

# *Accounting 280 Week 1 PowerPoint*

**Professor Arlint**

# *Accounting in Action*

## What is Accounting?

- Three activities
- Who uses accounting data

## The Building Blocks of Accounting

- Ethics in financial reporting
- Generally accepted accounting principles
- Assumptions

## The Basic Accounting Equation

- Assets
- Liabilities
- Stockholders' equity

## Using the Basic Accounting Equation

- Transaction analysis
- Summary of transactions

## Financial Statements

- Income statement
- Statement of retained earnings
- Balance sheet
- Statement of cash flows

# *What is Accounting?*

The purpose of accounting is to:

- (1) **identify, record, and communicate** the economic events of an
- (2) organization to
- (3) interested users.

# Who Uses Accounting Data?

## Internal Users









## External Users

# *Who Uses Accounting Data?*

## Common Questions Asked

## User

- |   |  |                        |
|---|--|------------------------|
| 1. Can we afford to give our employees a pay raise?         |    | <b>Human Resources</b> |
| 2. Did the company earn a satisfactory income?              |    | <b>Investors</b>       |
| 3. Do we need to borrow in the near future?                 |    | <b>Management</b>      |
| 4. Is cash sufficient to pay dividends to the stockholders? |    | <b>Finance</b>         |
| 5. What price for our product will maximize net income?     |  | <b>Marketing</b>       |
| 6. Will the company be able to pay its short-term debts?    |  | <b>Creditors</b>       |

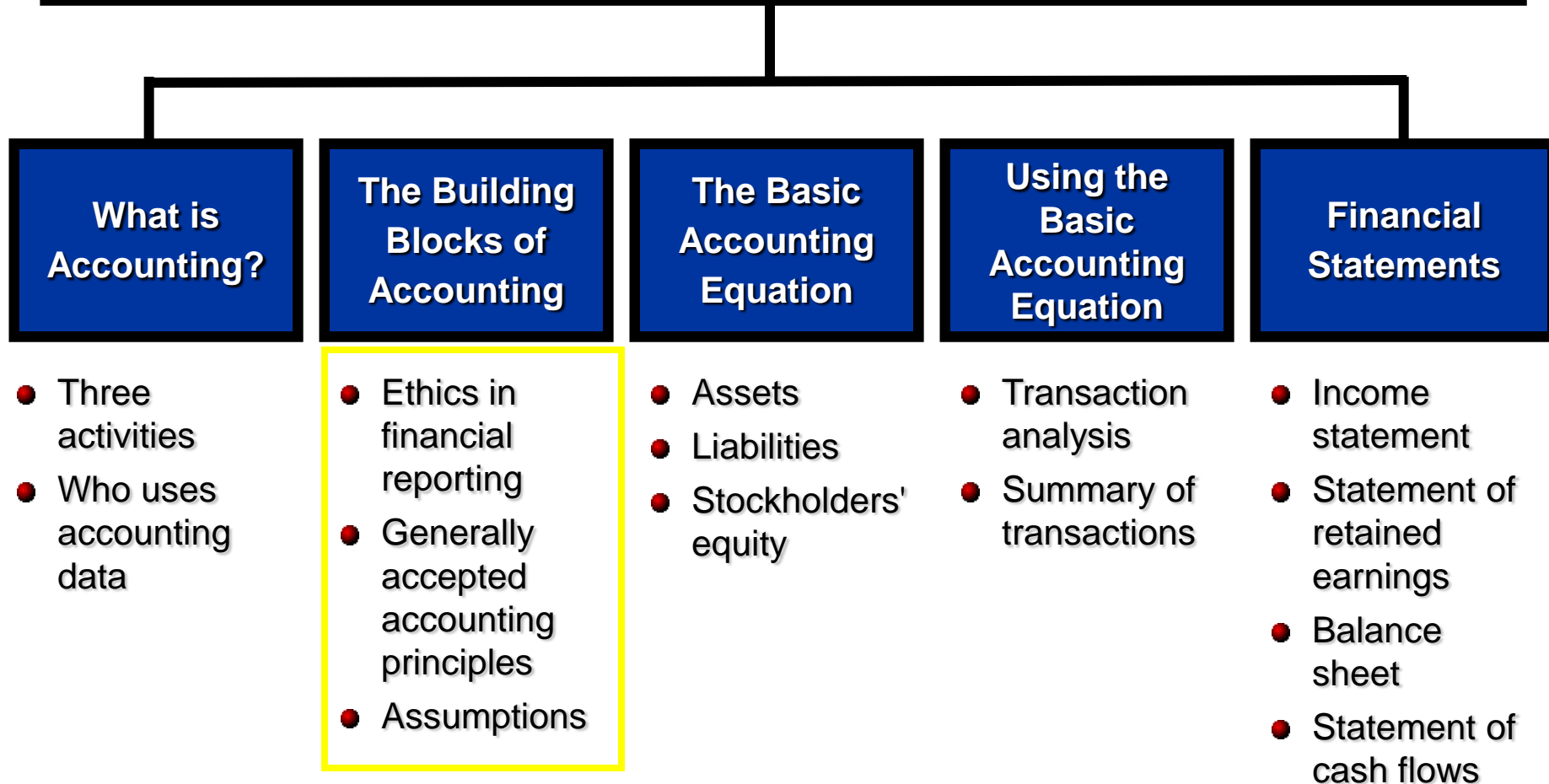
# *Who Uses Accounting Data?*

## **Discussion Question**

**Q1.** "Accounting is ingrained in our society and it is vital to our economic system." Do you agree? Explain.

See notes page for discussion

# *Accounting in Action*



# *The Building Blocks of Accounting*

## **Ethics In Financial Reporting**

Standards of conduct by which one's actions are judged as right or wrong, honest or dishonest, fair or not fair, are **Ethics**.

- Recent financial scandals include: **Enron**, **WorldCom**, **AIG**, and others.
- Congress passed Sarbanes-Oxley Act of 2002.
- Effective financial reporting depends on sound ethical behavior.



## Review Question

Ethics are the standards of conduct by which one's actions are judged as:

- a. right or wrong.
- b. honest or dishonest.
- c. fair or not fair.
- ☒ d. all of these options.

# *The Building Blocks of Accounting*

## **Organizations Involved in Standard Setting:**



Securities and Exchange Commission (SEC)

<http://www.sec.gov/>



Financial Accounting Standards Board (FASB)

<http://www.fasb.org/>



International Accounting Standards Board  
(IASB)

<http://www.iasb.org/>

# *The Building Blocks of Accounting*

Various users  
need financial  
information



## Financial Statements

- Balance Sheet
- Income Statement
- Retained Earnings Statement
- Statement of Cash Flows
- Note Disclosure



The accounting profession  
has attempted to develop  
a set of standards that  
are generally accepted  
and universally practiced.



**Generally Accepted  
Accounting  
Principles (GAAP)**

# Different Types of Accounting

There are different types of accounting

- Managerial
- Financial
- Income Tax

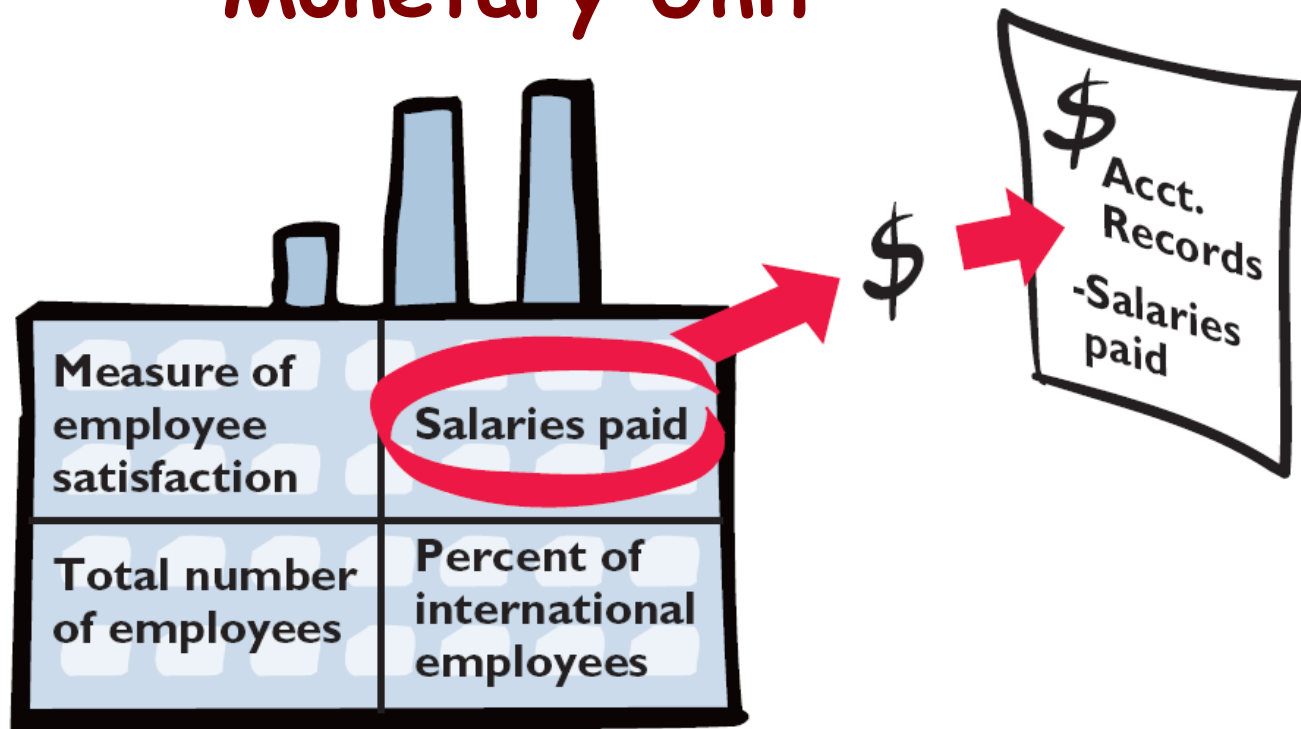
# *Assumptions*

**Assumptions provide a foundation for the accounting process.**

- Monetary Unit
- Economic Entity
- Time Period
- Going Concern

# Assumptions

## Monetary Unit

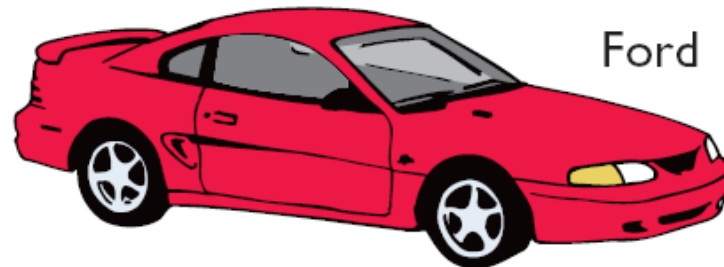


Only transaction data capable of being expressed in terms of money should be included in the accounting records of the economic entity.

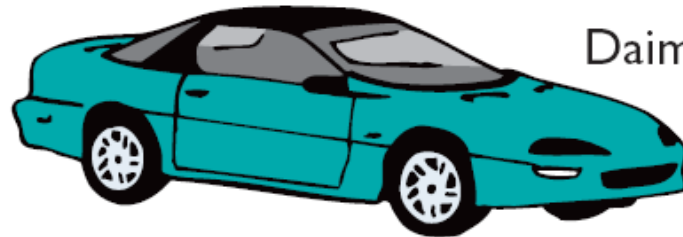
# Assumptions

## Economic Entity

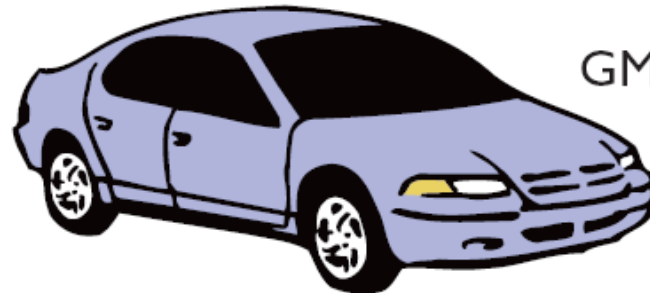
Economic events can be identified with a particular unit of accountability.



Ford



DaimlerChrysler



GM

# *Forms of Business Ownership*

## **Proprietorship**

- Generally owned by one person.
- Often small service-type businesses
- Owner receives any profits, suffers any losses, and is personally liable for all debts.

## **Partnership**

- Owned by two or more persons.
- Often retail and service-type businesses
- Generally unlimited personal liability
- Partnership agreement

## **Corporation**

- Ownership divided into shares of stock
- Separate legal entity organized under state corporation law
- Limited liability



# *Forms of Business Ownership*

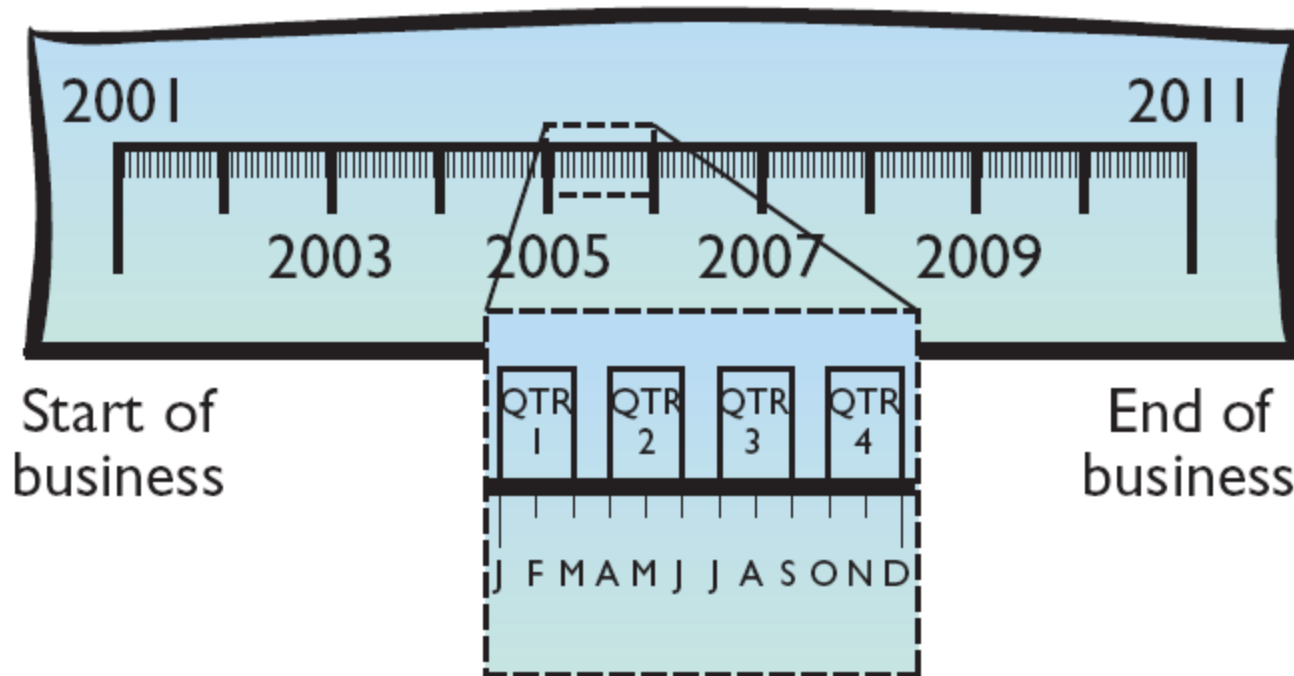
## **Review Question**

A business organized as a separate legal entity under state law having ownership divided into shares of stock is a

- a. proprietorship.
- b. partnership.
- ☒ c. corporation.
- d. sole proprietorship.

# Assumptions

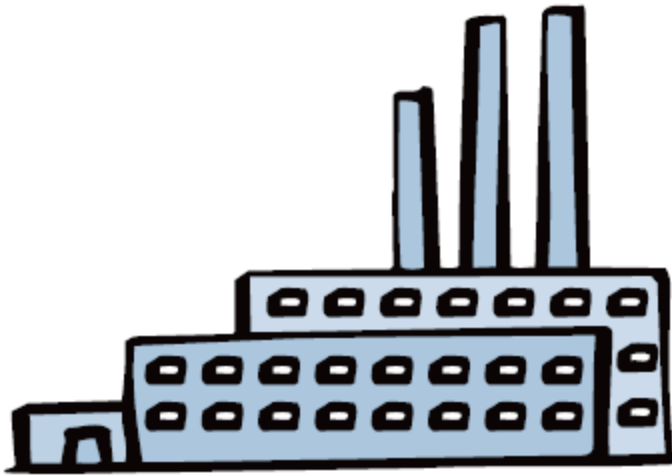
## Time Period



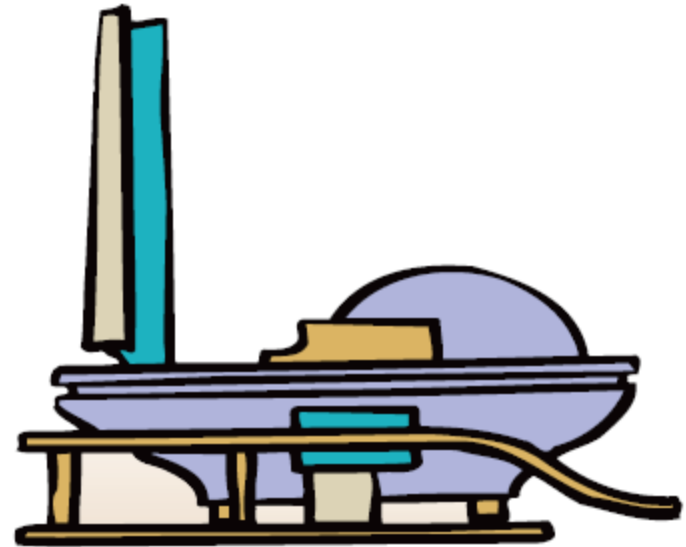
The economic life of a business can be divided into artificial time periods.

# Assumptions

## Going Concern



Now



Future

The enterprise will continue in operation long enough to carry out its existing objectives.

# Assumptions Group Question

**Illustration:** Identify which basic assumption of accounting is best described in each item below.

(a) The economic activities of FedEx Corporation are divided into 12-month periods for the purpose of issuing annual reports.

**Periodicity**

(b) Solectron Corporation, Inc. does not adjust amounts in its financial statements for the effects of inflation.

**Monetary  
Unit**

(c) Walgreen Co. reports current and noncurrent classifications in its balance sheet.

**Going Concern**

(d) The economic activities of General Electric and its subsidiaries are merged for accounting and reporting purposes.

**Economic  
Entity**

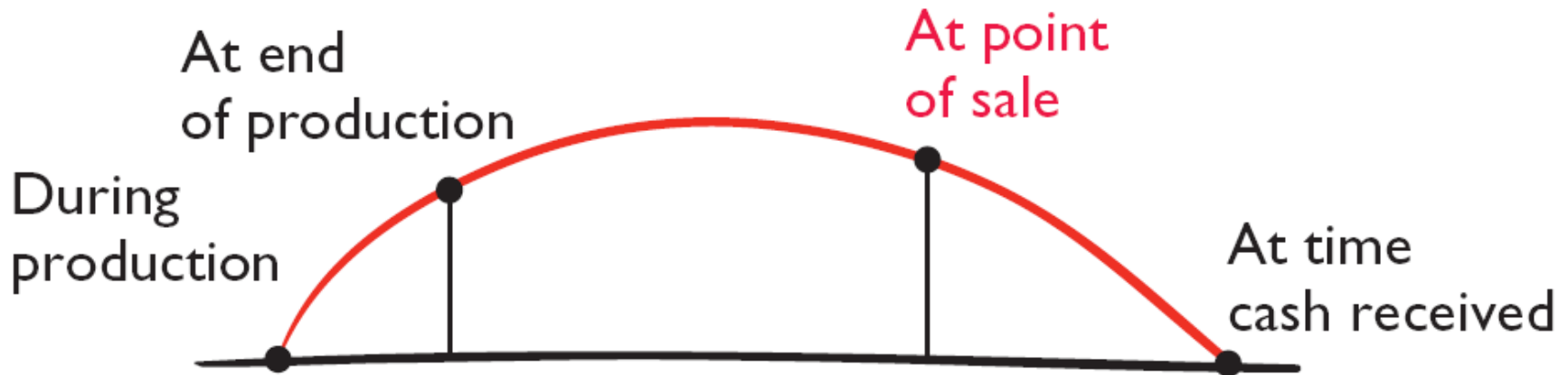
# *Principles*

**Accounting principles dictate how economic events should be recorded and reported.**

- Revenue Recognition
- Matching (Expense Recognition)
- Full Disclosure
- Cost

# Principles

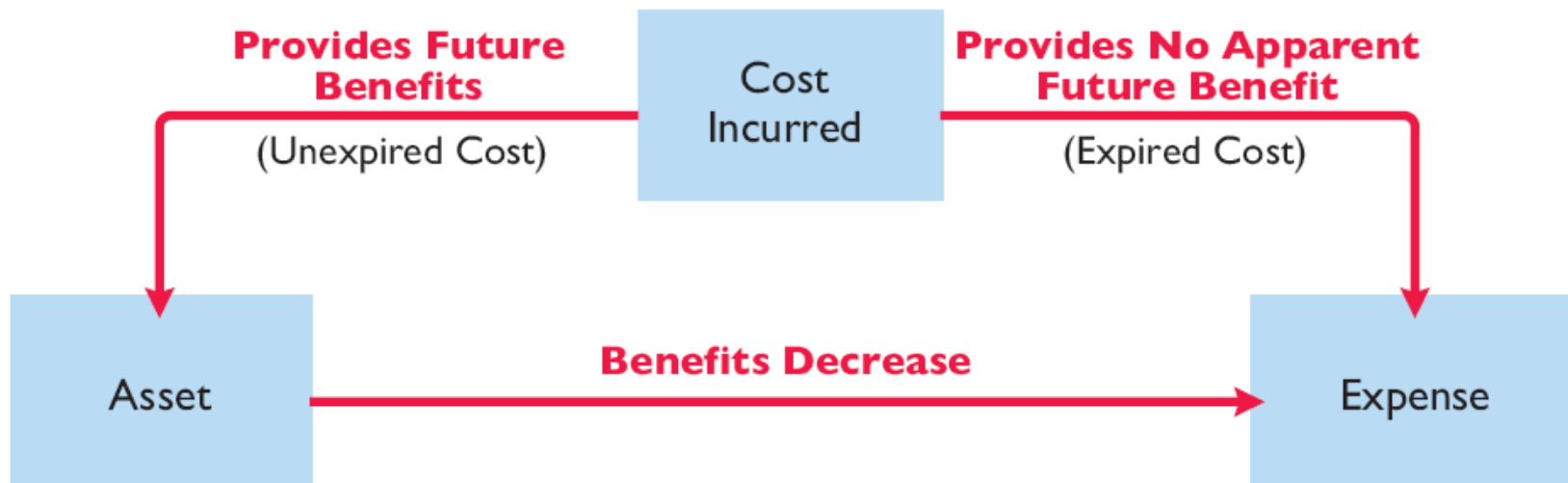
**Revenue Recognition** - companies should recognize revenue in the accounting period in which it is earned.



# Principles

**Matching** - efforts (expenses) should be matched with accomplishment (revenues) whenever it is reasonable and practicable to do so. "Let the expense follow the revenues."

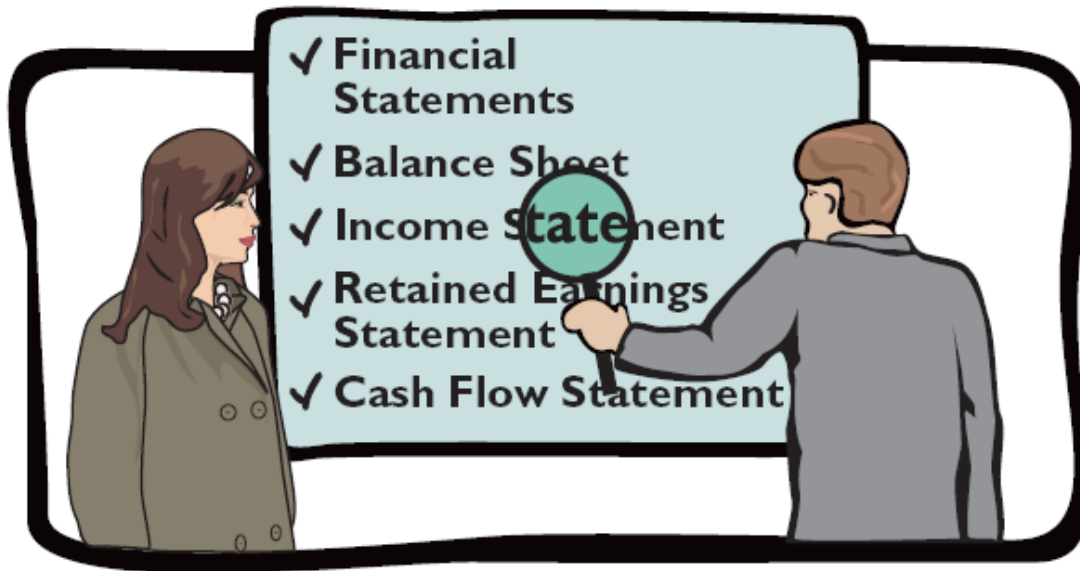
Illustration 7-4  
Expense Recognition



# Principles

**Full Disclosure** - Provided through financial statements, notes to the financial statements, and supplementary information.

Illustration 7-5  
Basic Principles



Circumstances and events that make a difference to financial statement users should be disclosed.



# Principles

**Cost Principle** - the price, established by the exchange transaction, is the "cost".

Illustration 7-5  
Basic Principles



Assets should be recorded at cost.

# Principles Group Question

**Illustration:** Identify which basic principle of accounting is best described in each item below.

(a) Norfolk Southern Corporation reports revenue in its income statement when it is earned instead of when the cash is collected.

**Revenue  
Recognition**

(b) Yahoo, Inc. recognizes depreciation expense for a machine over the 2-year period during which that machine helps the company earn revenue.

**Matching**

(c) Oracle Corporation reports information about pending lawsuits in the notes to its financial statements.

**Full  
Disclosure**

(d) Eastman Kodak Company reports land on its balance sheet at the amount paid to acquire it, even though the estimated fair market value is greater.

**Cost**

# *Constraints in Accounting*

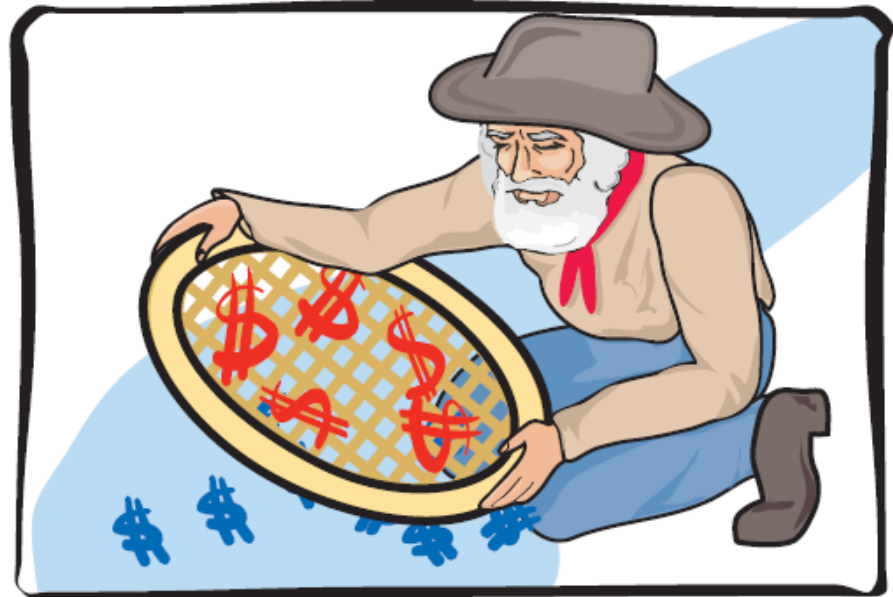
Constraints permit a company to modify generally accepted accounting principles without reducing the usefulness of the reported information.

- Materiality
- Conservatism

# *Constraints in Accounting*

**Materiality** - an item is material if its inclusion or omission would influence or change the judgment of a reasonable person.

Illustration 7-6  
Constraints

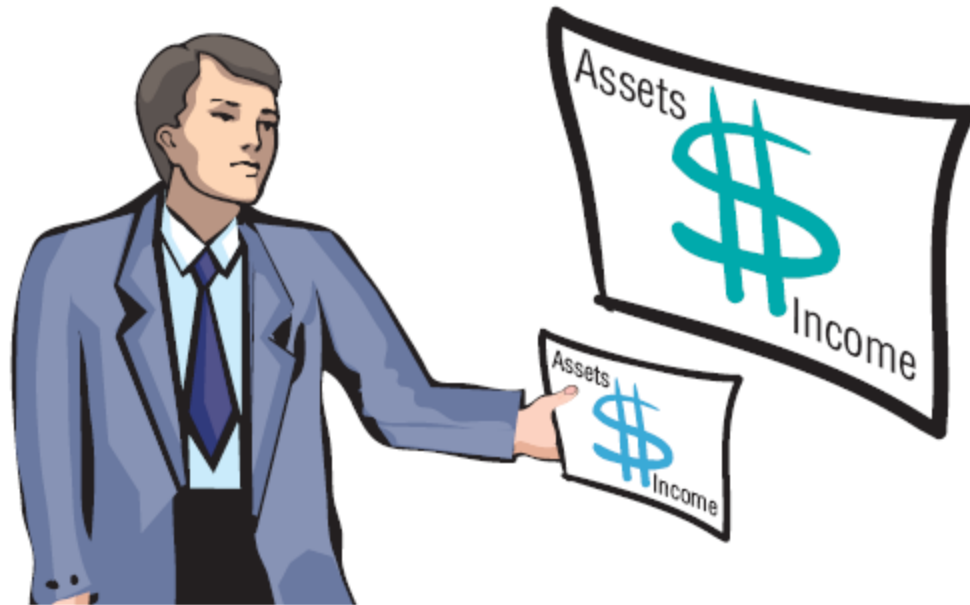


For small amounts, GAAP  
does not have to be followed.

# *Constraints in Accounting*

**Conservatism** - When in doubt, choose the method that will be least likely to overstate assets and income.

Illustration 7-6  
Constraints



# *Constraints in Accounting Group Question*

**Illustration** What accounting constraints are illustrated by the items below?

(a) Crimson Tide Corporation does not accrue a contingent lawsuit gain of \$650,000.

**Conservatism**

(b) Sun Devil Corporation expenses the cost of wastebaskets in the year they are acquired.

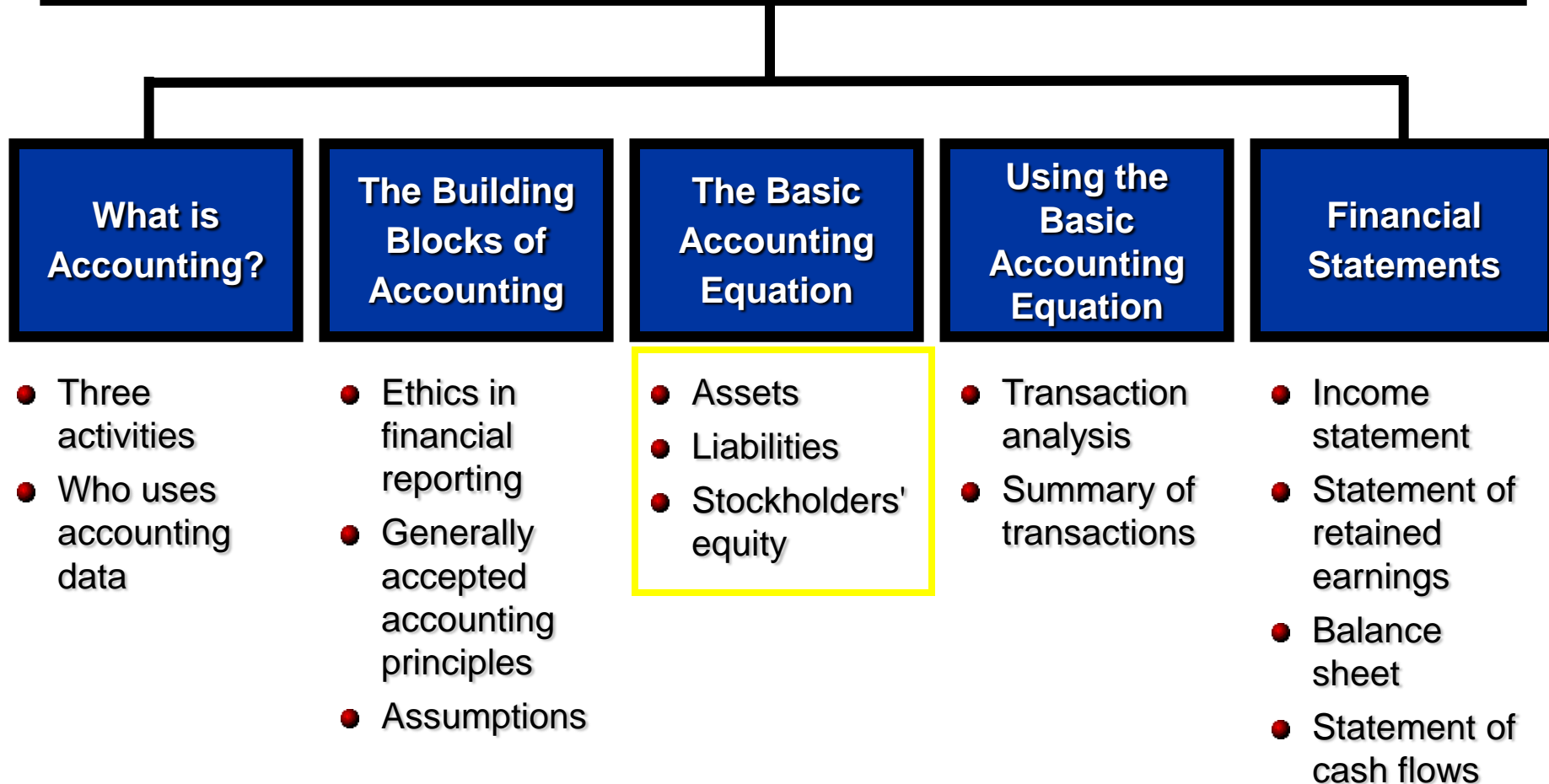
**Materiality**

# *Objectives of Financial Reporting*

Qualitative characteristics of useful financial information:

- Relevance
- Reliability
- Comparability
- Consistency

# *Accounting in Action*





# *The Basic Accounting Equation*

$$\boxed{\text{Assets}} = \boxed{\text{Liabilities}} + \boxed{\text{Stockholders' Equity}}$$

Provides the **underlying framework** for recording and summarizing economic events.

Assets are claimed by either creditors or owners.

Claims of creditors must be paid before ownership claims.

# *The Basic Accounting Equation*

$$\boxed{\text{Assets}} = \boxed{\text{Liabilities}} + \boxed{\text{Stockholders' Equity}}$$

Provides the **underlying framework** for recording and summarizing economic events.

## **Assets**

- Resources a business owns.
- Provide future services or benefits.
- Cash, Supplies, Equipment, etc.

# *The Basic Accounting Equation*

$$\boxed{\text{Assets}} = \boxed{\text{Liabilities}} + \boxed{\text{Stockholders' Equity}}$$

Provides the **underlying framework** for recording and summarizing economic events.

## **Liabilities**

- Claims against assets (debts and obligations).
- Creditors - party to whom money is owed.
- Accounts payable, Notes payable, etc.

# *The Basic Accounting Equation*

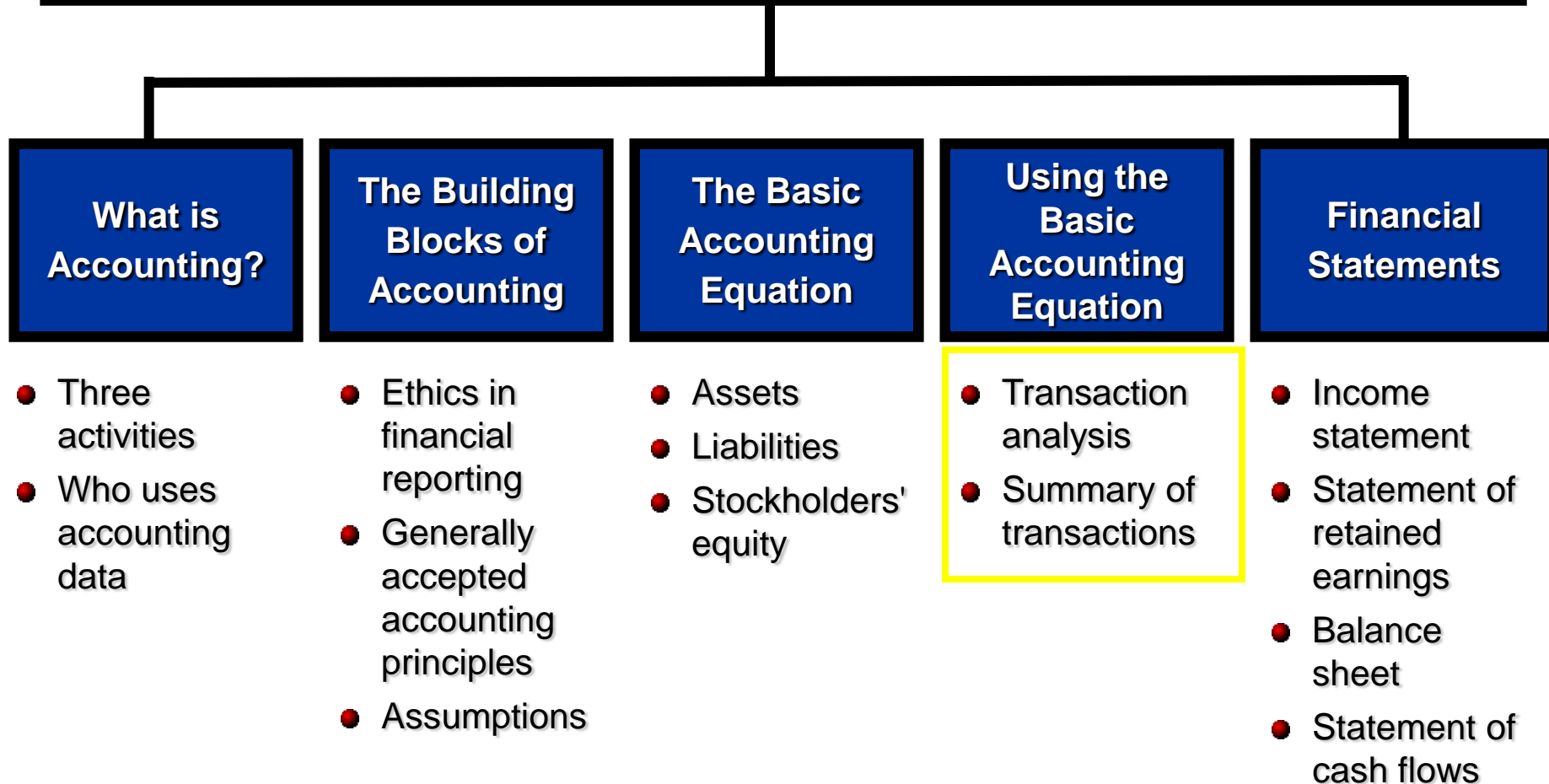
$$\boxed{\text{Assets}} = \boxed{\text{Liabilities}} + \boxed{\text{Stockholders' Equity}}$$

Provides the **underlying framework** for recording and summarizing economic events.

## **Stockholders' Equity**

- Ownership claim on total assets.
- Referred to as residual equity.
- Paid-in Capital, Retained Earnings (Corporation).

# *Accounting in Action*



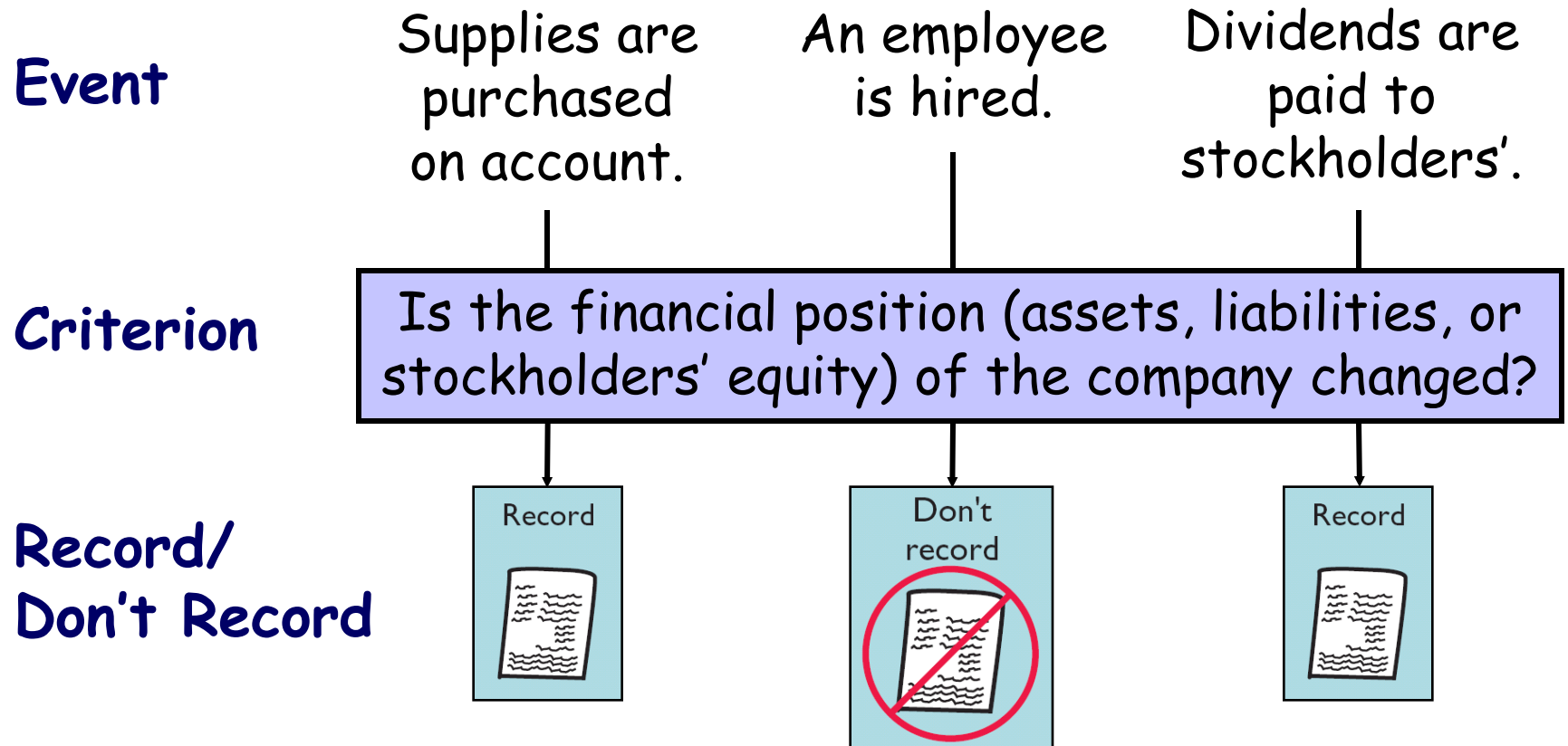
# *Using The Basic Accounting Equation*

**Transactions** are a business's economic events *recorded by accountants.*

- May be external or internal.
- Not all activities represent transactions.
- Each transaction has a **dual effect** on the accounting equation.

# Transactions

**Question:** Are the following events recorded in the accounting records?



# Transactions

## Discussion Question

**Q18.** In February 2008, Paula King invested an additional \$10,000 in Hardy Company. Hardy's accountant, Lance Jones, recorded this receipt as an increase in cash and revenues. Is this treatment appropriate? Why or why not?

See notes page for discussion



# Transactions (Problem)

**P1-1A:** Barone's Repair Shop was started on May. Prepare a tabular analysis of the following transactions for the month of May.

**1. Stockholders invested \$10,000 cash to start the repair shop.**

Assets			Liabilities	Stockholders' Equity	
Cash	Accounts Receivable	Equipment	Accounts Payable	Common Stock	
1. +10,000				+10,000	Investment

# Transactions (Problem)

## 2. Purchased equipment for \$5,000 cash.

Assets			Liabilities	Stockholders' Equity	
Cash	Accounts Receivable	Equipment	Accounts Payable	Common Stock	
1. +10,000				+10,000	Investment
2. -5,000		+5,000			

# Transactions (Problem)

## 3. Paid \$400 cash for May office rent.

Assets			Liabilities	Stockholders' Equity	
Cash	Accounts Receivable	Equipment	Accounts Payable	Common Stock	Retained Earnings
1. +10,000				+10,000	
2. -5,000		+5,000			
3. -400					-400
					<b>Expense</b>

# Transactions (Problem)

## 4. Received \$5,100 from customers for repair service.

Assets			Liabilities	Stockholders' Equity	
Cash	Accounts Receivable	Equipment	Accounts Payable	Common Stock	Retained Earnings
1. +10,000				+10,000	
2. -5,000		+5,000			
3. -400					-400
4. +5,100					+5,100
					Revenue

# Transactions (Problem)

## 5. Paid dividends of \$1,000 cash.

Assets			Liabilities	Stockholders' Equity	
Cash	Accounts Receivable	Equipment	Accounts Payable	Common Stock	Retained Earnings
1. +10,000				+10,000	
2. -5,000		+5,000			
3. -400					-400
4. +5,100					+5,100
5. -1,000					-1,000

# Transactions (Problem)

## 6. Paid part-time employee salaries of \$2,000.

Assets			Liabilities	Stockholders' Equity	
Cash	Accounts Receivable	Equipment	Accounts Payable	Common Stock	Retained Earnings
1. +10,000				+10,000	
2. -5,000		+5,000			
3. -400					-400
4. +5,100					+5,100
5. -1,000					-1,000
6. -2,000					-2,000
					<b>Expense</b>

# Transactions (Problem)

## 7. Incurred \$250 of advertising costs, on account.

Assets			Liabilities	Stockholders' Equity	
Cash	Accounts Receivable	Equipment	Accounts Payable	Common Stock	Retained Earnings
1. +10,000				+10,000	
2. -5,000		+5,000			
3. -400					-400
4. +5,100					+5,100
5. -1,000					-1,000
6. -2,000					-2,000
7.			+250		-250
					<b>Expense</b>

# Transactions (Problem)

8. Provided repair services on account to customers \$750.

Assets			Liabilities	Stockholders' Equity	
Cash	Accounts Receivable	Equipment	Accounts Payable	Common Stock	Retained Earnings
1. +10,000				+10,000	
2. -5,000		+5,000			
3. -400					-400
4. +5,100					+5,100
5. -1,000					-1,000
6. -2,000					-2,000
7.			+250		-250
8.	+750				+750
					Revenue

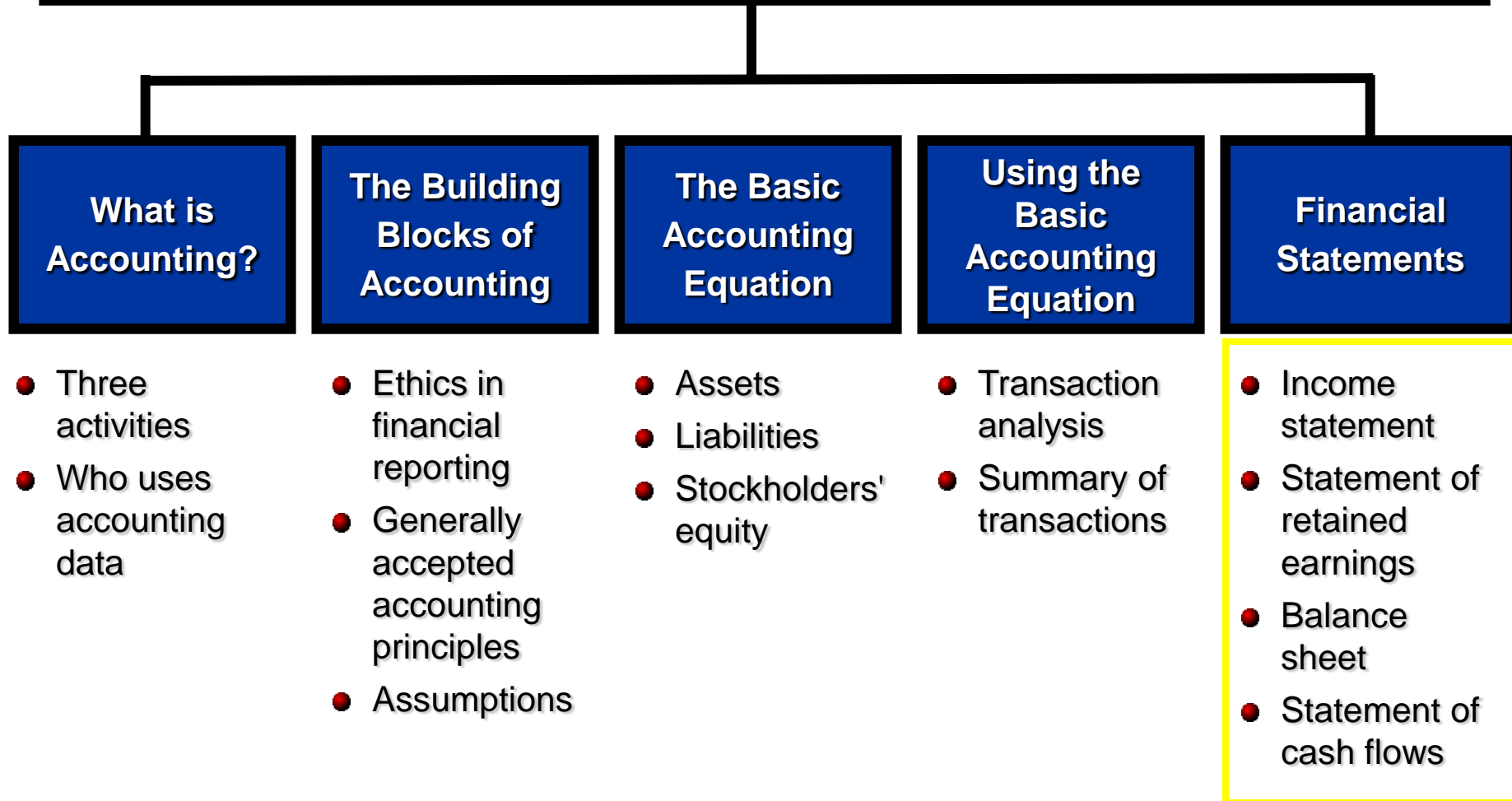


# Transactions (Problem)

## 9. Collected \$120 cash for services previously billed.

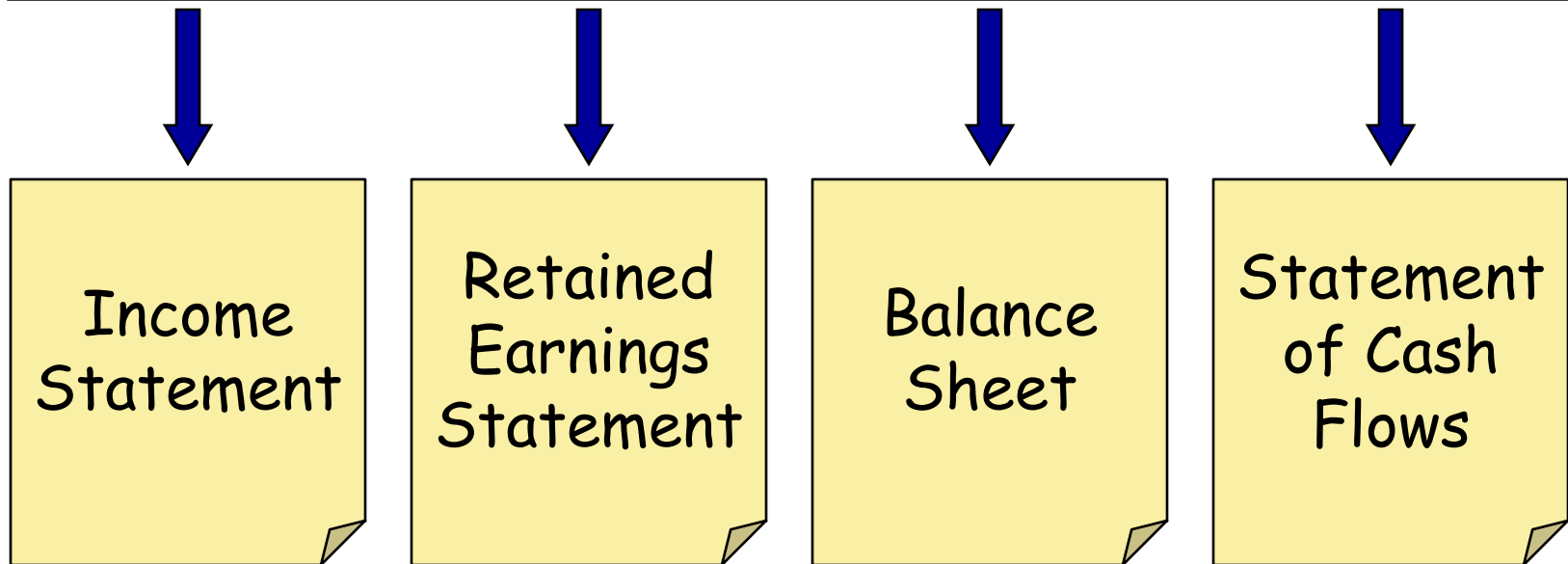
Assets			Liabilities	Stockholders' Equity	
Cash	Accounts Receivable	Equipment	Accounts Payable	Common Stock	Retained Earnings
1. +10,000				+10,000	
2. -5,000		+5,000			
3. -400					-400
4. +5,100					+5,100
5. -1,000					-1,000
6. -2,000					-2,000
7.			+250		-250
8.	+750				+750
9. +120	-120				
6,820	630	5,000	250	10,000	2,200

# *Accounting in Action*



# *Financial Statements*

Companies prepare four financial statements from the summarized accounting data:



# *Financial Statements*

## **Review Question**

Net income will result during a time period when:

- a. assets exceed liabilities.
- b. assets exceed revenues.
- c. expenses exceed revenues.
- ☒ d. revenues exceed expenses.

# Financial Statements

## Income Statement

Barone's Repair Shop	
Income Statement	
For the Month Ended May 31, 2007	
<hr/>	
Revenues:	
Service revenue	\$ 5,850
Expenses:	
Salary expense	2,000
Rent expense	400
Advertising expense	250
Total expenses	2,650
Net income	<u><u>\$ 3,200</u></u>

- Reports the revenues and expenses for a specific period of time.
- Net income - revenues exceed expenses.
- Net loss - expenses exceed revenues.

# Financial Statements

## Retained Earnings Statement

- Statement indicates the reasons why retained earnings has increased or decreased during the period.

Barone's Repair Shop		
Retained Earnings Statement		
For the Month Ended May 31, 2007		
Retained earnings, May 1	\$	-
Add: Net income		3,200
Less: Dividends		(1,000)
Retained earnings, May 31	\$	2,200

# Financial Statements

## Balance Sheet

Barone's Repair Shop

Balance Sheet

May 31, 2007

### Assets

Cash	\$ 6,820
Accounts receivable	630
Equipment	5,000
Total assets	<u>\$ 12,450</u>

### Liabilities

Accounts payable	\$ 250
------------------	--------

### Stockholders' Equity

Common stock	10,000
Retained earnings	<b>2,200</b>
Total liab. & equity	<u>\$ 12,450</u>

- Reports the assets, liabilities, and stockholders' equity at a specific date.
- Assets listed at the top, followed by liabilities and stockholders' equity.
- Total assets must equal total liabilities and stockholders' equity.

# Financial Statements

- Information for a specific period of time.
- Answers the following:
  - Where did cash come from?
  - What was cash used for?
  - What was the change in the cash balance?

## Statement of Cash Flows

Barone's Repair Shop	
Statement of Cash Flows	
For the Month Ended May 31, 2007	
<b>Cash flow from Operations</b>	
Cash receipts from customers	\$ 5,220
Cash paid for expenses	(2,400)
Cash provided by operations	2,820
<b>Cash flow from Investing</b>	
Purchase of equipment	(5,000)
<b>Cash flow from Financing</b>	
Investment by owners	10,000
Drawings by owners	(1,000)
Cash provided by financing	9,000
Net increase in cash	6,820
Cash balance, May 1	-
Cash balance, May 31	\$ 6,820



# *Financial Statements*

## **Review Question**

Which of the following financial statements is prepared as of a specific date?

- ☒ a. Balance sheet.
- b. Income statement.
- c. Statement of stockholders' equity.
- d. Statement of cash flows.

# *Financial Statements*

## **Discussion Question**

**Q19.** "A company's net income appears directly on the income statement and the retained earnings statement, and it is included indirectly in the company's balance sheet." Do you agree? Explain.

See notes page for discussion

# *The Recording Process*

## The Account

- Debits and credits
- Debit and credit procedure
- Stockholders' equity relationships
- Expansion of basic equation

## Steps in the Recording Process

- Journal
- Ledger

## The Recording Process Illustrated

- Summary illustration of journalizing and posting

## The Trial Balance

- 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.

# *Debits and Credits*

## **Double-entry** accounting 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.**

# *Debits and Credits Summary*

## **Review 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.



# *Debits and Credits Summary*

## **Discussion Question**



**Q4.** Maria Alvarez, a beginning accounting student, believes debit balances are favorable and credit balances are unfavorable. Is Maria correct? Discuss.

See notes page for discussion

# Revenue and Expense

Revenue	
Debit / Dr.	Credit / Cr.
	
Normal Balance	

Chapter 3-26

Expense	
Debit / Dr.	Credit / Cr.
	
Normal Balance	

Chapter 3-27

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



# *Debits and Credits Summary*

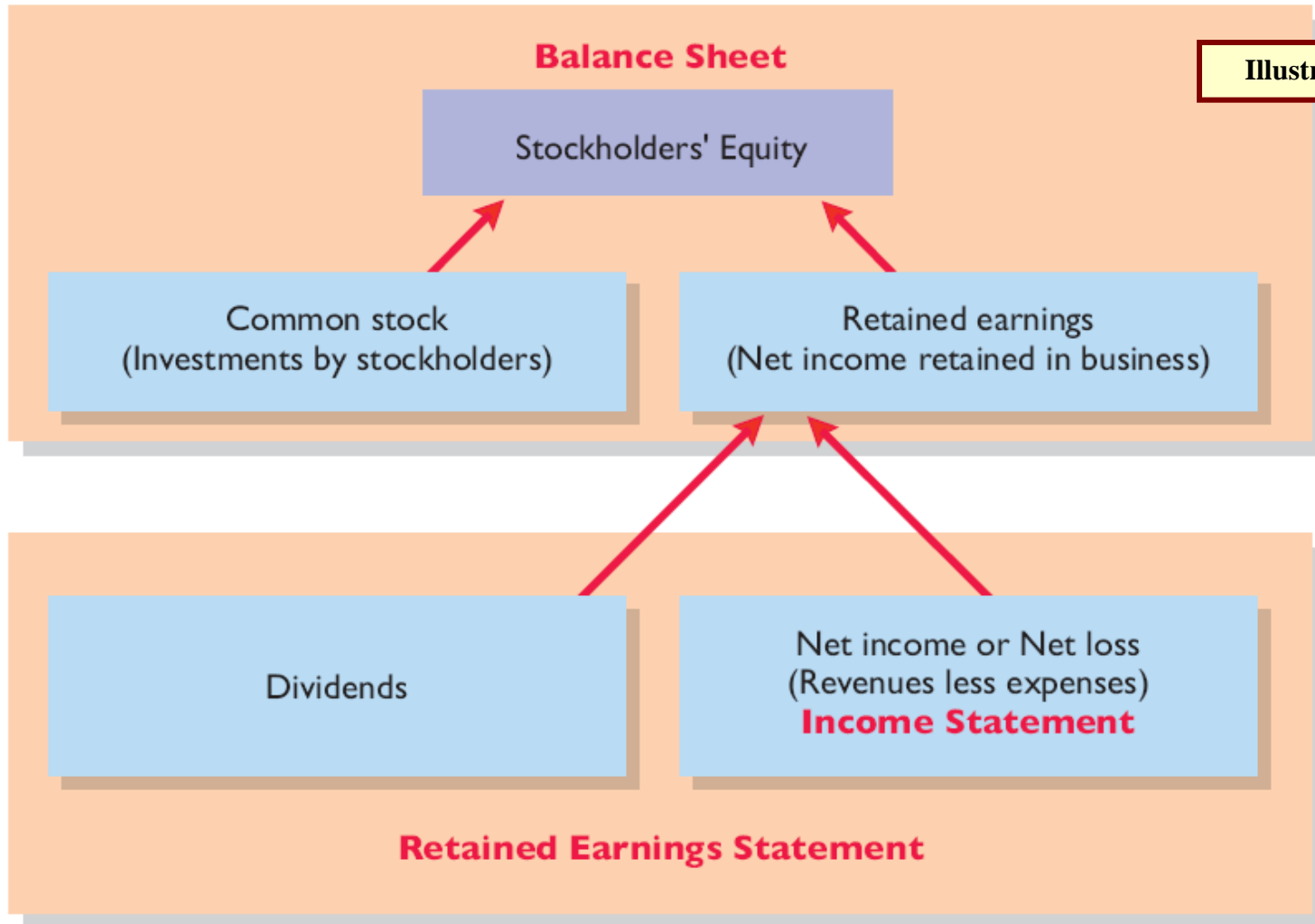
## **Review Question**

Accounts that normally have debit balances are:

- a. assets, expenses, and revenues.
- b. assets, expenses, and equity.
- c. assets, liabilities, and dividends.
- ☒ d. assets, dividends, and expenses.

# Stockholders' Equity Relationships

Illustration 2-11



# Expansion of the Basic Equation

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

Illustration 2-12

**Basic Equation**

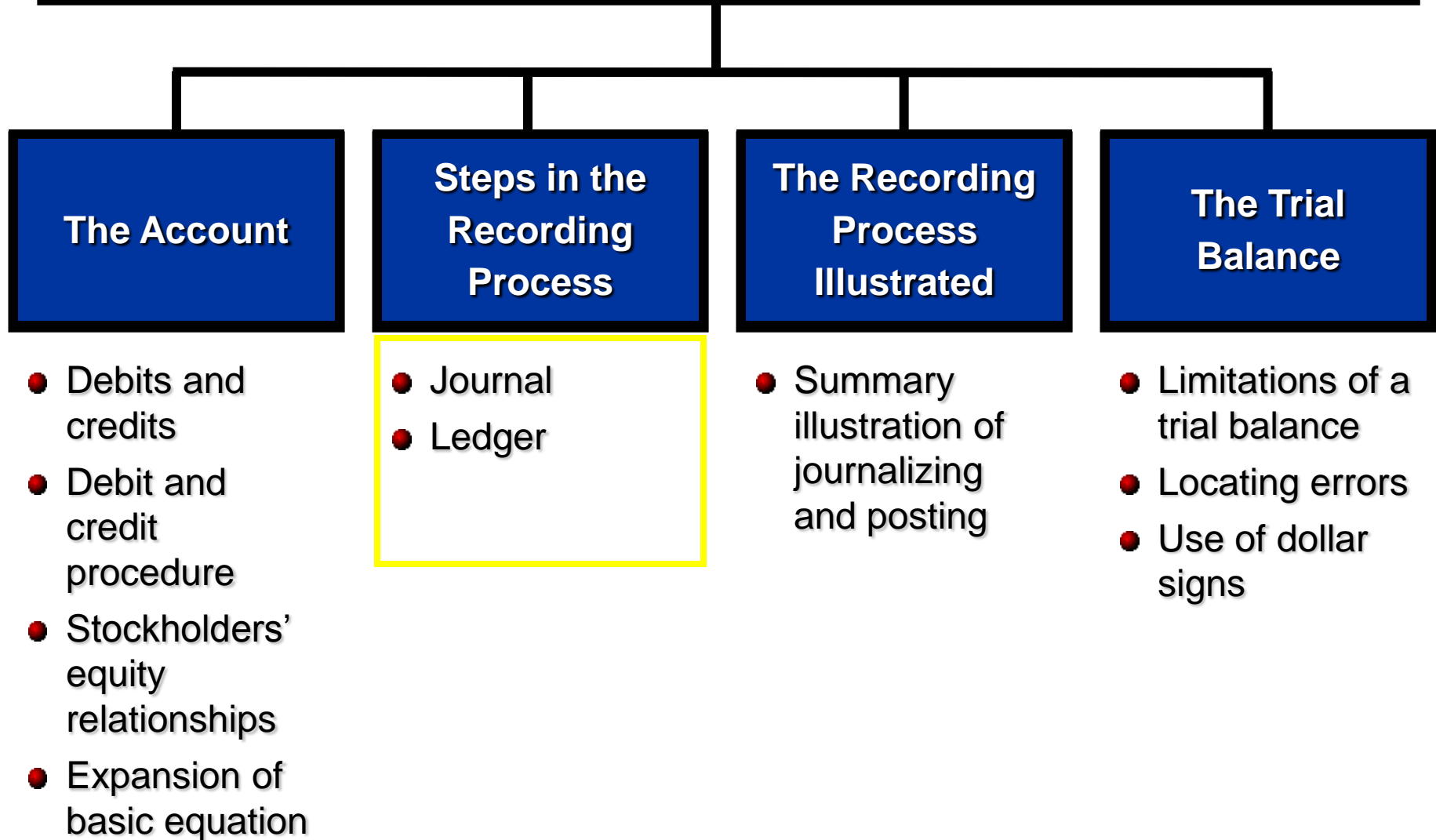
Assets = Liabilities + Stockholders' Equity

**Expanded Basic Equation**

<b>Assets</b>	=	<b>Liabilities</b>	+	<b>Common Stock</b>	+	<b>Retained Earnings</b>	-	<b>Dividends</b>	+	<b>Revenues</b>	-	<b>Expenses</b>
Dr.   Cr.		Dr.   Cr.		Dr.   Cr.		Dr.   Cr.		Dr.   Cr.		Dr.   Cr.		Dr.   Cr.
+   -		-   +		-   +		-   +		+   -		-   +		+   -

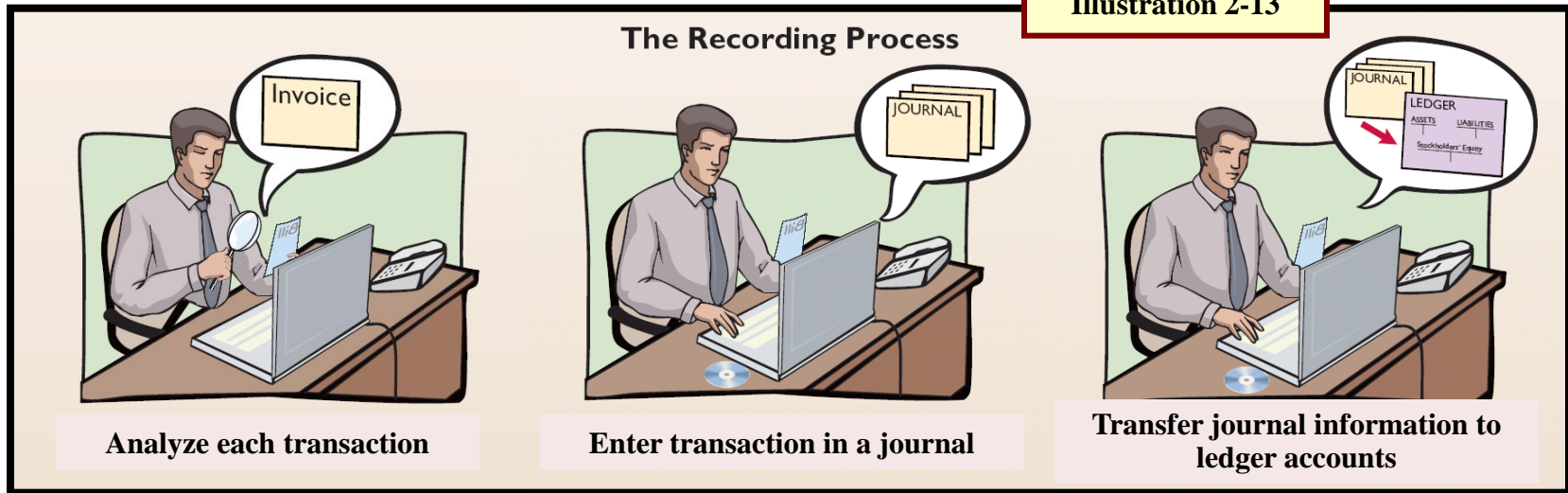
The equation must be in balance after every transaction. For every **Debit** there must be a **Credit**.

# *The Recording Process*



# Steps in the Recording Process

Illustration 2-13



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

# *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.

# *Journalizing Group Activity*

**Journalizing** - Entering transaction data in the journal.

**E2-4 (Facts)** Presented below is information related to Hanshew Real Estate Agency.

- Oct. 1 Pete Hanshew begins business as a real estate agent with a cash investment of \$15,000.
- 3 Purchases office furniture for \$1,900, on account.
- 6 Sells a house and lot for B. Kidman; bills B. Kidman \$3,200 for realty services provided.
- 27 Pays \$700 on balance related to transaction of Oct. 3.
- 30 Pays the administrative assistant \$2,500 salary for Oct.

**E2-5 Instructions** - Journalize the transactions for E2-4.

# Journalizing

**E2-4 (Facts)** Presented below is information related to Hanshew Real Estate Agency.

**Oct. 1** Pete Hanshew begins business as a real estate agent with a cash investment of \$15,000.

General Journal				
Date	Account Title	Ref.	Debit	Credit
Oct. 1	Cash		15,000	
	Common stock			15,000
	(Owners investment)			



# Journalizing

**E2-4 (Facts)** Presented below is information related to Hanshew Real Estate Agency.

**Oct. 3** Purchases office furniture for \$1,900, on account.

General Journal				
Date	Account Title	Ref.	Debit	Credit
Oct. 3	Office furniture		1,900	
	Accounts payable			1,900
	(Purchase furniture)			

# Journalizing

**E2-4 (Facts)** Presented below is information related to Hanshew Real Estate Agency.

**Oct. 6** Sells a house and lot for B. Kidman; bills B. Kidman \$3,200 for realty services provided.

General Journal				
Date	Account Title	Ref.	Debit	Credit
Oct. 6	Accounts receivable		3,200	
	Service revenue			3,200
	(Realty services provided)			

# Journalizing

**E2-4 (Facts)** Presented below is information related to Hanshew Real Estate Agency.

**Oct. 27** Pays \$700 on balance related to transaction of Oct. 3.

General Journal				
Date	Account Title	Ref.	Debit	Credit
Oct. 27	Accounts payable		700	
	Cash			700
	(Payment on account)			

# Journalizing

**E2-4 (Facts)** Presented below is information related to Hanshew Real Estate Agency.

**Oct. 30** Pays the administrative assistant \$2,500 salary for Oct.

General Journal				
Date	Account Title	Ref.	Debit	Credit
Oct. 30	Salary expense		2,500	
	Cash			2,500
	(Payment for salaries)			

# Journalizing

**Simple Entry** – Two accounts, one debit and one credit.

**Compound Entry** – Three or more accounts.

**Example** – On June 15, H. Burns, purchased equipment for \$15,000 by paying cash of \$10,000 and the balance on account (to be paid within 30 days).

General Journal				
Date	Account Title	Ref.	Debit	Credit
June 15	Equipment		15,000	
	Cash			10,000
	Accounts payable			5,000
	(Purchased equipment)			

# *The Ledger*

- **Ledger** contains the entire group of accounts maintained by a company.
- A **general ledger** contains all the asset, liability, stockholder's equity, revenue, and expense accounts.
- Chart of Accounts

# *The Recording Process*

## **The Account**

- Debits and credits
- Debit and credit procedure
- Stockholders' equity relationships
- Expansion of basic equation

## **Steps in the Recording Process**

- Journal
- Ledger

## **The Recording Process Illustrated**

- Summary illustration of journalizing and posting

## **The Trial Balance**

- Limitations of a trial balance
- Locating errors
- Use of dollar signs

# Chart of Accounts

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

Hanshew Real Estate Agency Chart of Accounts			
Assets		Stockholders' Equity	
101	Cash	300	Common stock
112	Accounts receivable	306	Retained earnings
126	Supplies	350	Dividends
130	Prepaid insurance		
150	Office furniture		
158	Accumulated depreciation		
Liabilities		Revenues	
200	Accounts payable	400	Service revenue
201	Notes payable		
209	Unearned revenue		
212	Salaries payable		
230	Interest payable		
		Expenses	
		631	Supplies expense
		711	Depreciation expense
		722	Insurance expense
		726	Salaries expense
		729	Rent expense
		905	Interest expense



# *Standard Form of Account*

T-account form used in accounting textbooks.

In practice, the account forms used in ledgers are much more structured.

Cash					No. 101
Date	Explanation	Ref.	Debit	Credit	Balance
Oct. 1			15,000		15,000
27				700	14,300
30				2,500	11,800

# Posting

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

General Journal				J1
Date	Account Title	Ref.	Debit	Credit
Oct.	Cash	101	15,000	
	Common stock			15,000

General Ledger

Cash

Acct. No. 101

Date	Explanation	Ref.	Debit	Credit	Balance
Oct. 1	Owner investment	J1	15,000		15,000

# Posting

## Review 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.



# *The Recording Process*

## **The Account**

- Debits and credits
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## **Steps in the Recording Process**

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## **The Recording Process Illustrated**

- Summary illustration of journalizing and posting

## **The Trial Balance**

- Limitations of a trial balance
- Locating errors
- Use of dollar signs

# *The Trial Balance*

- A list of accounts and their balances at a given time.
- Purpose is to prove that debits equal credits.

## Hanshew Real Estate Agency

Trial Balance  
October 31, 2008

	Debit	Credit
Cash	\$ 11,800	
Accounts receivable	3,200	
Office furniture	1,900	
Accounts payable		\$ 1,200
Common stock		15,000
Service revenue		3,200
Salaries expense	2,500	
	<u>\$ 19,400</u>	<u>\$ 19,400</u>

# *The 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.

# *The Trial Balance*

## **Review 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 dividends is debited to the Dividends account 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.

# *Recording Process*

## **Discussion Question**

**Q2-19.** Jim Benes is confused about how accounting information flows through the accounting system. He believes the flow of information is as follows.

- a. Debits and credits posted to the ledger.
- b. Business transaction occurs.
- c. Information entered in the journal.
- d. Financial statements are prepared.
- e. Trial balance is prepared.

Is Jim correct? If not, indicate to Jim the proper flow of the information.

See notes page for discussion

*SO 7 Prepare a trial balance and explain its purposes.*