# Instructor's Manual

# to accompany

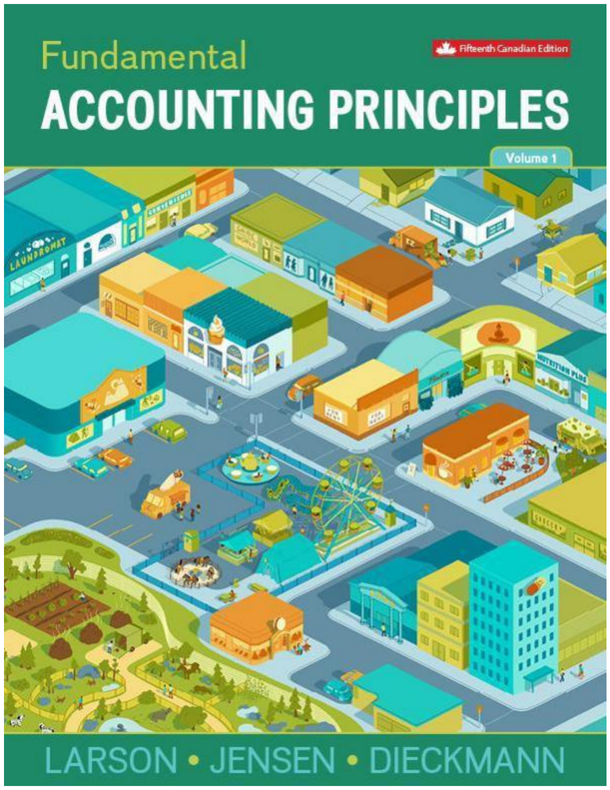
# *Fundamental Accounting Principles*,

# Chapter 2,

# 15th Edition,

# By Larson/Jensen/Dieckmann

Last revised September 9th, 2015.

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# CHAPTER 2

# ANALYZING AND RECORDING TRANSACTIONS

| ***Related Assignment Materials*** | | | |
|---|---|---|---|
| *Student Learning Objectives* | *Quick Studies* | *Exercises* | *Problems* |

| | | | |
|---|---|---|---|
| 1. Explain the accounting cycle. | | | 2-12A, 2-12B |
| 2. Describe an account, its use, and its relationship to the ledger. | 2-1 | 2-1 | |
| 3. Define debits and credits and explain their role in double-entry accounting. | 2-2, 2-3, 2-4, 2-12, 2-13, 2-16 | 2-1, 2-2, 2-5, 2-6, 2-7, 2-8, 2-9, 2-11, 2-12, 2-13, 2-15, 2-16, 2-17, 2-21, 2-22 | 2-1A, 2-3A, 2-4A, 2-7A, 2-10A, 2-12A, 2-14A, 2-1B, 2-3B, 2-4B, 2-7B, 2-10B, 2-12B, 2-14B |
| 4. Describe a chart of accounts and its relationship to the ledger. | 2-5 | 2-10 | 2-5A, 2-7A, 2-10A, 2-12A, 2-5B, 2-7B, 2-10B, 2-12B |
| 5. Analyze the impact of transactions on accounts | 2-6, 2-7, 2-8, 2-9, 2-10, 2-11, 2-12, 2-13, 2-14, 2-16 | 2-2, 2-3, 2-4, 2-5, 2-6, 2-7, 2-8, 2-9, 2-11, 2-12, 2-13, 2-14, 2-15, 2-16, 2-17, 2-21, 2-22 | 2-1A, 2-2A, 2-3A, 2-4A, 2-5A, 2-7A, 2-10A, 2-12A, 2-14A, 2-1B, 2-2B, 2-3B, 2-4B, 2-7B, 2-10B, 2-12B, 2-14B |
| 6. Record transactions in a journal and post entries to a ledger. | 2-15, 2-16, 2-17, 2-18 | 2-9, 2-11, 2-16, 2-17, 2-18, 2-19, 2-20, 2-21, 2-22, 2-23 | 2-5A, 2-6A, 2-7A, 2-8A, 2-9A, 2-10A, 2-11A, 2-12A, 2-13A, 2-14A, 2-5B, 2-6B, 2-7B, 2-8B, 2-9B, 2-10B, 2-11B, 2-12B, 2-13B, 2-14B |

*Note:* The Cumulative Comprehension Problem, for Echo Systems, a computer service business, covers many of these learning objectives. This problem can be solved manually or with an accounting software package. The problem will continue in Chapters 3, 4, and 5.

*Note:* Various other Analytical & Review Problems may be assigned for student enrichment.

## Chapter Outline

### I. The Accounting Cycle (LO1)

The steps followed in preparing financial statements. Emphasize that this is a process which is consistently followed.

### II. Accounts and the Chart of Accounts (LO2 and LO4)

An *account* is a detailed record of increases and decreases in a specific asset, liability, equity, revenue or expense item. A ledger is a record containing all accounts used by a business. There should be a separate account for each item on the income statement and balance sheet.

The major types of accounts are:

1. *Asset accounts* are resources controlled by an organization that have current and future benefits. Includes the following: Cash, Accounts Receivable, Notes Receivable, Prepaid Expenses, Supplies, Equipment, Buildings, and Land.

2. *Liability accounts* are obligations to transfer assets or provide services to other entities. Accounts Payable, Notes Payable, Mortgage Payable are examples.

## Chapter Outline

*Unearned Revenues* are another form of liability which results when customers pay in advance for products or services.
*Other Liabilities* include wages payable, taxes payable and interest payable.

3. E*quity Accounts* include Owner Capital, Owner Withdrawals, and a separate account for each type of Revenue and Expense. The owner capital account will be used for owner investments only. Students often try to keep using this account at this point. It should be pointed out that this account's transactions will be very few in comparison with the revenue and expense accounts. Owner withdrawals is also a new concept for students at this point.

The chart of accounts is a list of all the accounts.

**III. Debits and Credits ( LO3)**

A T-account is a helpful learning tool representing all accounts in the ledger. It shows the effects of transactions and events on specific accounts.

1. The *left* side of an account is called the *debit* side. A debit is an entry on the left side of an account.
2. The *right* side of an account is called the *credit* side. A credit is an entry on the right side of an account.
3. An account balance is the difference between the increases and decreases recorded in an account. Otherwise explained, the account balance is the difference between the increases (including the beginning balance) and decreases recorded in an account

*Assets* are on the *left side* of the fundamental accounting equation. Therefore the left or *debit* side of the T-account is the normal balance for assets.

*Liabilities and equity* are on the *right side* therefore the right or the credit side is the normal balance for liabilities and equity.

*Withdrawals, revenues, and expenses* are essentially changes in owner's equity but it is necessary to set-up temporary accounts for each of these items to accumulate data for statements. Withdrawals and expense accounts represent decreases in owner's equity therefore they are assigned debit balances. *Revenue* accounts represent increases in owner's equity and therefore they are assigned credit balances.

Double-entry accounting is an accounting system that records the effects of transactions and other events in at least two accounts with equal debts and credits. The total amount debited must equal the total amount credited. Therefore, the sum of the debit account balances in the ledger must equal the sum of the credit account balances. (Note: It is extremely important for students to practice analyzing each of the basic transactions into debits and credits.)

*Note: It is crucial that students understand basic debit-credit theory. After introducing the rules, illustrative transactions can be presented by:*

- Analyzing the transaction
- Determining the types of accounts affected (asset, liability, equity, revenue, expense)
- Determining which accounts increase and/or decrease
- Converting the increase/decrease to debit/credit.

## Chapter Outline

*Note:* Students often try to identify debit with decrease and credit with increase. Try to keep them on task by saying that debit only means LEFT and credit only means RIGHT at this point.

**IV. Recording and Posting Transactions (LO5)**

To help avoid errors, accounting systems first record transactions in a journal. The process of recording the transactions in a journal is called *journalizing*.

A *General Journal* is the most flexible type of journal because it can be used to record any type of transaction. Each journal entry must contain equal debits and credits.

A general journal entry will include:

1. Date of the transaction
2. Titles of affected accounts
3. Dollar amount of each debit and credit
4. Explanation

Posting is the process of copying journal entry information from the journal to the accounts in the ledger. Actual accounting systems use balance column accounts rather than T-accounts in the ledger. A balance column account has debit and credit columns for recording entries and a third column for showing the balance of the account after each entry is posted. It is possible for accounts to have abnormal balances. It is helpful to stress to students that the entering of the Posting Reference information should be the last step. In this way, it is easy to see where one left off if posting is interrupted. Exhibit 2.13 is very helpful, however, usually requires some explanation before students are able to see what is being done with the posting process.

The posting process is commonly done using a computer program in today's business environment.

**The Trial Balance (LO6)**

A. A trial balance is a summary of the ledger that lists the accounts and their balances. The total debit balances should equal the total credit balances. Two columns are used, one for debit balances and one for credit balances.

B. One purpose for preparing a trial balance is to test for the equality of the debit and credit account balances. Another reason is to simplify the task of preparing the financial statements.

C. When a trial balance does not balance (the columns are not equal), an error has occurred in one of the following steps:

   1. Preparing the journal entries
   2. Posting the journal entries to the ledger.
   3. Calculating account balances.
   4. Copying account balances to the trial balance.
   5. Totaling the trial balance columns.

   Any errors must be located and corrected before preparing the financial statements.

*Note*: Correcting errors

1. Errors must be corrected. Do not erase journal entries or postings in accounts. This may indicate an effort to conceal something.

## Chapter Outline

2. For errors discovered before posting and/or for incorrect amounts posted, correct by ruling a single line through the incorrect data and writing in the correct data.
3. For incorrect account postings—record a correcting journal entry and provide a complete explanation.

*Note*: Formatting conventions

1. Commas to indicate thousands of dollars and decimal points to separate dollars and cents are not necessary except on unruled paper.
2. Dollar signs are not used in journals and ledgers but are required on financial reports—before the first amount in each column of figures and before the first amount appearing after a ruled line that indicates an addition or subtraction.

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## I. VISUAL #2-1

# THREE PARTS OF AN ACCOUNT

(1) ACCOUNT TITLE Left

| Side | Right Side |
|---|---|
| Called | Called |
| (2) DEBIT | (3) CREDIT |

### Rules for using accounts

Accounts are assigned balance sides (Debit or Credit)

To increase any account, use the balance side

To decrease any account, use the side opposite the balance

### Finding account balances

If total debits = total credits, the account balance is zero.

If total debits are greater than total credits, the account has a debit balance equal to the difference of the two totals.

If total credits are greater than total debits, the account has a credit balance equal to the difference of the two totals.

General account use rules

- To increase any account, use balance side.
- To decrease any account, use side opposite the balance

All Revenue Accounts

| — | Credit + Balance |
|---|---|

All Expense Accounts

| Debit + — Balance | |
|---|---|

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This chart summarizes the rules of debit and credit in a very small space. I usually recommend students refer to this illustration as a way of pulling all of this information together. .

**EXHIBIT 2.8**

Debit and Credit Effects for Accounts