
2		J1	1,200		11,200
3		J1		900	10,300
4		J1		600	9,700
20		J1		500	9,200
26		J1		4,000	5,200
31		J1	10,000		15,200

Supplies No. 126

Date	Explanation	Ref.	Debit	Credit	Balance
2014					
Oct. 5		J1	2,500		2,500

Prepaid Insurance No. 130

Date	Explanation	Ref.	Debit	Credit	Balance
2014					
Oct. 4		J1	600		600

Equipment No. 157

Date	Explanation	Ref.	Debit	Credit	Balance
2014					
Oct. 1		J1	5,000		5,000

Notes Payable No. 200

Date	Explanation	Ref.	Debit	Credit	Balance
2014					
Oct. 1		J1		5,000	5,000

Accounts Payable No. 201

Date	Explanation	Ref.	Debit	Credit	Balance
2014					
Oct. 5		J1		2,500	2,500

Unearned Service Revenue No. 209

Date	Explanation	Ref.	Debit	Credit	Balance
2014					
Oct. 2		J1		1,200	1,200

Common Stock No. 311

Date	Explanation	Ref.	Debit	Credit	Balance
2014					
Oct. 1		J1		10,000	10,000

Dividends No. 332

Date	Explanation	Ref.	Debit	Credit	Balance
2014					
Oct. 20		J1	500		500

Service Revenue No. 400

Date	Explanation	Ref.	Debit	Credit	Balance
2014					
Oct. 31		J1		10,000	10,000

Salaries and Wages Expense No. 726

Date	Explanation	Ref.	Debit	Credit	Balance
2014					
Oct. 26		J1	4,000		4,000

Rent Expense No. 729

Date	Explanation	Ref.	Debit	Credit	Balance
2014					
Oct. 3		J1	900		900

Illustration 2-30

Trial Balance

PIONEER ADVERTISING AGENCY
Trial Balance
October 31, 2014

Illustration 2-31

	Debit	Credit
Cash	$ 15,200	
Supplies	2,500	
Prepaid Insurance	600	
Equipment	5,000	
Notes Payable		$ 5,000
Accounts Payable		2,500
Unearned Service Revenue		1,200
Owner's Capital		10,000
Owner's Drawings	500	
Service Revenue		10,000
Salaries and Wages Expense	4,000	
Rent Expense	900	
	$28,700	**$28,700**

LO 7 Prepare a trial balance and explain its purposes.

Trial Balance

Limitations of a Trial Balance

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.

Ethics Note

An *error* is the result of an unintentional mistake; it is neither ethical nor unethical. An *irregularity* is an intentional misstatement, which *is* viewed as unethical.

Trial Balance

Question

A trial balance will not balance if:

a. a correct journal entry is posted twice.

b. the purchase of supplies on account is debited to Supplies and credited to Cash.

c. a $100 cash drawing by the owner is debited to Owner's Drawing for $1,000 and credited to Cash for $100.

d. a $450 payment on account is debited to Accounts Payable for $45 and credited to Cash for $45.

INVESTOR INSIGHT

Why Accuracy Matters

While most companies record transactions very carefully, the reality is that mistakes still happen. For example, bank regulators fined Bank One Corporation (now Chase) $1.8 million because they felt that the unreliability of the bank's accounting system caused it to violate regulatory requirements.

Also, in recent years Fannie Mae, the government-chartered mortgage association, announced a series of large accounting errors. These announcements caused alarm among investors, regulators, and politicians because they fear that the errors may suggest larger, undetected problems. This is important because the home-mortgage market depends on Fannie Mae to buy hundreds of billions of dollars of mortgages each year from banks, thus enabling the banks to issue new mortgages.

Finally, before a major overhaul of its accounting system, the financial records of Waste Management, Inc. were in such disarray that of the company's 57,000 employees, 10,000 were receiving pay slips that were in error.

The Sarbanes-Oxley Act was created to minimize the occurrence of errors like these by increasing every employee's responsibility for accurate financial reporting.

?

In order for these companies to prepare and issue financial statements, their accounting equations (debits and credits) must have been in balance at year-end. How could these errors or misstatements have occurred? (See page 95.)

A Look at IFRS

Key Points

- Transaction analysis is the same under IFRS and GAAP but different standards sometimes impact how transactions are recorded.
- Rules for accounting for specific events sometimes differ across countries. For example, European companies rely less on historical cost and more on fair value than U.S. companies. Despite the differences, the double-entry accounting system is the basis of accounting systems worldwide.
- Both the IASB and FASB go beyond the basic definitions provided in this textbook for the key elements of financial statements, that is, assets, liabilities, equity, revenues, and expenses.

A Look at IFRS

Key Points

- A trial balance under IFRS follows the same format as shown in the textbook.
- As shown in the textbook, dollars signs are typically used only in the trial balance and the financial statements. The same practice is followed under IFRS, using the currency of the country that the reporting company is headquartered.
- In February 2010, the SEC expressed a desire to continue working toward a single set of high-quality standards.

LO 8 Compare the procedures for the accounting process under GAAP and IFRS.

A Look at IFRS

Looking to the Future

The basic recording process shown in this textbook is followed by companies across the globe. It is unlikely to change in the future. The definitional structure of assets, liabilities, equity, revenues, and expenses may change over time as the IASB and FASB evaluate their overall conceptual framework for establishing accounting standards.

LO 8 Compare the procedures for the accounting process under GAAP and IFRS.

A Look at IFRS

IFRS Self-Test Questions

Which statement is correct regarding IFRS?

a) IFRS reverses the rules of debits and credits, that is, debits are on the right and credits are on the left.

b) IFRS uses the same process for recording transactions as GAAP.

c) The chart of accounts under IFRS is different because revenues follow assets.

d) None of the above statements are correct.

IFRS Self-Test Questions

A trial balance:

a) is the same under IFRS and GAAP.

b) proves that transactions are recorded correctly.

c) proves that all transactions have been recorded.

d) will not balance if a correct journal entry is posted twice.

A Look at IFRS

IFRS Self-Test Questions

One difference between IFRS and GAAP is that:

a) GAAP uses accrual-accounting concepts and IFRS uses primarily the cash basis of accounting.

b) IFRS uses a different posting process than GAAP.

c) IFRS uses more fair value measurements than GAAP.

d) the limitations of a trial balance are different between IFRS and GAAP.

 LO 8 Compare the procedures for the accounting process under GAAP and IFRS.

Copyright