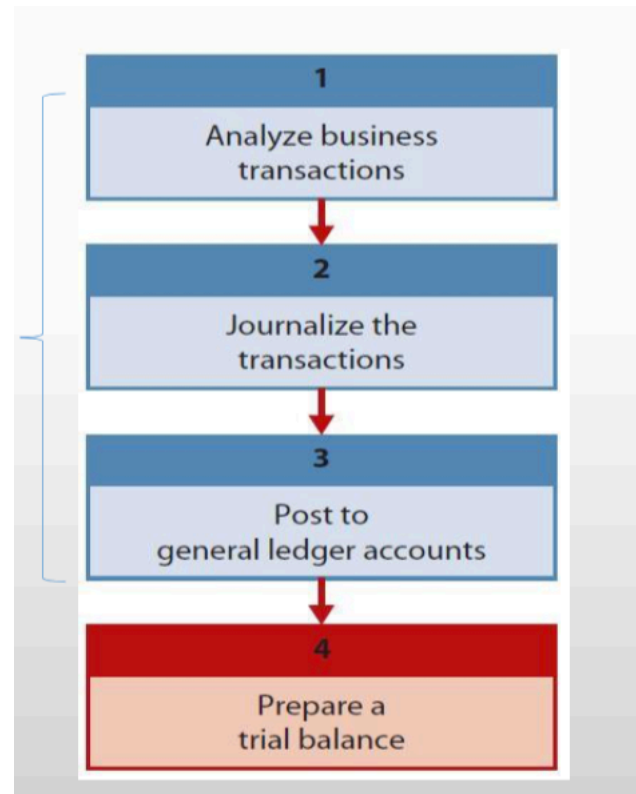


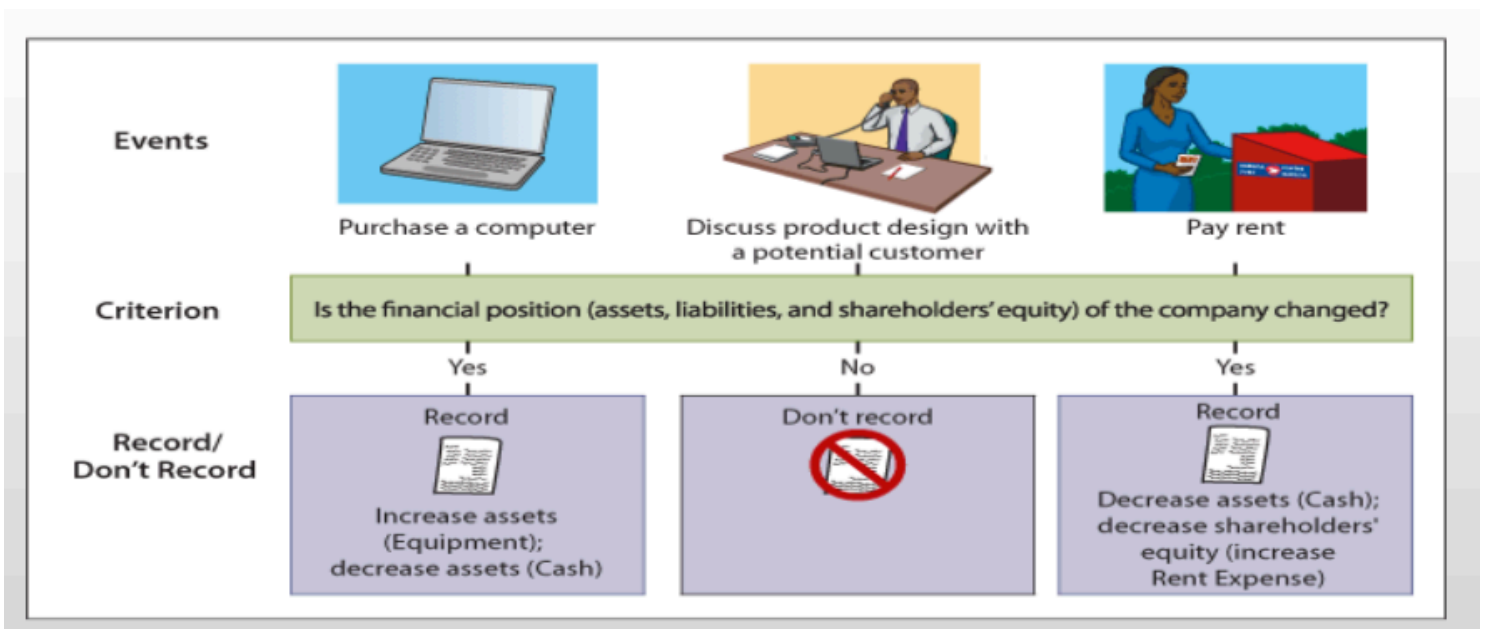
## Chapter 3- The Accounting information System

### The Recording Process



### Transaction Analysis

- Accounting transactions occur when assets, liabilities, or shareholders' equity items change as a result of some economic event.



**- Transaction analysis:**

- Each transaction has a dual effect on the accounting equation. For example, if an individual asset is increased, there must be either a corresponding decrease in another asset, increase in a specific liability, and/or an increase in shareholders equity.
- The accounting equation must always balance:
  - Assets = Liabilities + Shareholders' Equity

## Entry Examples

(Oct 1) Investment by Shareholders: Tom makes a \$10,000 cash investment into the company in exchange for 10,000 common shares.

- 10,000 increase to cash (**A**), 10,000 increase to common shares (**SE**)

(Oct 1) Purchase of Equipment: Tom borrowed \$5,000 from Scotiabank to purchase equipment. It promised to repay the bank loan, plus 6% interest per annum (year), in three months.

- 5,000 increase to equipment (**A**), 5,000 increase to Bank Loan Payable (**L**)

(Oct 2) Payment of Rent: Tom's company paid its office rent for the month of October in cash, \$900. Rent is an expense incurred by Tom in its effort to generate revenues. Expenses decrease retained earnings, which in turn decreases shareholders equity.

- 900 decrease to Cash (**A**), 900 decreases in Retained Earnings (**SE**)

(Oct 5) Purchase of Insurance: Tom paid \$600 for a one year insurance policy effective October 1 that expires next year on September 30. (One asset was exchanged for another)

- 600 decrease to Cash (**A**), 600 increase to Prepaid Insurance (**A**)

(Oct 7) Hiring of New Employees: Tom hires four new employees to begin working Monday, October 12. Each employee will receive a weekly salary of \$500 for a 5 day workweek, payable every 2 weeks. Employees will receive their first pay check on October 23.

- No transaction as the employees haven't started working yet

(Oct 9) Purchase of Supplies on Account: Tom purchased advertising supplies on account from Aero Supply Corp for \$2,500. This account is due in 30 days.

- 2,500 increase to Supplies (**A**), 2,500 increase to Accounts Payable (**L**)

(Oct 13) Services Performed on Account: Tom performed \$20,000 of advertising services for Copa Ltd. Tom sent Copa a bill for these services, asking for payment within 30 days.

- 20,000 increase to Accounts Receivable (**A**), 20,000 increase to Service Revenue (**SE**)

(Oct 19) Receipt of Cash in Advance from Customer: Tom received a \$1,200 cash advance from R. Gronkowski, a client for advertising services that are not expected to be completed until November. Revenue would not be recorded until the work has been performed. However, since cash was received before performing the advertising services, Tom has the liability for the work due. We call that liability unearned revenue.

- 1,200 increase to Cash (**A**), 1,200 increase to Unearned Revenue (**L**)

(Oct 22) Payment on Account: Tom made a partial payment of \$1,000 on the amount it owed for the supplies purchased from Aero Supply on October 9.

- 1,000 decrease to Cash (**A**), 1,000 decrease to Accounts Payable (**L**)

(Oct 23) Payment of Salaries: Employees worked two weeks, earning \$4,000 in salaries (4 employees x \$500/week x 2 weeks), and were paid on October 23.

- 4,000 decrease in Cash (**A**), 4,000 increase in Salaries Expense (**SE**) (this reduced Retained Earnings, in turn reducing Shareholders Equity)

(Oct 26) Payment of Dividend: Tom paid a \$500 cash dividend. Dividends are distribution of retained earnings rather than an expense—they are not incurred to generate revenue.

- 500 decrease in Cash (**A**), 500 decrease in Dividends (**SE**)

(Oct 30) Collection on Account: Copa paid Tom \$5,000 of the amount owing on its account.

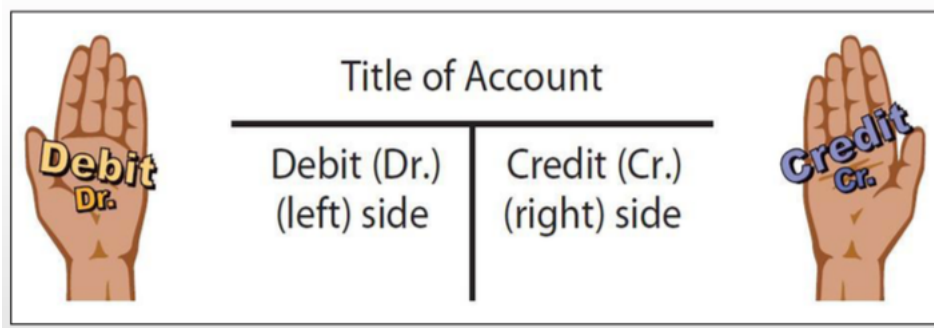
- 5,000 decrease to Accounts Receivable (**A**), 5,000 increase to Cash (**A**)

(Oct 30) Payment of Income Tax: Copa paid a monthly income tax instalment of \$1,800.

- 1,800 decrease to Cash (**A**), 1,800 increase to Income Tax Expense (**SE**) (this decreases shareholders equity)

### Debits and Credits

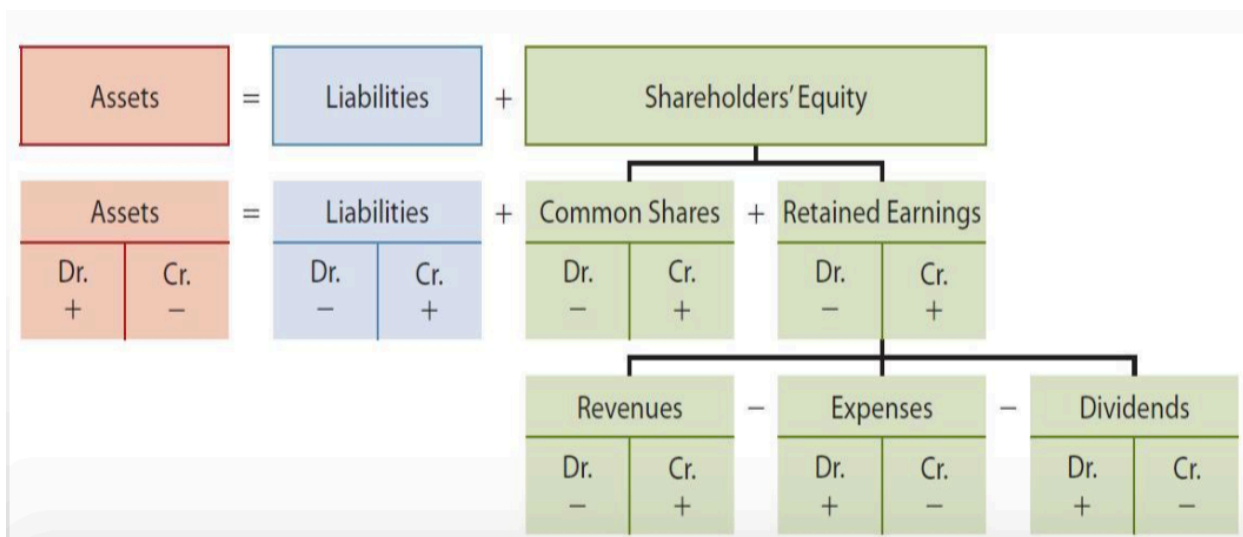
- An account is an individual accounting record of increases and decreases in a specific asset, liability, or shareholders' equity item.
- This is known as a T account



-The normal

balance of an account is always on its increase side.

- An account will have a debit balance if the total of the debit amounts recored exceeds the total of the credit amounts recorded. Conversely, an accounts will have a credit balance if the credit amounts exceed the debits.



## The Accounting Cycle

- The accounting cycle has nine steps.
  - 1: Analyze business transaction (*Evidence of the transaction comes from a **source document**, such as a sales slip, cheque, bill, or cash register tape.*)
  - 2: Journalize the transactions
  - 3: Post to general ledger accounts
  - 4: Prepare a trial balance

## The Journal

- Second step in the recording process is the journal.
- Each transaction must be analyzed to determine if it has an effect on the accounts.
- The journal has a place to record the debit and credit effects on specific accounts for each transaction.
- Transactions are entered in the journal in chronological order.
- Companies may use various types of journals, but every company has the most basic form of journal, a general journal.

### General Journal

- the general journal makes several contributions to the recording process:
  - 1: it discloses the complete effect of a transaction in one place, including an explanation and, where applicable, identification of the source document
  - 2: it provides a chronological record of transaction
  - 3: it helps to prevent and locate errors, because the debit and credit amounts for each entry can be quickly compared.
- When we enter data in the general journal it is known as **journalizing**

GENERAL JOURNAL			
Date	Account titles and explanation	Debit	Credit
Oct 1	Cash  Common shares (issue common shares)	100,000	100,000

## The Ledger

- contains all of the asset, liability and shareholders' equity accounts, as well as revenue and expense accounts.
- each account has a number so that it is easier to identify.
- it is arranged in the order in which accounts are presented in the financial statements, beginning with the statement of financial accounts. Assets first, then liabilities and then shareholders equity.
- provides management with the balances (or subtotals) in various accounts.
- posting in the general ledger:
  - third step in the recording process.
  - the process of transferring journal entries to the ledger accounts.
  - it accumulates the effects of journal transactions in the individual ledger accounts.

Order of listing:

1. asset accounts,
2. liability accounts,
3. equity accounts,
4. dividends,
5. revenues,
6. expenses.

## The Trial Balance

- provides a list of accounts and their balances at a specific time.
- proves the mathematical equality of debits and credits after posting.
- accounts in the trial balance are listed in the same order as they are listed in the general ledger.
- the retained earning amount shown in a trial balance would be as at the beginning of the period.
- uncovers errors in journalizing and posting.
- can not uncover errors, when:
  - a transaction is not journalized,
  - a correct journal entry is not posted,
  - a journal entry is posted twice,
  - incorrect accounts are used in journalizing and posting, or
  - offsetting errors are made in recording the amount of a transaction.