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ABSTRACT

This programed text is designed to teach the basic elements of the double entry system of accounting, including basic terms, procedures, definitions, and principles used. The text consists of frames, which are sequenced instructional steps and, in most cases, are composed of two parts. The first part states a fact or relates information and asks a question or specifies an action to be taken. The second part gives the correct answer to the question asked in the first part. The five chapters, each containing five or more frames, are Accounting Equation and Statements; Accounts and the Trial Balance; The Worksheet, Adjusting and Closing Entries; Depreciation, Bad Debts, Accrued and Deferred Items; and Special Journals. (SH)

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UNITED STATES ARMY FINANCE SCHOOL

FORT BENJAMIN HARRISON, INDIANA 46216

ELEMENTARY ACCOUNTING

A PROGRAMED TEXT

REVISED
APRIL 1973

PREFACE

PURPOSE:

a. With this programed instruction, you, the student will begin the study of double entry accounting. This programed instruction is designed to teach you the basic elements of the double entry system of accounting, basic terms, procedures, definitions, and principles used.

b. Throughout the Army, increasing numbers of military financial records are being kept under the double entry plan of accounting. This system of records, long used in civilian business, is achieving increasing popularity within governmental activities. Currently, the Army uses double entry accounting for certain nonappropriated funds, industrial funds, stock funds, and management funds.

c. The purpose of this programed instruction is to give you the necessary background for a study of installation accounting which will be presented in another course. This system of installation accounting is an integration of station disbursing and fiscal accounting.

HOW TO USE THIS PROGRAMED INSTRUCTION TEXT:

The material contained herein is broken up into a number of frames, which are simply convenient instructional steps. You proceed through the chapter one frame -- one step -- at a time. Most frames are composed of two parts: the first part states a fact or relates some information; usually a question is asked or an action to be taken is specified. The second part of the frame (not present in some frames) gives the correct answer to the question asked in the first part.

Each frame will end with a heavy dark line. If the frame asks you a question, the correct answer is printed on the next page, IDENTIFIED BY THREE ASTERISKS (***) BEFORE AND AFTER THE ANSWER. As you study each frame, do not look at the correct answer until you have written your answer in the space provided. If your answer is correct, read the next frame. If, however, your answer is incorrect, draw a line through it and write the correct answer.

Do not defeat the purpose of this programed instruction. Think your answers through, and then look at the correct answer. In this manner you will begin to comprehend the material presented and thus achieve the objectives of this text.

Success in learning is dependent upon the following two rules: (1) Write all required answers, (2) DO NOT look ahead for the suggested response until you have completed your own.

Some frames may be answered by recall or association, whereas others require logic and reasoning ability. If you have difficulty understanding the suggested response you should review previous frames prior to looking at the response.

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CHAPTER 1

ACCOUNTING EQUATION AND STATEMENTS

1 INTRODUCTION.

a. Property is an essential factor in the operation of a business because it is used to produce commodities or services. An increase in property generally indicates a profit or business success while a decrease in property generally indicates a loss or business failure.

b. Accounting records show the changes in property of a business. They are essential if the owner is to determine the success or failure of his operations. Records also assist the owner in making plans for future operations, avoiding repetition of his mistakes, and analyzing the reasons for changes which have taken place. The adequacy of the records a businessman maintains may determine his success or failure.

c. The duty of maintaining the financial records of a business usually falls on the clerks employed. It is their responsibility to record each transaction that has taken place during a specified period and, at the end of the period, to summarize the effects of the transactions in such a manner as to show the success or failure of operations for the period.

d. Establishment and analysis of business records and systems is the job of specialists in the field of accounting. The scope of this text is limited to teaching the basic principles to be followed in recording business transactions - the vocation referred to as elementary accounting.

List three reasons for the need of accounting records.

(1) ______________________________

(2) ______________________________

(3) ______________________________

* * * (1) To determine the success or failure of a business.

(2) Making plans or decisions for future operations.

(3) Avoid repetition of mistakes. * * *

---

2 THE ACCOUNTING EQUATION.

a. Any property used in business is called an asset; an asset is anything of value owned, such as cash, equipment, inventory, buildings, land, etc. The interest the owner of a business has in the assets is called proprietorship. If no other person has a claim or an interest in the assets, the accounting equation is presented as:

Assets = Proprietorship.

b. Most businesses find that property in addition to that owned is necessary to conduct business operations. To acquire this additional property, it sometimes is convenient to purchase on account by accepting the property and promising to pay at a future date. An alternate method is to borrow money with which to purchase the additional property. Either of these methods results ~~in~~ a liability or an amount owed to the creditor or the person from whom the additional property or money is acquired. The creditor then would have a right to or claim against the assets of the business equal to the value of the property or money borrowed. In this instance, the creditor and proprietor have mutual interest in the assets of the business and the equation resembles:

Assets = Liabilities + Proprietorship

To illustrate the accounting equation, assume George Moore opens a hardware business with an investment of $3,000. When he acquires additional inventory worth $1,000 on account, he has become liable to his creditor for the amount of merchandise purchased. His assets have increased, however, and the balanced equation will resemble:

Assets ($4,000) = Liabilities ($1,000) + Proprietorship ($3,000).

2 (Cont)

c. George Moore's proprietorship or net worth ($3,000) is equal to what he owns (assets--$4,000) less what he owes his creditors (liabilities--$1,000). The equation may be stated in three ways:

(1) Assets = Liabilities + Proprietorship.

(2) Assets - Liabilities = ______________________.

(3) ____________________ - ________________ = ____________.

---

* * * (2) Assets - Liabilities = Proprietorship.

(3) Assets - Proprietorship = Liabilities. * * *

3

a. A business continually buys and sells commodities and services. This buying and selling process always produces changes in the nature and amount of property used in the business. To illustrate, B. Black invests \$5,000 in a hardware business. His assets and proprietorship are expressed as:

Cash (\$5,000) = Proprietorship (\$5,000)

He purchases a building and land for \$2,000 in cash. His cash will decrease but another asset (land and buildings) has been created and the equation appears as:

Cash	+	Land and Buildings	=	Proprietorship
\$3,000	+	\$2,000	=	\$5,000

He purchases merchandise for \$2,000 in cash. Again, cash has decreased and a new asset has been created. The equation now appears as:

Cash	+	Land and Buildings	+	Merchandise	=	Proprietorship
\$1,000	+	\$2,000	+	\$2,000	=	\$5,000

The nature of Black's property has changed by exchanging one asset (cash) for other types of assets (land and merchandise).

b. In the illustration above, the <u>nature</u> of Black's assets changed but the <u>amount</u> of total assets remained the same because assets were exchanged for other assets of equal value. Since businesses are operated for a profit, property will generally be sold for a price greater than that paid for it. When property is sold for a profit or loss, a change in the amount of assets and the amount of proprietorship will result. Assume that Black sells merchandise which cost him \$100 for \$150. The asset "merchandise" will decrease \$100 and the asset "cash" will be increased \$150. The \$50 difference between cost and selling price is profit and will increase Black's proprietorship. This is represented by the equation:

3 (Cont)

Cash + Land and Buildings + Merchandise = Proprietorship
$1,150 + $2,000 + $1,900 $5,050

Since there are a number of items in the equation, it now becomes simpler to list them as:

Cash	$1,150
Land and Buildings	2,000
Merchandise	1,900
Total Assets	$5,050 = Total Proprietorship ($5,050)

If merchandise costing $100 were sold for $50, Black would suffer a $50 loss. His asset "cash" would increase $50 while "merchandise" would decrease $100. The loss will decrease Black's proprietorship and be shown in the equation as:

Cash	$1,200
Land and Buildings	2,000
Merchandise	1,800
Total Assets	$5,000 = Total Proprietorship ($5,000)

c. The transactions illustrate how changes in the amount of property effected a change in the assets and proprietorship. A change in the rights to property may also result. Assume that Black purchases $200 in merchandise on account. The creditor from whom the purchase is made (Acme Co.) has rights to Black's property and appears in the equation as:

Cash	$1,200
Land and Buildings	2,000
Merchandise	2,000
Total Assets	$5,200 = Total Liabilities and Proprietorship

Liabilities: Acme Co.	$ 200
Proprietorship	5,000
	$5,200 Total Liabilities and Proprietorship

3 (Cont)

Bill Moore began a package delivery business and during a short period he completed these transactions:

(1) Invested $1,500 cash in the business.

(2) Bought an office desk and chair for $200 cash.

(3) Bought $50 of office supplies on credit from Office Supply Company.

(4) Delivered packages for $50 cash for services performed.

Show by additions and subtractions, on the accounting equation below, the effect of each transaction. Show new totals after each transaction:

Cash	+ Office Equipment	+ Office Supplies	= Liabilities	+ Proprietorship
(1)				
(2)				
(3)				
(4)				

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* * *

	Cash	+	Office Equipment	+	Office Supplies	=	Liabilities	+	Proprietorship
a.	$1,500							+	$1,500
b.	- 200	+	200						
	$1,300	+	200						$1,500
c.					+50		+50		
	$1,300	+	200	+	50	=	50	+	$1,500
d.	+ 50								+ 50
	$1,350	+	200	+	50	=	50	+	$1,550

* * *

4 THE BALANCE SHEET.

To manage a business efficiently, a proprietor should know the nature and amount of each asset, each liability, and his proprietorship account. Assembling this information after each transaction is not practical since an immense amount of detail would result. It is usually satisfactory to assemble the information periodically on a statement called the "Balance Sheet." This statement shows the status of the business on a given date. Some businesses prefer to receive this statement monthly while others prefer annual statements.

a. The balance sheet, therefore, is a statement of the financial position of a particular business at a specified date showing the amounts and the various nature of the assets, liabilities, and proprietorship. This is illustrated by the heading of the balance sheet. It will always contain a specific date, never a range of time.

b. The balance sheet is segregated into various groups to separate the assets (the property belonging to the business), the liabilities (the legal right of the creditors toward the assets), and the proprietorship (the amount of the legal right the owner has toward the assets).

c. Dollar signs need not be written in books of original entry, ledger accounts, and trial balances. They should be used in balance sheets and other formal statements. In such statements, a dollar sign should be written beside the first amount in each column.

4
(Cont)

Which one of the following would be an acceptable date for the heading of a "Balance Sheet"?

(1) For the month ending March 31, 197*.

(2) January 31, 197*

(3) Between May 1, 197* - May 31, 197*.

5

The following definitions are descriptive of some of the items most likely to be found listed on a balance sheet:

1. Cash - currency, checks, money orders, etc.

2. Notes Receivable - written agreements or promises to pay a sum at a specified future date to the holder or bearer.

3. Accounts Receivable - claims against a person or agency that has made purchases on account.

4. Merchandise - goods that a business has purchased or manufactured for sale. The term "merchandise inventory" is commonly used to indicate the amount of merchandise on hand at a specified period.

5. Store Equipment - equipment used in the store and directly used in the selling of goods.

6. Office Equipment - equipment used to conduct the business as far as office requirements are concerned but not directly connected with the selling of goods.

7. Delivery Equipment - equipment used in the delivery of goods.

8. Buildings - structures owned by the business.

9. Land - cost of land owned by the business.

10. Store Supplies - supplies that are used in the store; directly connected with the selling of goods.

11. Office Supplies - supplies that are used for administrative purposes and are not directly connected with the selling of goods.

12. Prepaid Insurance - premiums paid in advance. As time elapses and the insurance expires, this asset is transferred to an expense account.

5

(Cont)

13. Notes Payable - written promises given by the owner of the business to pay a sum of money on the date prescribed.

14. Accounts Payable - obligations to pay for purchases made on account.

15. Proprietorship, Net Worth, or Capital - the owner's interest in the business.

Which one of the following is correct concerning the above list?

a. 1 through 13 are assets.

b. 13 through 15 are liabilities.

c. 12 is an asset.

---

* * * c. * * *

6

a. Assets and liabilities are normally segregated on the balance sheet. The classification of these items is as follows:

(1) Assets are segregated into two main categories:

(a) Current assets - cash, those assets readily convertible into cash (i.e., accounts receivable and merchandise), prepayments, and those assets which will be consumed in the coming business cycle (i.e., supplies).

(b) Fixed assets - assets which are of a permanent or fixed nature and are not intended to be converted into cash or consumed in the ordinary course of business operations (i.e., buildings, store equipment, delivery equipment, etc.).

(2) Liabilities are segregated into two main categories:

(a) Current liabilities - liabilities which will be paid in a short period of time after they are established (i.e., accounts payable, notes payable, etc.).

(b) Long-term liabilities - liabilities which will not be satisfied in a short period of time. Usually, long-term debts are included in this category (i.e., mortgage payable, etc.).

b. The balance sheet is prepared as shown in Figure 1, page 13. In observing Figure 1, note the following:

(1) The "heading" or "title" gives the name of the business or the owner, the name of the statement, and the date for which the statement is prepared.

(2) The headings "Assets" and "Liabilities and Proprietorship" are written over the left and right sides of the balance sheet so that the three parts of the equation may be identified more clearly.

6 (Cont)

(3) Proprietorship is indicated by the name of the proprietor followed by the word "Capital" and includes information concerning profits and proprietor's withdrawals of cash for the period.

c. Figure 1, page 13, shows the account form balance sheet and Figure 2, page 14 illustrates the report form balance sheet. Both forms show the same facts but the arrangement is different. The choice of the form to be used is merely a matter of personal preference.

Prepare a "Balance Sheet" in account form, refer to the illustration on page 13, for the Bad Smell Company on December 31, 197* using the following account balances: Cash--$1,000; Office Supplies--$500; Machinery--$3,000; Buildings--$2,000; Accounts Payable--$500; Notes Payable--$5,000; and Bad Smell Company Capital -- $__________.

B. Black
Balance Sheet
30 September 19--

Assets		
Current Assets:		
Cash		$600.00
Accts Receivable		600.00
Merchandise Inv.		2000.00
Store Supplies		100.00
Office Supplies		50.00
Prepaid Insurance		300.00
Total Current Assets		$3650.00
Fixed Assets:		
Buildings	$3000.00	
Delivery Equipment	1500.00	
		4500.00
Total Assets		$8150.00

Liabilities & Proprietorship			
Current Liabilities:			
Accts Payable			$1
Notes Payable			
Total Current Liabilities			$2
Long-Term Liabilities			
Mortgage Payable			4
Total Liabilities			$6
Proprietorship:			
B. Black Capital 1 Sep 19--		$1750.00	
Net Income for Sep:	$500.00		
Less: withdrawal	100.00	400.00	
B. Black Capital 30 Sep 19--			2
Total Liabilities & Proprietorship			$8

Figure 1

13

B. Black
Balance Sheet
30 September 19--

...ts			Liabilities & Proprietorship		
...nts:			Current Liabilities:		
		$600.00	Accts Payable		$1500.00
...ceivable		600.00	Notes Payable		500.00
...dise Inv.		2000.00	Total Current Liabilities		$2000.00
...pplies		100.00			
...pplies		50.00	Long-Term Liabilities		
...Insurance		300.00	Mortgage Payable		4000.00
...ent Assets		$3650.00			
			Total Liabilities		$6000.00
...s:					
...s	$3000.00		Proprietorship:		
...Equipment	1500.00		B. Black Capital		
		4500.00	1 Sep 19--	$1750.00	
			Net Income for Sep: $500.00		
			Less: withdrawal 100.00	400.00	
			B. Black Capital		
			30 Sep 19--		2150.00
...s		$8150.00	Total Liabilities & Proprietorship		$8150.00

Figure 1

B. Black
Balance Sheet
30 September 19--

ASSETS			
Current Assets:			
Cash			$ 600 00
Accounts Receivable			600 00
Merchandise			2000 00
Store Supplies			100 00
Office Supplies			50 00
Prepaid Insurance			300 00
Total Current Assets			$ 3650 00
Fixed Assets:			
Buildings		$ 3000 00	
Delivery Equipment		1500 00	
Total Fixed Assets			$ 4500 00
Total Assets			$ 8150 00
LIABILITIES			
Current Liabilities:			
Accounts Payable		$ 1500 00	
Notes Payable		500 00	
Total Current Liabilities			$ 2000 00
Long-term Liabilities			
Mortgage Payable			4000 00
Total Liabilities			$ 6000 00
PROPRIETORSHIP			
B. Black, Capital 1 September 19--		$ 1750 00	
Net Profit for September	$ 500		
Less Withdrawal	100	400 00	
B. Black, Capital 30 September 19--			$ 2150 00
Total Liabilities and Proprietorship			$ 8150 00

Figure 2

* * *

BAD SMELL COMPANY
Balance Sheet
December 31, 197*

ASSETS			LIABILITIES & PROPRIETORSHIP	
Current Assets			Current Liabilities	
Cash		$1,000	Accounts Payable	$ 500
Office Supplies		500	Notes Payable	5,000
Total Current Assets		$1,500	Total Current Liabilities	$5,500
Fixed Assets			Proprietorship	
Machinery	$3,000		Bad Smell Co. Capital	1,000
Buildings	2,000			
Total Fixed Assets		5,000	Total Liabilities and Proprietorship	$6,500
Total Assets		$6,500		

* * *

7 INCOME STATEMENT.

The primary objective of any business is to increase the proprietorship by accumulation of profits. The proprietor must know at frequent intervals the amount and causes of his profits or losses. Without this information, the proprietor cannot make future plans for increasing his profits or decreasing his losses. For this reason, a report is required which will show the total receipts from sale of goods or services, the total cost of furnishing these goods or services to the customer, and the difference which will be the income or loss from operations. A report or statement giving such information is the "Income Statement." The income statement is usually prepared to reflect the operations of a business for the period between two balance sheets. This statement is also illustrated by looking at the heading. The date in the heading specifies a period of time, indicating the statement is reflecting operations over a period of time.

Which one of the following is correct for the proper date on an "Income Statement?"

(1) For the month ending May 31, 197*.

(2) January 31, 197*.

(3) For the year 197*.

* * * (1) -- (3) is wrong because a business cycle could end on any date, therefore, the ending date must be specified.

* * *

8

The simplest form of an income statement is one which shows the purchase and sale of one unit of property. For example, B. Black sells a washing machine costing $100 for a price of $150 and illustrates the transaction as:

Sale Price of Washing Machine	$150
Cost of Machine	100
Profit	$ 50

Assuming that Black bore the expense of installing the washing machine, the expense would reduce his profit and be illustrated as:

Sale Price of Washing Machine	$150
Cost of Machine	100
Gross Profit	$ 50
Installation Expense	10
Net Income	$ 40

Note in the illustration above that the amount by which the selling price exceeds the cost is termed gross profit. In making the sale, an expense has been incurred and reduces the gross profit. This difference between the gross profit and the expenses incurred is termed net income.

If G. Good bought merchandise for $200 and sold it for $220 and expenses were 30% of gross profit, what would the net income or loss be?

* * *

Sale Price	$220
Cost	200
Gross Profit	$ 20
Expenses ($20 x .30 = $6)	6
Net Income	$ 14

* * *

9

Many transactions are made during a period. To determine the profit or loss on each item is not practical. It would be extremely difficult because Black must incur other expenses in the conduct of his business (store supplies expense, office supplies expense, salaries expense, etc.) which will not be fully ascertained until the end of the period for which the statements are being prepared. For this reason, sales of commodities or services and the expenses of operations are totaled at the end of the period. These totals are then expressed in a simple form of the income statement.

Sales for the Month	$3,000
Cost of Goods Sold	2,000
Gross Profit on Sales	$1,000
Less: Expenses	500
Net Income	$ 500

In the illustration above, the term "Cost of Goods Sold" has been used as a deduction from the total receipts represented by sales. If a business purchased merchandise and sold all of it during a period, the amount of the Cost of Goods Sold would equal the total value of the merchandise purchased. This does not always occur because businessmen endeavor to maintain an adequate stock of merchandise to satisfy the need of all their customers. As a result, merchandise will always be on hand at the end of the period. This creates the problem, "What was the cost of the merchandise sold during this period?" To compute Cost of Goods Sold, the owner of a business must first determine by inventory count the value of his stock at the start of a period and at the end of a period. He must also know the merchandise he has purchased during the period to replenish the stock he has on hand. With this information, he may compute the Cost of Goods Sold. Assume that Black has a merchandise inventory on 1 September which totals $3,000. During September, he purchases $1,000 worth of additional merchandise for resale. He now has

9 (Cont)

$4, 000 worth of merchandise available for sale. On 30 September (the date his statements are prepared), another inventory is taken and he finds that he has $2, 000 worth of merchandise remaining. Black's computation of Cost of Goods Sold is as follows:

Cost of Goods Sold:

Inventory, 1 September 19--	$3, 000	
Purchases	1, 000	
Merchandise Available for Sale	$4, 000	
Less Inventory, 30 September 19--	2, 000	
Cost of Goods Sold		$2, 000

If the Good Company has beginning inventory of $22, 000, purchases for the period of $28, 000, and ending inventory of $13, 000, what is the "Cost of Goods Sold" amount?

24

* * *

Beginning Inventory	$22,000
Purchases	28,000
Merchandise Available for Sale	$50,000
Ending Inventory	13,000
Cost of Goods Sold	$37,000

* * *

10

The inflow of Cash, Accounts Receivable, or Other Assets in exchange for goods or services is known in accounting as REVENUE.

The usual method of presenting the various items on an "Income Statement" is:

Revenue - Cost of Goods Sold - Expenses = Net Income or Net Loss

By placing the items in a vertical sequence, we have the following example of an Income Statement:

	Revenue from Sales	$5,000	
(minus)	Cost of Goods Sold	2,000	
(equal)	Gross Profit on Sales		$3,000
(minus)	Operating Expenses		800
(equal)	Net Income		$2,200

If the Cost of Goods Sold is $13,000, Gross Profit on Sales is $9,500, and Operating Expenses is $6,000, what is the Amount of the Net Income from Sales?

Cost of Goods Sold	$13,000
Gross Profit on Sales	9,500
Income	$22,500

Gross Profit on Sales	$9,500
Operating Expenses	6,000
Net Income	$3,500

11

To facilitate the analysis of the operations of a business and the determination of factors regarding the income and expenses for the period under consideration, a more detailed and descriptive statement is preferred. Such a statement contains the items broken down into major categories, the more common of which are shown below:

(a) Gross Sales - the total revenue from sale of merchandise.

(b) Sales Returns and Allowances - goods which have been returned by the customers because of deficiencies or allowances in price which were granted to the buyer by the seller as a compensation for deficiencies.

(c) Cost of Goods Sold - the purchase price of the goods sold. This item can be determined by taking the beginning inventory, adding to it the cost of the purchases plus any additional charges involved (such as delivery charges), and deducting the ending inventory. (Note the Cost of Goods Sold section in Figure 3, page 22.)

(d) Freight-in - the delivery cost incurred by the buyer of the merchandise. This cost is added to the cost of purchases of merchandise for resale to determine the Cost of Goods Sold.

(e) Expenses - items that are consumed in the operations of the business. Expenses are normally summarized into categories. The most commonly used categories in a mercantile business would be selling expenses and general expenses.

11 (Cont)

(1) Selling expenses - those expenses incurred during the period that are directly connected with the cost of selling. Examples may be seen in Figure 3, page 22.

(2) General expenses - those expenses incurred during the period that are directly connected to the operation of the business. Examples may be seen in Figure 3, page 22.

Prepare an Income Statement for Bad Smell Company for the month of May 197* -- refer to the illustration on Page 22 -- with the following account balances: Cash $8,000; May 1, 197* Inventory $14,900; Purchases $9,000; Advertising Expense $1,200; Rent Expense $4,000; Salary Expense $14,000; May 31, 197* Inventory $2,000; and Sales $52,000. Selling Expenses are not used.

B. Black
Income Statement
For the Month Ended 30 September 19--

Income from Sales:			
Gross Sales			$6000.00
Less: Sales Returns and Allowances			70.00
Net Sales			$5930.00
Cost of Goods Sold:			
Merchandise Inventory 1 Sep 19--		$3050.00	
Purchases	$5,000		
Freight-In	100	5100.00	
Merchandise Available for Sale		$8150.00	
Less: Merchandise Inventory 30 Sep 19--		3100.00	
Cost of Goods Sold			5050.00
Gross Profit on Sales			$880.00
Expenses:			
Selling Expenses:			
Sales Clerks' Salaries	$200.00		
Advertising	50.00		
Store Supplies Expense	20.00		
Depreciation of Delivery Equipment	10.00		
Total Selling Expenses		$280.00	
General Expenses:			
Office Salaries	$100.00		
Office Supplies Expense	10.00		
Depreciation of Office Equipment	5.00		
Total General Expenses		115.00	
Total Expenses			395.00
Net Income			$485.00

Figure 3

* * *

BAD SMELL COMPANY
Income Statement
For the Month Ending May 31, 197*

Revenue from Sales:		
Sales		$52,000
Cost of Goods Sold		
Inventory May 1, 197*	$14,900	
Purchases	9,000	
Merchandise Available for Sale	$23,900	
Less: Inventory May 31, 197*	2,000	
Cost of Goods Sold		21,900
Gross Profit		$30,100
General Expenses:		
Advertising	$ 1,200	
Rent	4,000	
Salary	14,000	
Total		19,200
Net Income		$10,900

* * *

CHAPTER 2

ACCOUNTS AND THE TRIAL BALANCE

12 GENERAL. Every transaction performed by a business produces a change in the components of the equation: Assets = Liabilities and Proprietorship. The effect of each transaction must be determined if accurate statements are to be prepared. Some balance sheet items (such as cash) can be determined by physical count at the end of the period. However, a count will not be proof that the amount on hand is correct unless the increases and decreases to that asset during the month are known. When preparation of the income statement is attempted, the total sales and expenses will be unknown unless a continuous record has been kept.

<u>TRUE or FALSE:</u> Not every transaction performed by a business produces a change in the components of the accounting equation.

*** False ***

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ACCOUNTS. Though it would be conceivable to record the effect of each transaction on assets, liabilities, and proprietorship by preparing a new balance sheet after each transaction, this system would be highly impractical. It is more practical to maintain a separate record of each item on the balance sheet and income statement. These individual records show the amount of the item at the beginning of the period, the increases and decreases occurring during the period, and the amount at the end of the period. A record such as this is known as an account; a group of accounts is known as a ledger.

Define the terms account and ledger.

31

* * * An account is a separate record of each item on the balance sheet and income statement. A ledger is a grouping of these accounts.

* * *

14

Accounts are maintained on ruled columnar paper as seen in the illustration below. A separate page is required for each account. The pages are inserted usually in a loose-leaf binder or similar folder for convenience. The loose-leaf binder or folder is known as the ledger. The purpose of each column is as follows:

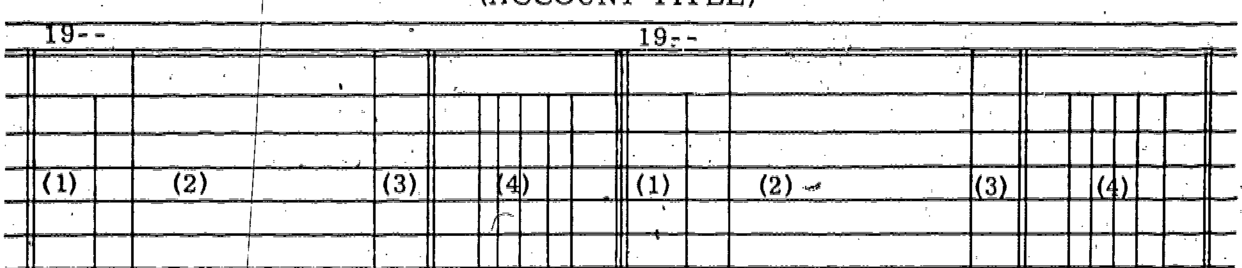
(1) These are date columns, the first column for the month and the second for the day. The year is written at the top of the column as shown. Once the month has been entered in column 1, it need not be written again.

(2) This column is for explanations concerning any entry made and is seldom used.

(3) This column is known as the folio or posting reference column and cross reference information is placed here.

(4) This is the money or amount column.

(ACCOUNT TITLE)



Which alphabetical capital letter does the account resemble?

* * * For reasons of brevity, an illustrative account form known as the "T" account will be used in subsequent paragraphs. This form of account is simply a capital T which shows the effect of business transactions as amounts entered on the left or right side.

* * *

15

DEBIT AND CREDIT. A transaction is an event involving the exchange of money, goods, or services. For example, when Black sold merchandise for $100, a transaction was completed. Money, $100 cash was exchanged for merchandise. A grouping of like transactions under a descriptive or common heading is called an account. An account is a record of an individual item which shows the increases and decreases brought about by business transactions. Each account has three parts. Immediately above the account in a prominent position is the title of the account naming that item to which the account refers. Below the title are two sections - the left section of the account is called the debit side and the right section is called the credit side. When an amount is placed on the left side, the account is said to be debited; when an amount is placed on the right side, the account is said to be credited. If the debits normally exceed the credits, then the account is said to have a debit balance and if the credits exceed the debits, the account is said to have a credit balance. Each time there is a debit to an asset or expense account, there is an equal or offsetting credit to a liability, proprietorship, or income account. The offsetting entries serve to keep the equation in balance. Since a debit and credit entry is made for each transaction, the system is called the Double Entry Accounting System.

Construct a cash account with $1,000 debited and $630 credited. Do you have a debit or credit balance?

* * *

Cash	
$1,000	$630
$370 debit bal	

* * *

---

16 The cost of an asset is entered on the left side of its related account just as the asset itself appears on the left side of the balance sheet. The amount of a liability or of proprietorship is entered on the right side of an account as it appears on the right side of the balance sheet. To illustrate, B. Black's balance sheet on 1 September appeared as follows:

B. Black
Balance Sheet -- 1 September 19--

ASSETS		LIABILITIES	
Cash	1200 00	Acme Co.	200 00
Merchandise Inv.	2000 00	Proprietorship	
Land & Buildings	2000 00	B. Black, Capital	5000 00
Total Assets	5200 00	Total Liab. & Prop.	5200 00

Black's ledger on this date appears as follows:

Cash	
1200	

Acme Company	
	200

Merchandise Inventory	
2000	

B. Black, Capital	
	5000

Land and Buildings	
2000	

34

16 (Cont)

To increase any one of Black's asset accounts, an entry is made on the debit (left) side of the account; however, to decrease any one of the asset accounts, an entry is made on the credit (right) side of the account. To increase Black's liabilities or proprietorship, an entry is made on the credit (right) side of the account. To decrease liabilities or proprietorship, an entry is made on the debit (left) side. A graphic presentation of the above information is:

Assets	=	Liabilities	+	Proprietorship

Asset Accounts		Liability Accounts		Proprietorship Accounts	
(Debit)	Credit	(Debit)	(Credit)	(Debit)	(Credit)
+	-	-	+	-	+

Prepare "T" accounts for the Bad Smell Company using the following "Balance Sheet."

Bad Smell Company
Balance Sheet
January 31, 197*

Assets		Liabilities	
Cash	$9,000	Accts Payable	$?
Inventory	6,000	Proprietorship	9,200
Office Supplies	1,500		
Total Assets	$16,500	Total Liabilities and Proprietorship	$?

* * *

Cash	
9000	

Inventory	
6000	

Office Supplies	
1500	

Accts Payable	
	7300

Proprietorship	
	9200

Total Liabilities and Proprietorship -- $16,500

* * *

17

Establishment of accounts which will record the net increase or net decrease to proprietorship is a more intricate problem than that of recording changes in assets. It was brought out in the discussion of the income statement that when gross profit from sales or other sources exceeded expenses, a net income representing an increase in proprietorship resulted. If the reverse were true, a net loss with a decrease to proprietorship resulted. To record increases and decreases directly on the balance sheet was shown to be impractical. The method used is to total all profit and expenses and compute the net increase or net decrease to proprietorship at the end of the period by preparing the income statement. In accumulating the required information for the latter statement, it becomes necessary to establish accounts in which to record the increases and decreases to proprietorship. These accounts are termed <u>Proprietorship Accounts</u>; another acceptable title is <u>Income Statement Accounts</u>. By expanding the equation to show the effect of the accounts, the graphic presentation assumes the following form:

17

(Cont)

Assets = Liabilities + Proprietorship + (Revenue - Expense)

Asset Accounts		Liability Accounts		Proprietorship Accounts		Revenue Accounts		Expense Accounts	
+	-	-	+	-	+	-	+	+	-

The illustration above shows income as an increase to proprietorship. An entry on the credit (right) side of an income account increases the account just as a credit entry increases the proprietorship account. For example, in a mercantile business which buys and sells merchandise for a profit, sales will represent a revenue account and bear a credit entry for each sale. Expense accounts represent a decrease to proprietorship. An entry on the debit (left) side of an expense account increases the amount of the expense and thereby decreases proprietorship indirectly. For example, purchases of merchandise will be an expense which reduces total revenue because it is an element which increases Cost of Goods Sold. On the income statement, Cost of Goods Sold reduces total revenue leaving gross profit on sales. Other expense accounts must be maintained to record the cost of rent, salaries, etc., incurred during the period. These expenses will be totaled from the various expense accounts at the end of the period and will be deducted from gross profit on the income statement to determine net income or net loss for the period.

Mark the following account balances as either an increase or decrease to the Proprietorship Account. Also, state whether they are a credit or debit balance. The first one is done for you.

17

(Cont)

	Proprietorship −	Proprietorship +	Revenue −	Revenue +	Expense +	Expense −
(1) Cost of Goods Sold	Dec				Debit Bal	
(2) Sales						
(3) Rent Expense						
(4) Salary Expense						
(5) Sales Return and Allowances						

* * *

		Proprietorship		Revenue		Expense	
		-	+	-	+	+	-
(1)	Cost of Goods Sold	Dec				Debit Bal	
(2)	Sales		Inc		Credit Bal		
(3)	Rent Expense	Dec				Debit Bal	
(4)	Salary Expense	Dec				Debit Bal	
(5)	Sales Return and Allowance	Dec			Credit Bal		

* * *

18

Transactions by Black during the month of September appear below. Only the ledger accounts affected by each transaction are shown.

Black pays $50 to Acme Company to apply on his account. Cash has decreased and is credited for $50. The liability account has also decreased and is debited for $50.

Cash	
1200	50

Acme Company	
50	200

Bad Smell invests $2, 000 to start a business. Show the effects of this transaction on the accounts.

Cash	

Bad Smell, Capital	

Liability	

* * *

Cash	
$2,000	

Bad Smell, Capital	
	$2,000

* * *

19

Black purchases a showcase and counters to display his merchandise. A new asset has been acquired and an account titled "Furniture and Fixtures" is debited for the value of the asset. Because Black paid $300 in cash for the furniture and fixtures, Cash must be decreased by a credit.

Cash	
$1200	$ 50
	300

Furniture and Fixtures	
$300	

Bad Smell buys $200 of Office Supplies on account from Office Supply Company. Show the effects of this transaction on the accounts.

Office Supplies	

Cash	

Accounts Payable Office Supply Company	

* * *

Office Supplies	
$200	

Office Supply Company	
	$200

* * *

20

Black sells merchandise for $1,100 in cash. That portion of the money received which exceeds the cost of the merchandise sold represents profit. It would be possible to credit Merchandise Inventory for the cost of the merchandise sold and also credit B. Black, Capital for the amount of profit which he earned on the sale. A computation of profit or loss on each sale would be impractical because the entries required would be too numerous and too burdensome. The total amount of revenue from the sale is therefore credited to a revenue account, Sales, which accumulates all sales revenue during the period and furnishes a total sales revenue amount to be used in preparing the statement of profit and loss. Merchandise Inventory account will be adjusted for the decrease in inventory at the end of the period by a method to be discussed in a later chapter. Because of the receipt of cash, the Cash Account in this case has increased and will be debited.

Cash	
$1200	$ 50
1100	300

Sales	
	$1100

20

(Cont)

Bad Smell Company sells \$4,000 of merchandise to Harold Nice for Cash. Show the effects of this transaction on the accounts.

Cash	Accounts Receivable	Sales

* * *

Cash	
$4,000	

Sales	
	$4,000

* * *

21

Black pays $1,000 in cash for merchandise for resale. Merchandise Inventory could be debited in this case because merchandise has increased. However, it was shown in Chapter 1 that it is desirable to show purchases as a separate item in the "Cost of Goods Sold" section on the income statement. For this reason, when a purchase is made of merchandise for resale, the amount is recorded in a separate account; an expense account is established and is given the title "Purchases." Purchases represent an expense because the cost of the merchandise sold will reduce the sales profit on the income statement. An expense decreases proprietorship by showing debit. The Purchase account is debited for $1,000 showing an increase in purchases and indirectly decreasing proprietorship. Cash has decreased and is credited for $1,000.

Cash	
$1,200	$ 50
1,100	300
	1,000

Purchases	
$1,000	

Bad Smell Company bought $650 of merchandise from They Sell Company on account.

Cash	

(They Sell Co.) Account Payable	

Purchases	

* * *

Account Payable	
	$650

Purchases	
$650	

* * *

22

Black purchases office supplies worth $25 on account from the Paper Supply Company: This purchase is distinguished from the purchase made in the preceding transaction by the fact that the items purchased here are <u>not intended for resale</u> but for consumption during operation of the business. Until used, the materials represent assets and an asset account titled "Office Supplies" is established to receive them. The Office Supplies account is <u>debited</u> and the liability to the Paper Supply Company is expressed as a <u>credit</u> in the account established to show the liability.

Office Supplies	
$25	

Accounts Payable Paper Supply Company	
	$25

Bad Smell Company bought for Cash from Land Sellers $6,000 of land not intended for resale. Show the effects on the accounts.

Cash	

Account Receivable	

Land	

Purchases	

* * *

Cash			Land	
	$6000		$6000	

* * *

23

Black needs $100 for personal reasons not connected with the business. This transaction introduces a new account -- B. Black, <u>Drawings.</u> The purpose of this account is to record <u>withdrawals.</u> The Drawings account may be <u>debited</u> for merchandise, cash, or other property withdrawn as a salary allowance or in payment of the personal debts of the proprietor. The account is ultimately shown as a <u>reduction of the Capital account on the balance sheet.</u> If <u>cash is withdrawn, the Cash account is credited to</u> record the decrease in cash; if merchandise is withdrawn, the Purchases account is credited to record the decrease in merchandise.

Cash			B. Black, Drawings	
$1200	50		100	
1100	300			
	1000			
	100			

Bad Smell took $250 of Office Supplies from his company for his own personal use. Show the effects on the accounts.

Cash		Office Supplies		Sales		B. Smell, Drawings	

* * *

Office Supplies	
	$250

Bad Smell, Drawings	
$250	

* * *

24

Black pays clerk salaries for the period amounting to $150. Salaries will be an expense which decreases proprietorship. As an Expense account, Salaries will be debited while the decrease to Cash is recorded as a credit.

Cash	
1200	50
1100	300
	1000
	100
	150

Salaries	
150	

Bad Smell Company pays the monthly rental charge of $300 by check. Show the effects on the accounts.

Cash	

Merchandise	

Rent	

Proprietorship	

* * *

Cash		Rent	
	300	300	

* * *

25

THE TRIAL BALANCE.

Because the double entry system requires equal debit and credit entries, the ledger will always be in balance if the transactions are posted properly. The total debits in the ledger should always equal the total credits. This fact provides the accountant with a test to determine the accuracy of work to this point; this test is known as a "<u>Trial Balance</u>."

Define the term "Trial Balance."

* * * Shows the equality of debit and credit balances of all the accounts.

* * *

26

To add the debits in all ledger accounts and then add all the credits for comparison would be inconvenient and the resulting lists of debits and credits would be of great length. The task is simplified by adding the debits and then the credits of each individual account. The total debits of the account may then be compared with the total credits and a net debit or credit <u>balance</u> for the account can be determined. If debits exceed credits, a debit balance results; if credits exceed debits, a credit balance results. After determination of the debit or credit balance of each account in the ledger, the account titles are listed in the order of assets, liabilities, proprietorship, income, and expense on two-column paper. After each title, the respective debit or credit balance in that particular account is listed in the appropriate debit or credit money column. On completion of the listing, the debits and credits are totaled and compared. If the transactions have been recorded properly, the debits and credits will be equal.

Of the accounts listed below, state whether they have a credit or debit balance and the corresponding amount.

Cash		Land		Salary		Sales	
2000	1500	3000		600		400	650

* * *

Cash	
$500 (debit)	

Land	
$3, 000 (debit)	

Salary	
$600 (debit)	

Sales	
	$250 (credit)

* * *

27

To illustrate the trial balance, Black's ledger accounts are assembled from illustrations given in previous frames. The numbers in parentheses beside each entry in the accounts represent transactions which were explained in the previous frames. The beginning balance of an account taken from Black's balance sheet of 1 September is indicated by an asterisk beside the amount in the individual account.

Assets = Liabilities + Proprietorship + Revenue - Expense

Cash	
(*) 1200	50(1)
(3) 1100	300(2)
	1000(4)
	100(6)
	150(7)

Acme Co.	
(1) 50	200(*)

Paper Supply Co.	
	25 (5)

B. Black, Capital	
	5000(*)

B. Black, Drawings	
(6) 100	

Sales	
	1100(3)

Purchases	
(4) 1000	

Salaries	
(7) 150	

Merchandise Inventory	
(*) 2000	

Furniture and Fixutres	
(2) 300	

Land and Buildings	
(*) 2000	

Office Supplies	
(5) 25	

27

(Cont)

To prepare Black's trial balance, it is necessary to determine the net debit or credit balance of each account. The accountant determines the balance and enters the amount in small pencil figures in the explanation column on the appropriate side of the account. The pencil figures are only to facilitate listing the account balances.

Determine the balances for the above listed accounts and enter them on the appropriate debit or credit side.

* * *

Cash	
$700	

Merchandise Inventory	
$2000	

Furniture and Fixtures	
$300	

Land and Buildings	
$2000	

Office Supplies	
$25	

Acme Co.	
	$150

Paper Supply Co.	
	$25

B. Black, Capital	
	$5000

B. Black, Drawings	
$100	

Sales	
	$1100

Purchases	
$1000	

Salaries	
$150	

* * *

28

The formal preparation of Black's trial balance will appear as in Figure 4. Note that the heading is similar to that used in the balance sheet and income statement in that it includes the ________________________, ____________________, and ____________________ for which the trail balance is prepared. The trial balance is not a formal statement like the balance sheet or income statement. It is only a test of accuracy made by the accountant. The trial balance does facilitate preparation of the statements in that items and their values which will appear on the statements are summarized and listed. However, before statements may be prepared, certain adjustments must be made to determine expenses and profits for the period. These adjustments will be discussed in the next chapter.

B. Black
Trial Balance, 30 September 19--

Cash	$ 700 00	
Merchandise Inventory	2000 00	
Furniture and Fixtures	300 00	
Land and Building	2000 00	
Office Supplies	25 00	
Acme Company		$ 150 00
Paper Supply Company		25 00
B. Black, Capital		5000 00
B. Black, Drawings	100 00	
Sales		1100 00
Purchases	1000 00	
Salaries	150 00	
	$ 6275 00	$ 6275 00

Figure 4

52

* * * owner's name, title of the form, and the date * * *

29

A book of original entry called the "General Journal" is maintained to show the debit and credit resulting from each transaction and a descriptive explanation of the transaction which took place. The transaction is first recorded in general journal and at a more convenient time is posted or transferred to the particular accounts affected.

Special types of journals may be developed and used for each type of business. These special journals will be discussed in a later chapter. The simplest type of journal is one which records transactions as they occur. The act of recording the transactions in the journal is known as "Journalizing."

Define the term "Journalizing."

* * * The act of recording debits and credits in a book of original entry called the "General Journal." * * *

30

Shown below is the simplest form of a journal page with an explanation of each of the columns.

General Journal

Page 1

Date 19--	Account Titles and Explanation	LP	Debit	Credit
(1)	(2)	(3)	(4)	(5)

(1) Date Column. The year is written at the top of the column as indicated and need not be repeated except for a new year. The month is entered in the wider of the two columns for the date and need not be repeated for transactions occurring in that month. The day of the month on which the particular transaction took place will be noted for each transaction.

(2) Title Column. The titles of the accounts which are affected are written in this column. It is common practice to write the title of the account to be debited near the left border of the column and the title of the account to be credited on the second line in a position to the right as shown in Figure 5, page 50. The explanation of the transaction is written below the account titles across the breadth of the column and utilizing as many lines as necessary. Clear explanations are essential.

(3) Ledger Page or Folio Column. When posting (or transferring amounts) to the ledger accounts, the accountant records in this column the ledger account page to which the individual amount is posted. It will be remembered from the study of the ledger that a folio column exists on that form also. The page of the general journal from which the posting is being done is placed in the folio column of the ledger account page. In this manner, on glancing at any

30 (Cont)

particular amount in the ledger account, the folio column will reveal the page of the general journal from which that amount was posted. By looking at the page number written in the folio column of the general journal, it can be determined to which ledger account the particular amount was posted.

(4) Debit Column. An amount representing a debit entry is entered in this column on the same line as the title of the account which will receive the debit.

(5) Credit Column. An amount representing a credit entry is entered in this column on the same line as the title of the account which will receive the credit.

(6) Transactions having more than one debit and/or more than one credit, are called compound journal entries.

(7) The account names written in journal entries should be the exact names of the accounts as they appear in the ledger.

For what purpose is "LP" used on the General Journal?

JOURNAL

Page 1

Date 19--		Account Titles and Explanation	LP	Debit	Credit
Sep	1	Cash		1200 00	
		Merchandise Inventory		2000 00	
		Land and Building		2000 00	
		Acme Company			200 00
		B. Black, Capital			5000 00
		Invested cash, merchandise, and property in a retail hardware business.			
	2	Acme Company		50 00	
		Cash			50 00
		Paid on account with Acme Company			
	3	Furniture and Fixtures		300 00	
		Cash			300 00
		Purchased showcase and counters for cash			
	4	Cash		1100 00	
		Sales			1100 00
		Sold merchandise for cash			
	5	Purchases		1000 00	
		Cash			1000 00
		Purchased merchandise for cash			
	6	Office Supplies		25 00	
		Paper Supply Company			25 00
		Purchased typing paper on account			
	7	B. Black, Drawings,		100 00	
		Cash			100 00
		Withdrew cash for personal use			
	8	Salaries		150 00	
		Cash			150 00
		Paid clerk salaries for period			

Figure 5

31

To illustrate "journalizing," assume Black opened his business on 1 September purchasing the assets and incurring the liabilities as they appear on his balance sheet of that date (Frame 16). Black's general journal would receive the first entry in any of Black's records. Subsequent transactions would be journalized in chronological order as they occurred and Black's journal would appear as shown in Figure 5, page 50. Note that the folio column is blank because it is assumed that posting of the entries to the ledger has not taken place.

In posting Black's journal entries to the ledger accounts, the process is accomplished step by step. Each account affected is located in the ledger. The amount is entered on the debit or credit side of the account as the journal entry dictates. The journal page number from which the posting is done is entered in the account's folio column. The ledger page number to which each account is posted is entered in the journal's folio column. This process is repeated for each entry on the journal until the ledger accounts contain the information found in the journal.

Using the General Journal illustration, page 50, journalize in the General Journal below Bad Smell Company transactions of Frames 18, 19 and 20. Use Oct 1, 197* as the date for the preceding transactions.

Journal Page 1

Date	Explanation	LP	Debit	Credit
Oct 1 197*				

* * *	Oct 1, 197*	Cash	2,000	
		Bad Smell Capital		2,000
		Invest Cash in Business		
	1	Office Supplies	200	
		Office Supplies Co.		200
		Purchased Office Supplies on account		
	1.	Cash	4,000	
		Sales		4,000
		Sold Merchandise for Cash		
				* * *

58

CHAPTER 3

THE WORKSHEET, ADJUSTING AND CLOSING ENTRIES

32

GENERAL. Because transactions do not always coincide with the accounting period, it often becomes necessary to adjust the value of some asset and expense accounts to reflect their actual value at the end of the period. For example, store supplies purchased for consumption during the period are considered assets until used. If at the end of the period an inventory of store supplies reveals that half of the stock has been consumed, the consumed portion must be removed from the asset account and placed in an expense account. The result of such an entry in the ledgers would be a reduction of an asset (credit) to its actual value as determined by an end-of-period inventory and establishment of an expense account (debit) to record the cost of the store supplies used during the period. Further, the value of the Merchandise Inventory account has changed during the period because of sales and purchases. This asset account was not affected during the period. The inventory of merchandise taken at the end of the period is the true value to be reflected on the statements and it becomes necessary to adjust the old merchandise account to reflect the new value.

33

ADJUSTING PREPAID ACCOUNTS. Commodities and services purchased for use in the operation of a business are assets until used. Though these assets are gradually consumed, daily decreases are not recorded in the account. As a result, the account is not stated at the correct amount at the end of the period. The amount in the account represents part asset and part expense. For this reason, such an account is called a "mixed account." An adjusting entry is necessary to adjust the value of the account to the amount determined by an end-of-period inventory.

Define the term "mixed account."

---

* * * The amount in an asset account that is partly an asset and the remaining portion an expense. * * *

34

Listed in the following frames are explanations and examples of some mixed accounts. Though all types of such accounts are not listed, the principle of adjustment remains the same.

Store Supplies. At the end of the period and before statements are prepared, an inventory of store supplies on hand is made. The difference between the inventory amount and the value of the account represents the amount of supplies used in the conduct of operations. For example, store supplies on hand at the start of the period were worth $50. The end-of-period inventory of store supplies revealed only $10 worth on hand. Store supplies worth $40 must have been used during the period. Put the required adjustment in the form of a journal entry.

Store Supplies	
$50	

Store Supplies Expense	$40	
Store Supplies		$40
To record store supplies used as an expense		

Store Supplies	
$50	$40

Store Supplies Expense	
$40	

34

(Cont)

The Store Supplies account now contains a net debit balance of $10 which is the amount determined by the inventory. The expense incurred by use of store supplies is recorded in an expense account. Office supplies are adjusted in the same manner as store supplies.

Journalize and post the following adjustment: Store Supplies at the beginning of the period is $200 and the ending inventory count is $195.

* * * Store Supplies Expense $5
Store Supplies $5

Store Supplies	
$200	$5

Store Supplies Expense	
$5	

* * *

35

<u>Prepaid Rent.</u> Rent paid in advance is carried as an expense if the rent paid is only for the period covered.

Rent	XXX	
Cash		XXX

Paid rent for the period.

Cash	
	XXX

Rent	
XXX	

36

If the rent paid in advance covers more than the current period, a residual amount at the end of the period appears as an asset and the expired portion is recorded as an expense. Assuming prepaid rent of $300 covers a 6-month period and records are on a monthly basis, an adjustment is necessary to record one-sixth of the prepaid rent as an expense.

Prepaid Rent

$300	

Rent Expense	$50.00	
Prepaid Rent		$50.00
To record 1/6 of prepaid rent as an expense of the current period		

Prepaid Rent

$300	$50

Rent Expense

$50	

61

36 (Cont)

Note in the illustration above that the Prepaid Rent account now has a $250 debit balance representing the correct value of the asset. After six months' time, the Prepaid Rent account will be completely balanced out while expenses have been recorded in each period as they were incurred.

Journalize and post the following adjustment: Prepaid Rent has a $600 balance, but only 1/5 of the amount applies to this period.

Prepaid Rent	
$600	

* * *	Rent Expense	$120	
	Prepaid Rent		$120

Prepaid Rent	
$600	$120

Rent Expense	
$120	

* * *

37

Insurance and similar items which are likely to be paid in advance are adjusted in the same way as the illustrations in the previous frames. When it is definitely determined at time of purchase that the entire amount of the item will be consumed during the period and no portion will remain as an asset at the end of the period, it is usually better practice to debit an expense account rather than an asset account. This will avoid making an adjustment at the end of the period. For example, if insurance was paid for a 2-week period, this amount would be an expense at the end of the month. Rather than record the purchase of insurance as prepaid insurance (an asset), record it immediately as insurance expense.

Journalize and post the following adjustment. Prepaid Insurance balance is $400, but the amount of the expense for this period is only 1/4 of the balance.

Prepaid Insurance	
$400	

* * *

Prepaid Insurance	
$400	$100

Insurance Expense	
$100	

Insurance Expense	$100	
Prepaid Insurance		$100

* * *

---

38 ADJUSTING MERCHANDISE INVENTORY.

a. As was observed in Chapter 2, the merchandise account is not credited for sales nor is it debited for purchases of merchandise intended for resale. The account shows the same amount at the end of the period as it did at the start of the period. This amount represents a cost of merchandise on hand at the beginning of the period. At the end of the period, it becomes necessary to adjust the Merchandise Inventory account to the value determined by the ending inventory.

b. If no purchases of merchandise are made during the period, the total difference between the beginning inventory and the ending inventory will represent the Cost of Goods Sold.

Sales		$1,000
Less Cost of Goods Sold		
Merchandise Inventory, 1 July	$700	
Merchandise Inventory, 31 July	100	
Cost of Goods Sold		600
Gross Profit on Sales		$ 400

The problem of adjustment is one of replacing the old Merchandise Inventory account balance with a new one. The Merchandise Inventory account has a $700 debit balance and is credited for $700 to remove the balance. The debit in this entry will be to an account which is established for summarization of income and expense accounts. This new account is titled "Profit and Loss Summary" and will be

38 (Cont)

discussed in more detail later in this chapter. The accounts and entry will appear as follows:

Merchandise Inventory	
$700	

Income Summary	$700.00	
Merchandise Inventory		$700.00
To transfer the inventory of 1 July to the Income Summary		

Merchandise Inventory		Income Summary	
$700	$700	$700	

The Merchandise Inventory account is now balanced out. The value of the merchandise on hand at the end of the period as determined by physical inventory must be <u>debited</u> to the merchandise account. The off-setting credit will be made to the Income Summary account. The accounts and entry will appear as follows:

Merchandise Inventory		Income Summary	
$700	$700	$700	

Merchandise Inventory	$100.00	
Income Summary		$100.00
To transfer the inventory of 31 July to the Merchandise Inventory account		

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38

(Cont)

Merchandise Inventory	
$700	$700
100	

Income Summary	
$700	$100

The Merchandise Inventory account now shows the correct balance to enter on the statements and the Income Summary account shows a debit balance of $600 - the Cost of Goods Sold. It will be seen later that the Income Summary account will receive all the <u>income</u> and <u>expense</u> accounts which appear on the income statement.

Journalize and post the transaction pertaining to the Merchandise Account based on the following information: the beginning balance is $6,000 and the ending balance is $4,000.

Merchandise Inventory	
$6,000	

Income Summary	

* * *

Income Summary	$6,000	
Merchandise Inventory		$6,000
Merchandise Inventory	4,000	
Income Summary		4,000

Merchandise Inventory		Income Summary	
$6,000	$6,000	$6,000	$4,000
4,000			

39 THE WORKSHEET.

a. The worksheet is merely an extension of the trail balance. The trail balance was described as a tool which the accountant employed to test the accuracy of debits and credits. The worksheet is a tool the accountant uses to summarize the information which will appear on the statements. By use of the worksheet, the accountant can be assured that values of items found on the statements are correct before actual preparation of the statements is undertaken.

b. The worksheet consists of 10-column paper with account titles and folio columns found on the extreme left (refer to Figure 6, page 66).

(1) The first two money columns are the trail balance totals columns. This is merely a result of entering the previously prepared trial balance.

(2) The second pair of columns are the adjustments columns used to record the adjustments discussed in the previous frames. All year-end adjustments will be entered into these columns in "debit" and "credit" form.

39 (Cont)

(3) All adjustments will be entered in the Account Columns below the trial balance totals. New accounts will show both the debit and credit adjustments, below the trial balance, whereas adjustments to existing accounts will show one adjustment directly to the affected account, and the other to the related accrual account listed below the trial balance.

(4) The third pair of columns pertain to adjusted trial balance. The amounts in the original trial balance are combined with the adjustments and are entered in the adjusted trial balance columns.

(5 The fourth pair of columns contain the revenue and expense items which will appear on the income statement. This column will be derived by transferring the revenue and expense items in the adjusted trial balance to the income statement columns. Revenue amounts will appear in the right-hand (credit) column and expenses will appear in the left-hand (debit) column. When totaled, the difference between the debit and credit columns will indicate the net income or net loss for the period. If the credit column which contains revenue items exceeds the debit column with its expense items, a net income has resulted. If the reverse is true, a net loss has resulted.

(6) The fifth pair of columns contains the assets, liabilities, and proprietorship. The net income or net loss determined in the income statement columns is carried to the balance sheet columns. A net income representing an increase in proprietorship is carried to the credit column. A net loss representing a decrease in proprietorship is carried to the debit column. The net income or net loss amount causes the balance sheet columns to equal.

Worksheet
30 September 19--

Account	LP	Trial Balance Debit	Trial Balance Credit	Adjustments Debit	Adjustments Credit	Adjusted Trial Balance Debit	Adjusted Trial Balance Credit	Income Statement Debit	Income Statement Credit
Cash	1	70000				70000			
Merchandise Inventory	2	200000		(b) 230000	(a) 200000	230000			
Furniture & Fixtures	3	30000				30000			
Land & Building	4	200000				200000			
Office Supplies	5	2500			(c) 1000	1500			
Acme Company	6		15000				15000		
Paper Supply Company	7		2500				2500		
B. Black, Capital	8		500000				500000		
B. Black, Drawings	9	10000				10000			
Sales	10		[illegible]0000				110000		11[illegible]
Purchases	11	100000				100000		100000	
Salaries	12	15000				15000		15000	
		62[illegible]	627500						
Income Summary	13			(a) 200000	(b) 230000	200000	230000	200000	23[illegible]
Office Supplies Expense	14			(c) 1000		1000		1000	
				431000	431000	857500	857500	316000	34[illegible]
Net Income								24000	
								340000	34[illegible]

Figure 6

B. Black
Worksheet
30 September 19--

LF	Trial Balance Debit	Trial Balance Credit	Adjustments Debit	Adjustments Credit	Adjusted Trial Balance Debit	Adjusted Trial Balance Credit	Income Statement Debit	Income Statement Credit	Balance Sheet Debit	Balance Sheet Credit
1	70000				70000				70000	
2	200000		(b) 230000	(a) 200000	230000				230000	
3	30000				30000				30000	
4	200000				200000				200000	
5	2500			(c) 1000	1500				1500	
6		15000				15000				15000
7		2500				2500				2500
8		500000				500000				500000
9	10000				10000				10000	
10		110000				110000		110000		
11	100000				100000		100000			
12	15000				15000		15000			
	627500	627500								
13			(a) 200000	(b) 230000	200000	230000	200000	230000		
14			(c) 1000		1000		1000			
			431000	431000	857500	857500	316000	340000	541500	517500
							24000			24000
							340000	340000	541500	541500

Figure 6

40

a. The worksheet is prepared and employed before adjusting entries. The reason for this is that the adjusting entries may be made in the adjustment columns and the information for the statements summarized prior to entry in any records. Errors discovered during the preparation of the worksheet may then be corrected before additional erroneous entries are made. The worksheet is not a formal report and may be prepared in pencil.

b. Figure 6 shows the work papers of B. Black dated 30 September 19--. The explanations below apply to the entries found on the work papers in the figure.

(1) The trail balance, as it appeared in Figure 6, is a list of the debits and credits appearing in the respective money columns. Note that the folio column bears account page numbers. These numbers have not appeared in previous illustrations but are introduced now for subsequent illustration of their use in cross referencing.

(2) Adjustments are made in the adjustments columns. Related entries bear a letter in parentheses similar to the explanation of the adjusting entry found below.

(a) The merchandise inventory of 1 September 19-- must be removed from the Merchandise Inventory account by a credit. The debit entry is made in the Income Summary account. This is normally the first adjusting entry which will be made.

(b) A physcial inventory of 30 September 19-- reveals $2, 300 worth of merchandise inventory on hand. Since this amount represents the current value of the merchandise inventory, the Merchandise Inventory account is debited for $2, 300 and the credit is to the Income Summary account.

(c) A physical inventory of office supplies on 30 September 19-- shows $15 worth of supplies remaining on hand. This amount indicates a reduction in the Office Supplies account totaling $10 (1 September balance of $25 minus 30 September balance of $15). The $10 worth of office supplies

40 (Cont)

was consumed during operations of the business and necessitates an adjusting entry crediting the Office Supplies account for $10 and debiting a newly opened expense account, Office Supplies Expense for $10. This adjusting entry establishes a debit balance in the Office Supplies account totaling $15, the value of the 30 September inventory. The entry also establishes an expense account showing a debit balance of $10 which will decrease proprietorship by being a deduction from gross sales income on the income statement.

(d) The adjustments columns are totaled to determine equality of debits and credits.

(3) The amounts in the trial balance columns are combined with the amount in the adjustments columns and carried over to the adjusted trial balance columns. These columns are totaled again as a test for equality of debits and credits. This check provides insurance against transposition errors which might occur in carrying the figures from the trial balance and adjustments columns. A transposition is the erroneous rearrangement of digits, such as writing $542 as $452 or $524.

(4) Income and expense items which will appear on the income statement are entered in the respective debit and credit columns headed Income Statement. In tracing these amounts, observe that:

(a) Sales of $1,100 appear in the credit column representing an increase to Proprietorship.

(b) Purchases of $1,000 appear in the debit column representing a decrease in Proprietorship. Remember that purchases appear in the Cost of Goods Sold section which reduces sales income on the income statement.

75

40

(Cont)

(c) Salaries paid for the month are expenses which decrease Proprietorship and are deducted from gross income on the income statement. Because Salaries is an expense account, the entry is made on the debit side.

(d) The beginning inventory of merchandise is carried to the debit column while the ending inventory is carried to the credit column. This has the same effect as computation of Cost of Goods Sold. The beginning inventory ($2, 000) and purchases ($1, 000) are in the debit column while the ending inventory ($2, 300) is in the credit column. The net balance ($700) is in the debit column where it will be a deduction from sales.

(e) The credit column total exceeds the debit column total by $240. This balancing figure is placed in the debit column to force both column totals to be equal. Since the credit (revenue) column exceeds the debit (expense) column, an increase in Proprietorship is indicated. The balancing figure ($240) is net income and the title is written under the account titles on the extreme left of the worksheet.

(5) Assets, Liabilities, and Proprietorship are carried from the adjusted trial balance columns to the balance sheet columns. Observe the following values in the balance sheet columns.

(a) B. Black, Capital is carried to the credit column where it represents Proprietorship. B. Black, Drawings is carried to the debit column to illustrate a decrease in the Capital account. On the Balance Sheet, B. Black, Drawings are deducted from B. Black, Capital in the Proprietorship section (Figure 7).

(b) Net income represents an increase in Proprietorship and is taken from the debit income statement column to the credit balance sheet column which, in effect, is the same as adding the income directly to Proprietorship.

40

(Cont)

(6) When all information has been entered on the worksheet, the entries in the adjustments columns provide a guide for recording the adjusting entries in the journal and preparing the financial statements. Black's adjusting entries would be entered in the journal as follows:

Journal

Page 2

Date 19--		Account Titles and Explanation	LP	Debit	Credit
		Adjusting Entries			
Sep	30	Income Summary	13	200000	
		Merchandise Inventory	2		200000
		To remove the beginning inventory			
		from the Merchandise Inventory account.			
	30	Merchandise Inventory	2	230000	
		Income Summary	13		230000
		To enter the ending inventory in the			
		Merchandise Inventory account.			
	30	Office Supplies Expense	14	1000	
		Office Supplies	5		1000
		To record the expense of Office			
		Supplies used during the period			

In the above illustration, note the account numbers in the folio column indicating the journal entries have been posted to the respective accounts. The ledger accounts now appear as:

Cash (1)		Merchandise Inventory (2)		Furniture and Fixtures (3)	
1200	50	2000	2000 J2	300	
1100	300	J2 2300			
	1000				
	100				
	150				

40

(cont)

Land and Building (4)

2000	

Office Supplies (5)

25	10 J2

Acme Co. (6)

50	200

Paper Supply Company (7)

	25

B. Black, Capital (8)

	5000

B. Black, Drawings (9)

100	

Sales (10)

	1100

Purchases (11)

1000	

Salaries (12)

150	

Income Summary (13)

J2 2000	2300 J2

Office Supplies Expense (14)

J2 10	

(cont on next page)

10 (Cont) The trial balance of the ledger of Appliance Repair Shop at the end of its annual accounting period carried the following amounts:

APPLIANCE REPAIR SHOP

Trial Balance

December 31, 197*

Cash	1,125	
Prepaid Insurance	215	
Repair Supplies	1,550	
Repair Equipment	4,220	
Ajax Supply Company		250
Dale Howard, Capital		4,545
Dale Howard, Withdrawals	5,200	
Revenue from Repairs		13,475
Wages Expense	4,775	
Rent Expense	960	
Advertising Expense	225	
Totals	18,270	18,270

On a scratch sheet of paper draw a worksheet as illustrated in Figure 6, page 66. Enter the trial balance amounts in the Trial Balance columns of the worksheet and complete the worksheet using the following information:

a. $165 of insurance used for this period.

b. Repair supplies inventory was counted and only $380 was on hand.

(Answer on page 151)

41 CLOSING ENTRIES.

a. The ledger account balances shown on page 66 are those which appear on Black's statements with one exception. The balance in Black's Capital account, page 66 does not bear the same balance as shown in the Proprietorship section of Black's Balance Sheet (Figure 7, page 74). The reason for this difference is that increases and decreases in Proprietorship were entered in income and expense accounts (Sales, Purchases, and Office Supplies Expense) rather than in the permanent Proprietorship accounts. To show Black's Proprietorship at the current date and to clear the income and expense accounts from the books, it is necessary to transfer the effect of increases and decreases in Proprietorship (the net profit of $240 in this case) to Black's Capital account. The entries required to accomplish the above are referred to as Closing Entries.

b. The purpose of the Income Summary account is to summarize revenue and expenses at the end of the period. Since revenue and expense accounts represent increases and decreases in Proprietorship relative to only the current period's operations, it is desirable that these accounts be balanced out in the ledger to preclude subsequent confusion with similar entries applicable to later period.

Define the term Closing Entries.

B. Black
Income Statement
For Period Ended 30 September 19--

Sales		$ 1100 00
Cost of Goods Sold:		
Merchandise Inventory, 1 September	$ 2000 00	
Purchases	1000 00	
Merchandise Available for Sale	3000 00	
Merchandise Inventory, 30 September	2300 00	
Cost of Goods Sold		700 00
Gross Profit on Sales		$ 400 00
Expenses		
Selling Expenses:		
Salaries	$ 150 00	
General Expenses:		
Office Supplies Expense	10 00	
Total Expenses		160 00
Net Income		$ 240 00

B. Black
Balance Sheet
30 September 19--

ASSETS			LIABILITIES & PROPRIETORSHIP		
Current Assets:			Current Liabilities:		
Cash		$ 700 00	Acme Company		$ 150 00
Mdse Inventory		2300 00	Paper Supply Co.		25 00
Office Supplies		15 00	Total Current Liab.		$ 175 00
Total Current Assets		$ 3015 00	Proprietorship:		
Fixed Assets:			B. Black, Cap. 1 Sep	$ 5000 00	
Furniture & Fixtures	$ 300 00		Earnings, Sep $ 240 00		
Land & Building	2000 00		Less: Withdrwl 100 00	140 00	
Total Fixed Assets		2300 00	Capital, 30 Sep		5140 00
			Total Liab. and		
Total Assets		$ 5315 00	Proprietorship		$ 5315 00

Figure 7

* * * The process of transferring the
to the capital account. * * *

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The Income Summary account at this point bears two entries made during adjustment of the accounts. The debit entry represents the beginning inventory while the credit entry represents the ending inventory. In the process of closing the revenue and expense accounts into the Income Summary account, revenue items will be credited to the account and expense items will be debited to the account. To illustrate, below are the revenue and expense accounts of B. Black and necessary closing entries.

Sales (10)		Purchases (11)		Salaries (12)	
	1100	1000		150	

Office Supplies Expense (14)	
10	

Journal

Page 3

Date		ACCOUNT TITLES AND EXPLANATION	LP	Debit	Credit
19--		Closing Entries			
Sep	30	Sales	10	1100 00	
		Income Summary	13		1100 00
		To close Sales Income			
	30	Income Summary	13	1000 00	
		Purchases	11		1000 00
		To close Purchases Expense			
	30	Income Summary	13	150 00	
		Salaries	12		150 00
		To close Salaries Expense			
	30	Income Summary	13	10 00	
		Office Supplies Expense	14		10 00
		To close Office Supplies Expense			

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(Cont)

(1) To close Sales, the account is debited and Income Summary is credited by the closing journal entry.

(2) To close the expense accounts (Purchases, Salaries, and Office Supplies Expense) each is credited and the Income Summary account is debited by the closing journal entry.

Journalize the closing entries for the following account balances:

Revenue from Repairs	
	4000

Purchases	
2000	

Rent	
450	

Wages	
680	

* * * Revenue from Repairs 4,000
Income Summary 4,000

Revenue from Repairs	4,000	
Income Summary		4,000
Income Summary	2,000	
Purchases		2,000
Income Summary	450	
Rent Expense		450
Income Summary	680	
Wage Expense		680

43

The income and expense accounts with the Profit and Loss Summary account are shown below after the closing entries have been posted.

Income Summary (13)

2000	2300
J3 1000	1100 J3
J3 150	
3 10	

Sales (10)

1100	1100 J3

Purchases (11)

1000	00 J3

Salaries (12)

150	150 J3

Office Supplies Expense (14)

10	10 J3

Note from the above illustration that the net credit balance of the Income Summary account is equal to the net income for the period - $240.

From the journalizing of the closing entries on page 76, post them to the accounts as in the illustration above.

* * *

Income Summary

2000	4000
450	
680	

Revenue from Repairs

4000	4000

Purchases

2000	2000

Rent

450	450

Wages

680	680

* * *

44

The net result of business operations must now be transferred to the Proprietor's Drawings account. The balance of the Drawings account will then be transferred to the Capital account to show the Proprietor's interest in the business at the start of a new period of operations. This is accomplished by debiting Income Summary for the amount of net income which will balance out the account. The credit is to the Proprietor's Drawings Account. The closing entry for Black is journalized as follows:

Journal

Page 3

19--		Closing Entries (Cont'd)	LP		
Sep	30	Income Summary	13	240 00	
		B. Black, Drawings	9		240 00
		To transfer Net Income for period to			
		Proprietor's Drawings account			

Income Summary (13)

2000	2300
1000	1100
150	
10	
240	
3400	3400

B. Black, Drawings (9)

100	240

44

(Cont)

Journalize the following closing entry for clearing the Income Summary.

Income Summary	
1000	600

Drawings	
300	

* * * Drawings 400
Income Summary 400

Income Summary	
1000	600
	400

Drawings	
300	
400	

* * *

45

The balance of the Drawings account is now transferred to the Proprietor's Capital account with the following journal entry:

Journal

Page 3

19--		Closing Entries (Cont'd)	LP	Debit	Credit
Sep	30	B. Black, Drawings	9	140 00	
		B. Black, Capital	8		140 00
		To transfer the Net Increase in			
		Proprietorship for the period to			
		Proprietor's Capital account			

B. Black, Capital (8)	
	5000
	140

B. Black, Drawings (9)	
100	240
140	
240	240

It can be seen that after this final closing entry, the Proprietor's account balance is in agreement with the amount shown on the Balance Sheet in Figure 7, page 74. The revenue and expense accounts, Income Summary account, and the Proprietor's Drawings account all have a zero balance and are prepared to receive new amounts relative to operations in the new period.

45 (Cont)

Using the account balances of frame 44, close out the Drawing account to the Capital account.

Drawing	
700	

Capital	
	3000

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* * *

Capital	700	
Drawings		700

Drawing	
700	700

Capital	
700	3000

* * *

46

POST CLOSING TRIAL BALANCE. A Post Closing Trial Balance is the test made to assure that debit-credit equality has been maintained in the ledger throughout the adjusting, closing and balancing processes. The balances of accounts remaining open represent the Assets and the Liabilities and Proprietorship of the business. When the debits and credits have proven to be equal, the accounts are ready for the next period's entries.

Define the Post Closing Trial Balance.

* * * To assure the debit and credit equality has been maintained in the ledger throughout the adjusting, closing, and balancing process.

47

The Post Closing Trial Balance of B. Black will consist of a listing of open accounts with their balances. In preparing for the Post Closing Trial Balance, all debits and credits in each account are totaled. If no balance exists, a double line is drawn under the debit and credit totals to signify that the last entry for the current period is above the double line. If a balance exists, the balancing figure is written in the debit or credit column of the account with the word "Balance" written in the explanation column. The debits and credits are totaled and double lines are drawn below the totals.

Each account which bears a balancing figure is listed as in previous Trial Balances with the balancing amount appearing in the debit or credit column of the Trial Balance as appropriate.

B. Black's completed ledger in formal account form and his Post Closing Trial Balance for September appear on pages 87, 88, 89 and 90.

TRUE or FALSE: All of the accounts in the ledger are listed on the Post Closing Trial Balance.

90

* * * * False * * *

48

THE ACCOUNTING CYCLE.

a. The accounting procedure from the original entries to the Post Closing Trial Balance has been discussed in sequence. This sequence of procedure is known as the <u>accounting cycle.</u>

b. A summary of the procedures is:

(1) <u>Journalizing.</u> Transactions were entered in the general journal with an explanation. The date of each transaction was noted and the folio column was left blank until the amounts were transferred to the ledger accounts.

(2) <u>Posting.</u> Amounts were taken from the journal and entered in the individual accounts of the ledger. The journal page number was posted to the folio column of the ledger. At the same time, the account page number was posted to the folio column of the journal indicating to the bookkeeper that the amount had been posted and where it was posted.

(3) <u>Trial Balance Worksheet.</u> A test was made to determine equality of debits and credits. The debits and credits in each account were totaled lightly in pencil. A balance for each account was determined. A listing of accounts with their respective debit or credit balances was made and the debit column and credit column of the Trial Balance were totaled. To bring the uncurrent accounts up to date, adjustments were made on the worksheet recording the expense of expended assets and the current balance of merchandise on hand as determined by the end-of-period inventory. After the adjusting entries, the Trial Balance amounts were combined with the adjusting entry amounts and an Adjusted Trial Balance appeared on the worksheet. From the Adjusted Trial Balance, the information was further classified in income statement columns and balance sheet columns.

48
(Cont)

(4) Statements. The Income Statement and Balance Sheet were prepared from information contained in the worksheet.

(5) Journalizing and Posting the Adjusting Entries. The adjusting entries that appeared on the worksheet were entered in the general journal and posted to the ledger accounts.

(6) Closing Entries. The revenue and expense accounts were transferred to the Income Summary account. This account revealed a balance equal to the income for the period which was closed to the Drawings account. The Income Summary account was then in balance and closed out. The balance of the Drawings account was closed to the Capital account.

(7) Post Closing Trial Balance. This Trial Balance was made to prove the equality of debit and credit balances in the accounts remaining open after closing entries had been posted.

List the seven stages of the accounting cycle.

* * * 1. Journalizing

2. Posting

3. Worksheet

4. Statements

5. Adjusting Entries

6. Closing Entries

7. Post Closing Trial Balance * * *

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Cash

Page 1

Date		Item	P.R.	Debit	Date		Item	P.R.	Credit
19--					19--				
Sep	1		J1	1200 00	Sep	2		J1	50 00
	4		J1	1100 00		3		J1	300 00
						5		J1	1000 00
						7		J1	100 00
						8		J1	150 00
							Balance	✓	700 00
				2300 00					2300 00
Oct	1	Balance	✓	700 00					

Merchandise Inventory

Page 2

Date		Item	P.R.	Debit	Date		Item	P.R.	Credit
19--					19--				
Sep	1		J1	2000 00	Sep	30	Adjusting	J2	2000 00
	30	Adjusting	J2	2300 00			Balance	✓	2300 00
				4300 00					4300 00
Oct	1	Balance	✓	2300 00					

Furniture and Fixtures

Page 3

Date		Item	P.R.	Debit	Date		Item	P.R.	Credit
19--					19--				
Sep	3		J1	300 00			Balance	✓	300 00
Oct	1	Balance	✓	300 00					

Land and Building

Page 4

Date		Item	P.R.	Debit	Date		Item	P.R.	Credit
19--					19--				
Sep	1		J1	2000 00			Balance	✓	2000 00
Oct	1	Balance	✓	2000 00					

Office Supplies

Page 5

Date		Item	Ref.	Debit	Date		Item	Ref.	Credit
19--					19--				
Sep	6		J1	2500	Sep	30	Adjusting	J2	1000
							Balance	✓	1500
				2500					2500
Oct	1	Balance	✓	1500					

Acme Company

Page 6

Date		Item	Ref.	Debit	Date		Item	Ref.	Credit
19--					19--				
Sep	2		J1	5000	Sep	1		J1	20000
		Balance	✓	15000					
				20000					20000
					Oct	1	Balance	✓	15000

Paper Supply Company

Page 7

Date		Item	Ref.	Debit	Date		Item	Ref.	Credit
19--					19--				
	[illegible]	Balance	✓	2500	Sep	6		J1	2500
					Oct	1	Balance	✓	2500

B. Black, Capital

Page 8

Date		Item	Ref.	Debit	Date		Item	Ref.	Credit
19--					19--				
		Balance	✓	514000	Sep	1		J1	[illegible]
				514000				J3	[illegible]
									[illegible]
					Oct	1	Balance	✓	514000

B. Black, Drawings

Page 9

Date		Explanation	Ref.	Debit	Date		Explanation	Ref.	Credit
19--					19--				
Sep	7		J1	100 00	Sep	30	Closing	J3	240 00
	30	Closing	J3	140 00					
				240 00					240 00

Sales

Page 10

Date		Explanation	Ref.	Debit	Date		Explanation	Ref.	Credit
19--					19--				
Sep	30	Closing	J3	1100 00	Sep	4		J1	1100 00

Purchases

Page 11

Date		Explanation	Ref.	Debit	Date		Explanation	Ref.	Credit
19--					19--				
Sep	5		J1	1000 00	Sep	30	Closing	J3	1000 00

Salaries

Page 12

Date		Explanation	Ref.	Debit	Date		Explanation	Ref.	Credit
19--					19--				
Sep	8		J1	150 00	Sep	30		J3	150 00

Income Summary

Page 13

Date		Explanation	Ref.	Debit	Date		Explanation	Ref.	Credit
19--					19--				
Sep	30	Adjusting	J2	2000 00	Sep	30	Adjusting	J2	2300 00
	30	Closing	J3	1000 00		30	Closing	J3	1100 00
	30		J3	150 00					
	30		J3	10 00					
	30		J3	240 00					
				3400 00					3400 00

Office Supplies Expense

19--					19--				
Sep	30	Adjusting	J2	1000	Sep	30	Closing	J3	1000

B. Black
Post Closing Trial Balance
30 September 19--

Cash	1	70000	
Merchandise Inventory	2	230000	
Furniture and Fixtures	3	30000	
Land and Building	4	200000	
Office Supplies	5	1500	
Acme Company	6		15000
Paper Supply Company	7		2500
B. Black, Capital	8		514000
		531500	531500

In the illustration above, note the following:

1. The revenue and expense accounts are "closed out" by the closing entries with no balancing figure required.

2. A single line is drawn across the money column only when footing the column while double lines are drawn across all columns (except the explanation column) when the account has been balanced.

3. The balancing figure is carried to the next line below the double lines and given the first date in the succeeding period.

4. The accounts with one debit and one credit which are equal are not totaled but are designated as closed accounts by drawing double lines immediately below the entries. When it is not readily apparent that the total debits and total credits in an account are equal, the columns must be totaled before double lines may be drawn.

CHAPTER 4

DEPRECIATION, BAD DEBTS, ACCRUED AND DEFERRED ITEMS

49

DEPRECIATION. In the operation of a business, some assets are purchased for resale and some for consumption. While certain assets (store and office supplies) are actually consumed during operations, other assets are of a more permanent nature and do not change in quantity. Such permanent type assets are called fixed assets. In order to consider all costs in the determination of net income, a portion of the total cost of a fixed asset should be charged to each income period. The assigning of the costs of fixed assets to income periods is called depreciation.

Which one of the following assets will probably be depreciated?

a. Cash

b. Inventory

c. Machinery

d. Land

98

* * * c. Machinery * * *

50

The depreciation must be recorded as an expense of the period just as supplies become expenses of the period in which consumed. For example, assume a delivery truck purchased for \$3,600 is estimated to have a life of 3 years. Annual depreciation would be \$1,200 (3600 ÷ 3) and monthly depreciation would be \$100 (1200 ÷ 12). The depreciation expense of \$100 for a month's operation of the truck is recorded as an expense against any profits made during that month's business.

A machine purchased for \$6,000 is estimated to have a useful life of 10 years. What is the amount of depreciation that will be charged monthly?

---

(99)

* * * $\$6,000 \div 10 = 600 \div 12 = \$50$ monthly * * *

51

One might record the expense by crediting the Asset, Delivery Truck, and debiting the Expense, Depreciation. However, this entry would be impractical because the depreciation rate is based on an estimated truck life of three years. It may become necessary to adjust the Depreciation Expense and the Asset if the truck actually lasts four or five years. Also, by decreasing the asset account, the initial cost of the fixed asset will become lost to sight as entries are made and the account is carried forward to new pages. Because it is desirable to show the original value of an asset and the amount of depreciation of that asset charged to Expense, two accounts must be maintained for each fixed asset. One account will record the cost of the fixed asset and the second will show the accumulated depreciation against the asset. A third account will be used to record the expense of depreciation.

For example, assume the truck mentioned above appears in a Fixed Asset account as:

Delivery Truck	
3600	

At the end of a month's operations, the expense of depreciation on the truck must be recorded as a charge against profits. The expense is debited to an expense account titled Depreciation and the decrease in value of the asset is recorded as a credit to an account titled Allowance for Depreciation of Delivery Truck. This journal entry appears as:

Depreciation Expense	$100	
Allowance for Depreciation of Delivery Truck		$100

To record estimated depreciation of Delivery Truck for one month.

51

(Cont)

The accounts, when posted, will appear as:

Allowance for Depreciation	
	100

Depreciation Expense	
100	

Delivery Truck	
3600	

The Allowance for Depreciation will remain in the records as long as the asset is owned. The Depreciation Expense account will be closed to the Income Summary account just as other expenses are closed.

Journalize and post the machine depreciation for one month mentioned in frame 50.

Machine	
6000	

* * * Depreciation Expense $50
Allowance for Depreciation, Machine $50

Machine	
6000	

Depreciation Expense	
50	

Allowance for Depr	
	50

* * *

52

When depreciation has been estimated exactly, the Allowance for Depreciation account will have the same balance as the asset account on the date the asset becomes completely worn out and worthless. The worthless asset will be discarded and written off the books by the following entry:

Allowance for Depreciation of Delivery Truck $3, 600
Delivery Truck $3, 600
To write off fully depreciated Delivery Truck

During the 3-year period above, depreciation expense will have been recorded at $100 each month. The Allowance for Depreciation account will have received the $100 credit each month and totaled $3, 600 in three years, the original cost of the asset.

Assume the accounts concerning the machine mentioned in the previous frames appear as follows:

Machine	
6000	

Allowance for Depreciation	
	6000

Journalize the entry to write-off this worthless asset.

* * * Allowance for Depreciation $6,000
Machine $6,000
* * *

53

Fixed assets are often sold before they become completely worthless. At the time of sale, the book value of the asset must be determined. Book value refers to the original cost of the asset minus the Allowance for Depreciation.

What is the book value of a machine that was acquired for $9,000 and held for three years and depreciated at $2,000 a year?

* * * $9,000 − (2,000 x 3) = $3,000 book value * * *

54

Assume a delivery truck is sold after two and one-half years of service, the book value of the asset would be the original cost of $3,600 minus the Allowance for Depreciation of $3,000 ($100 per month for 30 months) or $600. If the sale price were $600 or book value, the entry would be:

Cash	$600	
Allowance for Depreciation of Delivery Truck	$3,000	
Delivery Truck		$3,600
To record the sale of Delivery Truck for book value.		

The debit to Cash records the receipt of $600. The debit to Allowance for Depreciation of Delivery Truck balances out that account which has received 30 credits of $100 each over the two and one-half year period. The credit to the Fixed Asset account, Delivery Truck, balances out that account.

Assume a machine that cost $6,000 was sold for $1,000 and the amount of Allowance for Depreciation was $5,000, what would the journal entry be to record this transaction?

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* * * Cash . $1,000
Allowance for Depreciation-Machine 5,000
Machine $6,000
* * *

55

If the delivery truck were sold for an amount in excess of the book value, a gain would be recognized. Assuming the sale price to be $800 after the two and one-half years of service, the journal entry would be:

Cash	$ 800	
Allowance for Depreciation of Delivery Truck	3,000	
Delivery Truck		$3,600
Loss or Gain on Disposal of Fixed Asset		200

To record disposal of truck for $200 over book value.

Note above that the sale price ($800) exceeded the book value of the asset ($600) by $200 which represents a gain on the sale. In the journal entry, such a gain is shown as a credit because it represents income. The credit established by this entry will be closed to the credit side of the Income Summary account. On the Income Statement, such a gain will be shown under the category "Other Income" to be distinguished from sales income. Had the truck been sold for less than book value, a loss would have resulted on the sale and the journal entry would have shown a debit instead of a acredit in the Loss or Gain account. The loss would be closed to the debit side of the Income Summary account.

Assume the machine mentioned in frame 54, page 97 was sold for $500, what would the entry be to record this transaction?

---

* * *

Cash	$ 500	
Allowance for Depreciation	5,000	
Loss on Disposal of Fixed Asset	500	
Machine		$6,000

* * *

56

The estimate of an asset's life is not always accurate. The asset may last longer or wear faster than expected. Such an occurrence means that the expense charged against previous periods was erroneous and must be adjusted. The income and losses of previous periods have been recorded in the Capital account by closing entries in those periods; therefore, the adjustment required by an erroneous estimate should be to the Capital account.

Suppose it was seen that, after one year's operations, the delivery truck would only last an additional six months rather than the total three years anticipated. After one year's operations, the asset and allowance accounts appear as:

Delivery Truck		Allowance for Depreciation of Delivery Truck	
3600			100
			100
			.
			.
			100
			1200

A computation of the depreciation rate of the asset based on a new estimated life of 18 months is $200 ($3600 \div 18$) a month as compared to the $100 a month charged off as expense over the past year. Adjustment of two items becomes necessary. First, only $1,200 has been recorded as depreciation expense over the past year when the new depreciation rate shows $2,400 should have been written off as expenses. The expense accounts and profits for the past year have been closed to the Capital account. The adjustment to correct past profits is a debit, or a decrease, to the Capital account for the amount of the error - $1,200. Second, the reserve account shows only $1,200 when $2,400 should be shown. A credit is required to increase the reserve. The correcting journal entry would be:

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(cont).

B. Black, Capital $1,200
Allowance for Depreciation of Delivery Truck $1,200
To correct depreciation expense of Delivery Truck with estimated life of one and one-half years.

From this point on, the accountant will write off depreciation at the rate of $200 a month debiting Depreciation and crediting Allowance for Depreciation. After six months, the Allowance account will have a balance of $3,600, the original cost of the asset.

Suppose it was seen that, after 18 month's operation, a machine would only last an additional six months rather than the total four years anticipated. After 18 months operation, the asset and allowance account appear as:

Machine	
4800	

Allowance for Depreciation	
	1800

Show the entry to correct the allowance account.

* * * Capital $1,800
Allowance for Depreciation $1,800 * * *

57

The net book value of the asset might be shown on the Balance Sheet. However, it is more desirable to show the original cost of the asset less the allowance for depreciation. The Fixed Asset section of the Balance Sheet should appear as follows:

Fixed Assets:		
Building	$100,000	
Allowance for Depreciation-Building	20,000	$ 80,000
Furniture and Fixtures	$ 30,000	
Allowance for Depreciation-Furniture and Fixtures	10,000	20,000
Delivery Equipment	5,000	
Allowance for Depreciation-Delivery Equipment	1,000	4,000
Total Fixed Assets		$104,000

Depreciation expense will be shown as a selling or a general expense on the Income Statement depending on whether the expense is related to the sales effort. For example, depreciation expense on the delivery truck would be a selling expense while depreciation on the building would be a general expense.

Construct the Fixed Asset section of the Balance Sheet using the following information: Machine $6,000, Building $10,000, Equipment $8,000, Allowance for Depreciation-Machine $2,000, Allowance for Depreciation-Building $8,000, and Allowance for Depreciation-Equipment $1,000.

* * *

Fixed Assets:

Machine	$6,000	
Allowance for Depreciation—Machine	2,000	$4,000
Building	10,000	
Allowance for Depreciation—Building	8,000	2,000
Equipment	8,000	
Allowance for Depreciation—Equipment	1,000	7,000
Total Fixed Assets		$13,000

* * *

58

BAD DEBTS. Experience has shown that some customers who purchase merchandise on account will not pay. Because the proprietor will not know until a subsequent period how many customers will not pay, he must estimate the loss from bad debts for the period in order to charge the expense in the proper period. From past experiences, businesses are able to estimate probable losses from bad debts by taking a percentage of the total sales or credit sales. Assuming a business has total sales of $20,000 and past experience has shown one percent of sales proves to be uncollectible, $200 is a rational estimate of the loss from bad debts which will be charged during the period.

Assume a business has total sales of $650,000 and past experience shows that one-half percent of sales proves to be uncollectible, what is the amount of loss for bad debts that must be charged for this period?

* * * $650,000
.005
$3250.000 * * *

59

If the Accounts Receivable and the amount estimated to be uncollectible are to be shown as separate items on the Balance Sheet, two additional accounts must be maintained in addition to the Accounts Receivable account. The amount estimated to be uncollectible will be titled Allowance for Bad Debts. The expense incurred by bad debt losses will be titled Bad Debts Expense. The journal entry to record the estimated bad debt loss at the end of the period is shown below.

Bad Debts Expense	$200	
Allowance for Bad Debts		$200
To record loss from bad debts estimated at 1% of total sales.		

The accounts established by the above entry bear the following balances:

Allowance for Bad Debts		Bad Debts Expense	
	200	200	

Record and post the estimated loss for bad debts of $3,250.

* * * Bad Debts Expense $3,250
Allowance for Bad Debts $3,250

Allowance for Bad Debts		Bad Debts Expense	
	3250	3250	

* * *

60

When an Accounts Receivable is found to be uncollectible, the customer's account is closed with a credit and the Allowance for Bad Debts is debited by the following entry:

Allowance for Bad Debts $50
D. Daly $50
To close Daly's account which is uncollectible.

The customer's account and the Allowance account, when posted, have the following balances:

D. Daly		Allowance for Bad Debts	
50	50	50	200

It was found that Mr. Chips' account of $450 would not be collectible. Record and post the entry of this transaction.

Mr. Chips		Allowance for Bad Debts	
450			1400

* * *

Allowance for Bad Debts	$450	
Mr. Chips		$450

Allowance for Bad Debts

450	1400

Mr. Chips

450	450

* * *

61

When a customer pays his account after it has been written off, his account must be adjusted to reflect the payment by reversing the entry made to write off the account. The customer's account is shown as paid up for credit reference. Assume D. Daly in the illustration above paid his bill on the day following the entry which closed his account to a bad debt expense. The following journal entries would be made.

D. Daly	$ 50	
Allowance for Bad Debts		$50
To re-establish customer's account previously charged off as a bad debt and now collected.		

Cash	$ 50	
D. Daly		$50
To record receipt of cash from customer in payment of account.		

The Accounts Receivable account of D. Daly now appears as:

D. Daly

50	50
50	50

61 (Cont)

On the Balance Sheet the total Accounts Receivable is shown less the Allowance for Bad Debts. The Current Asset section of the Balance Sheet appears as follows:

Current Assets:		
Cash		$ 5,000
Accounts Receivable	$20,000	
Less Allowance for Bad Debts	200	19,800
Notes Receivable		600
Merchandise Inventory		8,000
Total Current Assets		$33,400

The Bad Debts Expense will appear on the Income Statement with the other expenses of the period.

After Mr. Chips account was written off for $450, we received a check from him in the amount of $450. Record the transaction for the receipt of $450 from Mr. Chips:

113

* * *

Mr. Chips	$450	
Allowance for Bad Debts		$450
Cash	450	
Mr. Chips		450

* * *

62

SALES AND PURCHASES - RETURNS AND ALLOWANCES.

Occasionally, customers return merchandise. The procedure for recording such a transaction would seem to be a credit to the Accounts Receivable (or to cash, depending on the type of the original sale) and a debit to the Sales Account. If Sales is debited, the amount of sales shown on the Income Statement will be a net figure and the amount of returns will not be disclosed. Therefore, when goods sold on account or for cash are returned, the debit is made to an account titled Sales Returns and Allowances. The credit is made to Cash or to Accounts Receivable depending on the original transaction. An entry for the return of $500 merchandise by a customer who purchased on account is as follows:

Sales Returns and Allowances	$500	
Accounts Receivable		$500
To record merchandise returned by purchaser.		

In other instances, an allowance in price of the merchandise is made. When a customer has purchased merchandise and, finding it not suitable to his needs, wishes to return it, the seller allows the customer a reduction in price if the merchandise is not returned. This transaction is recorded as a debit to the Sales Returns and Allowances account and a credit to Accounts Receivable or to Cash depending on the original transaction. The Sales Returns and Allowances account will bear a debit balance and be shown as a deduction from Gross Sales on the Income Statement as follows:

Gross Sales	$10, 000	
Less: Sales Returns and Allowances	400	
Net Sales		$9, 600

Record the entry for the return of $1500 of merchandise by a customer who purchased the item for cash. We wrote him a check for the amount. 107.

* * * Sales Return and Allowances $1,500
Cash $1,500 * * *

63

Goods purchased from others are sometimes returned to the seller as unsatisfactory. When this occurs, the purchaser is either given credit on his account with the seller or the cash price of the merchandise is returned. When a business returns merchandise to the seller, the business records the transaction by debiting either the Accounts Payable account (if the original purchase was on account) or the Cash account and crediting the Purchases Returns and Allowances account. An entry to record the return of $100 in merchandise which was purchased on account is as follows:

Accounts Payable	$100	
Purchases Returns and Allowances		$100
To record merchandise returned to seller		

An allowance in price may be extended and the merchandise retained instead of returning it. In this case, the entry would remain the same as that shown above because the reduction in price decreases the liability to the seller (recorded by a debit to Accounts Payable) and decreases the cost of purchases (recorded by a credit to Purchases Returns and Allowances account which will be deducted from the Purchases on the Income Statement).

Purchases Returns and Allowances account will bear a credit balance and be shown as a deduction from Gross Purchases on the Income Statement as follows:

Gross Purchases	$6,000	
Less: Purchases Returns and Allowances	100	
Net Purchases		$5,900

Bear in mind that use of the Purchases Returns and Allowances account is restricted to purchases of merchandise intended for resale. When goods other than merchandise for resale are returned or an allowance in price is received, the adjustment is to the account originally debited. For example, if store equipment were returned to the vendor, the <u>asset</u> account,

63

(Cont)

Store Equipment, would be credited and Accounts Payable or Cash, depending on the original transaction, would be debited.

Assume that a business returned $2,200 of merchandise that it purchased on account, what would the general ledger entry be?

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* * * Accounts Payable $2,200
Purchases Returns and Allowances $2,200
* * *

64

CASH AND ACCRUAL BASIS.

a. To furnish accurate statements at the end of a period, it is necessary to allocate revenue to the period in which earned and expense to the period in which incurred even though the revenue is not collected and the expense is not paid.

(1) On the cash basis, revenue is allocated to the period in which it is physically collected regardless of when it was earned. Expense is allocated to the period in which it is physically paid regardless of when the expense was incurred. Assume a motel owner had revenue of $10,000 for the period while paying out $8,000 in expenses. On the cash basis, he would compute his net income for the period while paying out $8,000 in expenses. On the cash basis, he would compute his net income for the period by deducting his expenditures of cash in payment of debts from total cash rental revenue. The computation would appear as follows:

Rental Revenue	$10,000
Expenses	8,000
Net Income	$ 2,000

(2) On the accrual basis, revenue is allocated to the period in which earned regardless of when it is to be physically collected. Expense is allocated to the period in which incurred regardless of when it is to be paid. Assume the motel owner in the example above had received advance rental of $100 and owed an $80 electric bill covering the last two weeks in the current period. On the cash basis, the owner included the advance rental as revenue for the period and excluded the electric bill from expenses of the period. On the accrual basis, the owner excludes the advance rental from revenue for the period because he has not earned it during that period and includes the electric expense because it was incurred in the current period. His computation of net income on the accrual basis shows more accurate information. 110

64
(Cont)

Rental Revenue	$10,000	
Less: Rent collected in advance	100	
Rental Revenue		$9,900
Expenses	$ 8,000	
Add: Electric bill incurred this period but not paid	80	
Total Expenses		$8,080
Net Income		$1,820

b. The accrual basis of record keeping will provide more accurate and current information than the cash basis. The accrual basis is preferable in most businesses and is the basis under consideration in this text.

Explain the difference between the cash and accrual method of accounting.

* * * *

On the cash basis revenue is allocated to the period in which it is physically collected regardless of when it was earned. On the accrual basis, revenue is allocated to the period in which earned regardless of when it is to be physically collected.

* * *

65

ACCRUED AND DEFERRED ITEMS. Prior to adjusting and closing the books at the end of a period, accrued and deferred expenses and revenue must be considered for inclusion or exclusion in the computation of income for the period. Items to be considered are:

a. Accrued Expenses are expenses incurred in the current period but not paid at the time statements are prepared. These expenses will be shown as liabilities on the Balance Sheet and as an expense on the Income Statement.

b. Deferred Expenses are expenses paid in advance, usually referred to as "Deferred Charge" or "Prepaid Expense." These expenses are assets until used. Store and office supplies are good examples of such prepaid expenses.

c. Accrued Revenue is revenue earned in the current period but not collected. This item is an asset on the Balance Sheet and an income on the Income Statement.

d. Deferred Revenue is revenue which has been received but not earned in the current period. A liability exists for the services to be rendered in consideration of the revenue received. This item is a liability (unearned revenue) until earned and appears on the Balance Sheet.

Define the terms "Accrued Expenses" and "Accrued Revenue."

---

* * *

Accrued Expenses are expenses incurred in the current period but not paid at the time statements are prepared.

Accrued Revenue is revenue earned in the current period but not collected.

* * *

66

Chapter 3 discussed adjusting and closing entries for deferred expenses such as store and office supplies and prepaid insurance and rent.

These items were entered in Asset accounts until the end of the period when the portion consumed was transferred from the Asset account to an expense account. The remaining balance in the Asset account represented the balance to be shown for that item on the Balance Sheet. The balance of the expense account was transferred to the Income Summary account by a closing entry.

Define the terms "Deferred Expenses" and "Deferred Revenue."

* * * Deferred Expenses are expenses paid in advance.

Deferred Revenue is revenue which has been received but not earned in the current period. * * *

67

Deferred revenue is, in reality, revenue received in advance for services to be rendered in the future. The business involved has an obligation to provide such services and, because of this obligation, considers the revenue received as a liability. The earned revenue received is credited to a liability account and Cash is debited at the end of the period, because a portion of the services have been rendered, a portion of the unearned revenue is removed from the liability account and placed in a revenue account by an adjusting entry. The revenue account is then closed to Income Summary. These entries have the effect of reducing the liabilities and increasing the proprietorship. Assume that a real estate business receives $600 in advance rental revenue covering the succeeding 6-month period. The entries and accounts recording the transaction appear as follows:

Cash	$600	
Unearned Rental Revenue		$600

To record receipt of $600 advance rental for 6 months.

Cash	
600	

Unearned Rental Revenue	
	600

Unearned Rental Revenue	$100	
Rental Revenue		$100

To record 1/6 of advance rental as earned revenue.

Rent Revenue	
	100

Unearned Rental Revenue	
100	

67 (Cont)

Rent Revenue $100
Income Summary $100
To close Rent Revenue earned to Income Summary account.

Rent Revenue	
100	100

Income Summary	
	100

The liability account bears a credit balance of $500, the unearned revenue covering next five months. The $100 in rental revenue earned during the month is included in "Other Income" on the Income Statement where it becomes an element of the net income for the period in which it was earned.

Assume a magazine published received $1,200 of subscription in advance for three years. Only 1/3 of this amount applies to this period. Record and post these transaction to affect the receipt of cash and the portion of revenue for this period.

Cash	

Unearned Subscription Revenue	

Subscription Revenue	

Income Summary	

* * *	Cash	1200	
	Unearned Subscription Revenue		1200
	Unearned Subscription Revenue	400	
	Subscription Revenue		400
	Subscription Revenue	400	
	Income Summary		400

Cash	
1200	

Unearned Subscription Revenue	
400	1200

Subscription Revenue	
400	400

Income Summary	
	400

* * *

68

Some expenses such as salaries, accrue or are incurred day by day, and payment is made on a weekly, biweekly, or some other regular basis. If the last day of a pay period does not coincide with the last day of the period to be reported, there is an expense and a liability that must be recorded in the accounts by an adjusting entry. A closing entry transfers the expense account balance to the Income Summary account. When statements are prepared, the credit balance in the liability account is shown on the Balance Sheet and the expense appears on the Income Statement. After the statements have been prepared, the liability is transferred back to the expense account by what is known as a <u>reversing entry.</u> The reversing entry is the exact opposite of the adjusting entry. Assuming salaries are paid on each Thursday in a particular business and the books are to be closed on the next day which is the last day of the period, salaries for Thursday and Friday will be expenses of the current period which have accrued but will not be paid until the first payday of the ensuing period. Salaries Expense account shows salaries through Wednesday of $3,600. The problem is to record the accrued salaries expense of $1,200 for Thursday and Friday so the expense may be included in the computation of income and losses for the current period. The entries and accounts affected appear below:

Salaries Expense	$1,200	
Salaries Payable		$1,200

To adjust for accrued salaries expense incurred for the last two days of the period.

Salaries Expense	
3600	
1200	

Salaries Payable	
	1200

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(Cont)

Income Summary	$4,800	
Salaries Expense		$4,800
To close salaries expense to Profit and Loss Summary.		

Salaries Expense		Income Summary		Salaries Payable	
3600	4800	4800			1200
1200					
4800	4800				

Salaries Payable	$1,200	
Salaries Expense		$1,200
To reverse the adjusting entry.		

Salaries Expense		Income Summary		Salaries Payable	
3600	4800	4800		1200	1200
1200					
4800	4800				
	1200				

When $3,600 in salaries is paid on the first payday of the new period, $1,200 will be applicable to the last two days of the prior period and $2,400 will be salaries expense for four days in the new period. No adjustment is required in making this entry because the reversing entry will force a correct balance in Salaries Expense for the new period. The credit of $1,200 in the Salaries Expense account (posted from the reversing entry) will offset the total salaries paid in the first week of the new period leaving the correct debit balance in the expense account. To illustrate, on the following month's first payday, salaries of $3,600 are paid and the following entry is made:

68 (Cont)

Salaries Expense	$3,600	
Cash		$3,600
Paid Week's Payroll.		

Salaries Expense

3600	4800
1200	
4800	4800
3600	1200

Cash

	3600

Note that the debit balance in Salaries Expense account is $2,400, the actual salaries expense applicable to the new period.

The accrued salaries for a period is $2,000 and the amount recorded to date in the Salaries Expense account is $6,000. Record and post the entries to enter the adjustment, the salary payment of $6,000, and the reversal for the next period

Salaries Expense

6,000	

Salaries Payable

Income Summary

Cash

* * *

Salaries Expense	$2000	
Salaries Payable		$2,000
Income Summary	8,000	
Salaries Expense		8,000
Salaries Payable	2,000	
Salaries Expense		2,000
Salaries Expense	6,000	
Cash		6,000

Salaries Expense

6000	
2000	8000
6000	2000

Salaries Payable

2000	2000

Income Summary

8000	

Cash

	6000

* * *

69

Recording accrued revenue also requires a reversing entry. Revenue accrued during the period being reported must appear on the Income Statement and the Balance Sheet. The entry to accomplish this debits a receivable for the revenue due and credits a revenue account for the revenue accrued. The receivable will appear on the Balance Sheet and the revenue account will be transferred by a closing entry to the Income Summary account where it will enter into computation of income and losses for the period. After statements have been prepared, a reversing entry transfers the receivable back to the revenue account where, as a debit, it will offset revenue

69

(Cont)

accrued in later periods. Assume a \$1,000, 90-day note bearing interest at 6% is received on 1 December in payment of an account receivable. Notes Receivable is debited and Accounts Receivable is credited by the following entry and posted to the accounts as follows:

Notes Receivable	\$1,000	
Accounts Receivable		\$1,000
To record receipt of 90-day note bearing interest at 6%.		

Notes Receivable	
1000	

Accounts Receivable	
1000	1000

On 31 December, 1/3 of the interest on the note has accrued. Computation of interest:

$$\$1,000 \times .06 = \$60 \times \frac{90}{360} = \$15. \quad 1/3 \text{ of } \$15 = \$5.$$

The adjusting entry to record accrued interest revenue of \$5 as follows:

Accrued Interest Receivable	\$5	
Interest Revenue Earned		\$5
To adjust for interest accrued for 30 days at 6% on a \$1,000 90-day note.		

Accrued Interest Receivable	
5	

Interest Revenue Earned	
	5

69 (Cont)

The interest income for the period is closed to the Income Summary account.

Interest Revenue Earned $5
  Income Summary $5
To close revenue to Income Summary.

Income Summary	
	5

Interest Revenue Earned	
5	5

After statements are prepared, a reversing entry balances out the receivable by transferring the amount back to the debit side of the income account:

Interest Revenue Earned $5
  Accrued Interest Receivable $5
To reverse the adjusting entry.

Accrued Interest Receivable	
5	5

Interest Revenue Earned	
5	5
5	

The Interest Revenue account now bears a debit balance on the first day of the new period. On 31 January, when accrued interest is gain entered, total interest accrued to that date will be recorded and the offsetting debit in the Interest Revenue account creates a credit balance equal to the amount earned in the new period. To illustrate, $10 of the interest has accrued on 31 January (2/3 of $15 = $10). The adjusting entry to record this accrued interest is as follows:

Accrued Interest Receivable $10
  Interest Revenue Earned $10
To adjust for interest accrued for 60 days at 6% on a $1,000 90-day note

69 (Cont)

Accrued Interest Receivable

5	5
10	

Interest Revenue Earned

5	5
5	10

On 1 July 197*, a 6%, 180-day note was received for $3,000 of merchandise sold. What will the adjusting, closing and reversing entry be for 1 August 197*?

* * *

Accrued Interest Receivable	$15	
Interest Income Earned		$15
Interest Revenue Earned	15	
Income Summary		15
Interest Revenue Earned	15	
Accrued Interest Receivable		15

* * *

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Interest income is additional or "Other" income not derived from the selling operations of the business. As such, this income is shown on the Income Statement in a separate section titled "Other Income" which follows the expenses section. The total amount of "Other Income" is added to the income from selling operations to comprise the net profit. For example, a skeleton Income Statement showing the position of the "Other Income" section would appear as follows:

Income from Sales:			
Gross Sales			$2,525
Less Sales Returns & Allowances			56
Net Sales			$2,469
Cost of Goods Sold:			
Merchandise Inventory, 1 January		$3,000	
Purchases	$1,726		
Less Purchases Returns and Allowances	45	1,681	
Merchandise Available for Sale		$4,681	
Merchandise Inventory, 31 January		3,287	
Cost of Goods Sold			1,394
Gross Profit on Sales			$1,075
Expenses:			
Selling Expenses		$ 100	
General Expenses		220	
Total Expenses			320
Net Income from Operations			$ 755
Add Other Income			150
Net Income			$ 905

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Why is interest income placed on the "Income Statement," as "Other Income"?

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* * * Interest income is additional income not derived from the operation of the business. * * *

CHAPTER 5

SPECIAL JOURNALS

71 GENERAL. Many transactions in a business are of a constantly recurring nature. For this reason, it is possible to establish special journals for those which experience the most activity. For example, a Cash Journal may be established to receive all transactions which affect the Cash account and a Purchases or Sales Journal may be established to receive all transactions which affect the Purchases or Sales accounts.

Utilization of special journals eliminates duplication of effort and permits more than one person to work on the records at the same time. While one person is posting to the ledger from the General Journal, a second person can be recording transactions in the special journals.

Normally, the most frequently used accounts are Cash, Sales, and Purchases. Special journals used to summarize transactions affecting these accounts include a Cash Receipts Journal, Cash Payments Journal, and Purchases Journal. These journals will be discussed and illustrated in the following paragraphs.

State two purposes for the use of special journals.

1. ______________________________

2. ______________________________

* * * 1. Eliminates duplication of effort.

2. Permits more than one person to work on the records at the same time.

* * *

72

CASH RECEIPTS JOURNAL. A special journal in which all cash receipts are recorded is referred to as a Cash Receipts Journal. All transactions requiring a debit to the Cash account are entered in this special journal.

Define a Cash Receipts Journal.

---

* * * A special journal in which all cash receipts are recorded is referred to as a Cash Receipts Journal. * * *

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Columns are provided in each special journal to receive recurring entries. The first column in the Cash Receipts Journal is the cash debit column. All receipts of Cash are placed in this column. At the end of the period, the column total is posted as a debit to the Cash account. The second column is a sales credit column. When a cash sale is made, the amount is placed in the sales credit column and in the cash debit column. At the end of the period, both columns are totaled and posted to the respective accounts. If a General Journal had been utilized to record such transactions during the period, numerous journal entries and postings would have been required. The special journal simplifies the recording of the original entry and reduces the necessary posting at the end of the period. The third column is the accounts receivable credit column. Accounts receivable and the customer's accounts are reduced and cash is increased when cash is paid on account. The amount is entered in the cash debit and the accounts receivable credit columns. The totals of these columns are posted to the respective accounts at the end of the period. In addition to the cash, accounts receivable, and sales columns, the Cash Receipts Journal must have a general credit column in which to record the credits of those transactions which occur too infrequently to warrant a special credit column.

TRUE or FALSE: If a business paid $6,000 for a building, would this appear on their Cash Receipts Journal?

* * * FALSE -- Only debit entries to cash in the Cash Receipts Journal. * * *

74

Larger businesses maintain a considerable number of accounts for customers. It is desirable, however, to show on the Balance Sheet the total amount due from customers rather than a complete listing of accounts receivable. At the same time, the customer's account must be kept current if a record of what the customer owes is to be available when needed. Therefore, an Accounts Receivable account <u>in addition</u> to the individual accounts is maintained for each customer. The Accounts Receivable account is termed the "control account" and appears in the General Ledger with other accounts while the individual customer's accounts are termed "Subsidiary Ledger" and make up an <u>extra</u> ledger maintained for information purposes. The total of all individual amounts due from customers (the Subsidiary Ledger) should be equal to the amount appearing in the Accounts Receivable control account. For example, Black had 10 customers each owing \$5. The control account, Accounts Receivable, will appear in the General Ledger with a debit balance of \$50. The Subsidiary Ledger will contain 10 accounts, one for each customer, and each account will have a debit balance of \$5. Whenever Black receives a cash payment, he will record the amount received in the cash debit and accounts receivable credit columns of the Cash Receipts Journal. As each amount is entered in these columns, the customer's name is written in an explanation column on the left side of the journal and the amount in the accounts receivable credit column is credited to the individual customer's account in the Subsidiary Ledger. At the end of the period, when column totals of the Cash Receipts Journal are posted, Accounts Receivable control account in the General Ledger will receive a credit from the accounts receivable credit column in the journal. This credit will be equal to all the credits posted individually during the month in the Accounts Receivable Subsidiary Ledgers.

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(Cont)

If the G. Good Company has the following balances, listed below, from their customers in the Subsidiary Ledger, what will the Account Receivable Control Account total be?

Subsidiary Ledger Account

Mr. X

140	100

Mr. W

100	

Mr. L.

60	

Mr. B

180	

Account Receivable

?	

* * *

Account Receivable	
380	

* * *

75

A Cash Receipts Journal with the special columns just described, in previous frames, appears below:

Cash Receipts Journal

Date Page 1

19--		Accounts Credited	LP	General Credit	Sales Credit	Accts Rec Credit	Cash Debit
Nov	1	Balance $100	✓				
	6	Sales	✓		30000		30000
	7	T. Grey	✓			5000	5000
	9	J. Jones	✓			10000	10000
	10	B. Black, Capital	10	100000			100000
	15	A. Larkin	✓			3000	3000
	30	Sales	✓		50000		50000
				100000	80000	18000	198000
				(✓)	(12)	(5)	(1)

The balance of cash in the ledger account on the first day of the period is entered in the account credited column. Note that the amount is not entered in the cash debit money column. To do so would result in a duplicate posting because the $100 is already in the ledger account - Cash. The L. P. column bears a check mark signifying that the transaction is complete and no further recording of that information is necessary. This is a memorandum entry which facilitates the daily balancing of the Cash account.

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(Cont)

The entry of 6 November records cash sales of $300. Sales is credited and cash is debited. The L.P. column is checked because no further recording is necessary for this transaction. The amounts in the money columns will be included in the column totals which will be posted at the end of the period to the Sales and Cash account respectively.

The entry of 7 November records the receipts of $50 in cash paid by T. Grey on his account. After the entry is made in the Cash Receipts Journal, the bookkeeper turns to the Accounts Receivable Subsidiary Ledger, locates T. Grey's individual account and credits it for the amount received. A check mark is placed in the folio column of the Cash Receipts Journal to signify that no further recording of the information on that line is necessary. At the end of the period, the amount received from T. Grey will be included in the column total of the accounts receivable credit column which will be posted as a total credit to the Accounts Receivable control account in the General Ledger.

The entry of 9 November is similar to that of the 7th.

The entry of 10 November records the additional investment of $1,000 made by B. Black. The receipt of cash is represented by the amount in the cash debit column. The increase in the Capital account is recorded as a credit in the general credit column which receives credits for which no special column exists. The bookkeeper will locate the B. Black, Capital account in the ledger and post a credit of $1,000, entering the account number (10) in the folio column of the Cash Receipts Journal to signify that no further recording of the information on that line is necessary.

The entry of 15 November is similar to that of the 7th and 9th. The individual customer's account in the Subsidiary Ledger receives a credit and a check mark is placed in the folio column of the journal to signify the information on that line is fully recorded.

The entry of 30 November is similar to that of the 6th.

75

(Cont)

After all columns of the Cash Receipts Journal are totaled at the end of the period, the totals are posted to the appropriate accounts in the General Ledger. Double lines are drawn beneath the column totals across all columns except the "account credited" column as shown in the illustration. The column totals are posted to the respective accounts as indicated by the column heading and the number of the account to which the total is posted is entered in parentheses directly below the column total as shown.

A check mark appears below the total of the general credit column to signify that no posting is required. The amounts in this column were individually posted to the account which appears in the account credited column.

The total cash sales for the period as evidenced by the sales credit column total are credited to the Sales account which is account number 12 in the ledger. The account number is shown below the column total in parentheses to indicate the total has been posted.

The total decrease in the Accounts Receivable control account as evidenced by the accounts receivable credit column total is credited to the control account. Accounts Receivable, which is account number 5 in the General Ledger. The individual amounts in the column were credited to the individual customer's accounts in the Subsidiary Ledger at the time the cash was received. The decrease in the Subsidiary Ledger agrees with the decrease in the control account in the General Ledger. The account number of the Accounts Receivable control account is entered below the column total to show that the account has been posted.

The total increase in cash in the cash debit column is debited to the Cash account and the account number 1 is shown in parentheses below the column total.

The equality of debits and credits in the Cash Receipts Journal may be determined by adding all the credit column totals and comparing the sum with the debit total in the cash column.

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(Cont)

Rainbow Sales, a wholesale and retail paint store, completed the following transactions:

Oct	8	Borrowed $3000 from Guaranty Bank by giving a note payable.
	10	Paid one month's rent on the store building, $1,150.
	12	Received a $637 check from Gary Bill in payment of the October 3d sale.
	15	Cash sales for the first half of the month, $2,110.
	22	Sold $15 of unneeded store equipment for cash.
	31	Cash sales for the last half of the month, $1,950.

REQUIRED:

1. Using a sheet of paper, prepare a Cash Receipts Journal illustration in frame 75, page 132.
2. Enter the transaction in the journal.

* * *

Cash Receipts Journal

197*		Acct Credited	LP	General Credit	Sales Credit	Acct.Rec Credit	Cash Debit
Oct	8	[1] Guaranty Bank		3000.00			3000.00
	12	Gary Bill				637.00	637.00
	15				2110.00		2110.00
	22	Store Equipment		15.00			15.00
	31				1950.00		1950.00
				3015.00	4060.00	637.00	7712.00

[1] Could also be Note Payable.

* * *

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CASH PAYMENTS JOURNAL. A special journal in which all cash payments are recorded is referred to as a Cash Payments Journal. All transactions requiring a credit to the Cash account are entered in this special journal.

What is the difference between a Cash Receipts Journal and a Cash Payments Journal?

* * * Cash Receipts Journal records only debits to cash, while a Cash Payments Journal records only credits to cash.

* * *

77

As with the Cash Payments Journal, the first column to be considered is the cash column. Each amount paid is placed in this column. At the end of the period, the column total is credited to the Cash account. Most cash paid out goes to creditors. A column titled accounts payable debit is added to the special journal. The Accounts Payable account in the ledger will be debited at the end of the period. There is an Accounts Payable control account in the General Ledger and an Accounts Payable Subsidiary Ledger which contains all the individual accounts. This system permits showing the numerous amounts due various creditors as one total, Accounts Payable, on the Balance Sheet while maintaining records for each individual creditor. In addition to the cash and accounts payable columns, the Cash Payments Journal has a general debit column in which to record the debits of those cash transactions which occur too infrequently to warrant a special debit column.

TRUE or FALSE: The total of the Accounts Payable control will equal the subsidiary ledger accounts total of Accounts Payable.

---

* * * TRUE * * *

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A Cash Payments Journal with the columns described, in the previous frames, is illustrated below.

Cash Payments Journal

Page 1

Date	19--	Account Debited	LP	General Debit	Accts. Pay Dr		Cash Credit	
Nov	1	John Roe	✓		50 00		50 00	
	3	Purchases	14	100 00			100 00	
	4	Rent Expense	20	50 00			50 00	
	5	Acme Wholesale	✓		25 00		25 00	
	15	Salaries Expense	19	100 00			100 00	
	30	Purchases	14	200 00			200 00	
				450 00	75 00		525 00	
				(✓)	(10)		(11)	

The entry of 1 November records the payment of $50 in cash to John Roe to apply on his account. The bookkeeper locates Roe's account in the Accounts Payable Subsidiary Ledger and enters a $50 debit. A check mark is then placed in the folio column of the Cash Payments Journal to signify that no further recording of the information on that line is necessary. At the end of the period, the amount paid to Roe will be included in the column total of the accounts payable debit column which will be posted as a debit to the Accounts Payable control account in the General Ledger.

The entry of 3 November records the cash purchase of merchandise for resale. Because no special column exists for the debit to Purchases, the amount appears in the general debit column. The bookkeeper will post the amount individually to the Purchases account number 14, entering the page

78

(Cont)

number of the Cash Payments journal in the accounts folio column and placing the account number in the folio column of the Cash Payments Journal to indicate where the amount was posted.

The entry of 4 November records the payment of rent. The Rent Expense account in the ledger is debited and the account number is entered in the folio column of the Cash Payments Journal. The page number of the Cash Payments Journal will be entered in the folio column of the Rent Expense account.

The entry of 5 November is similar to that of 1 November. The Acme Wholesale account in the Subsidiary Ledger is debited. The abbreviation and page number of the Cash Payments Journal (CP1) will be placed in the accounts folio column to indicate the source of the posting. At the end of the period, the accounts payable column total will be debited to the Accounts Payable control account in the General Ledger. This total will include the $25 paid to Acme Wholesale.

The entries of 15 and 30 November are similar to those of the 4th and 3rd.

After all columns of the Cash Payments Journal are totaled at the end of the period, the totals are posted to the appropriate accounts in the General Ledger. Double lines are drawn beneath the column totals across all columns except the account debited column as shown in the illustration. Column totals are posted to the respective accounts as indicated by the column heading and the number of the account posted is entered in parentheses directly below the column total as shown.

A check mark appears below the general debit column total to indicate that no further posting of this amount is required. The amounts in this column were individually posted to the account whose title appears in the account debited column and whose account number appears in the folio column of the journal.

78
(Cont)

The accounts payable debit column total is debited to the Accounts Payable control account in the General Ledger. It will be remembered that, during the period, each payment caused an individual debit to be placed in the customer's account in the Subsidiary Ledger. Now that the accounts payable column total is debited to the control account, the control and subsidiary accounts reflect the same information, one in total and one in individual amounts by customer's name. The account number of Accounts Payable is placed in parentheses below the column total to show that the posting has been completed.

The total decrease in cash as evidenced by the total in the cash credit column is credited to the Cash account and the account number 1 is shown in parentheses below the column total.

The equality of debits and credits in the Cash Payments Journal may be determined by adding all the debit columns and comparing the total with the credit total in the cash column.

The Cash Receipts Journal and the Cash Payments Journal sometimes are combined to form what is sometimes referred to as the Cash Book. The Cash Receipts Journal is normally maintained on one page and the Cash Payments Journal is maintained on a separate page. These pages are placed in a looseleaf binder together so that the pages face each other and show the cash transactions of a period at a glance.

Rainbow Sales, a wholesale and retail paint store, completed the following transactions:

Oct	10	Paid one month's rent, $1150.
	12	Sent Phoenix Manufacturing Co. a check for $1200 for merchandise purchased.
	15	Bought land for $6000 cash.
	29	Sold merchandise on credit to Western Supply Company, $1300.
	31	Paid monthly salaries, $1000.

78 (Cont)

REQUIRED:

1. Using a sheet of paper, prepare a Cash Payments Journal -- illustration in frame 78, page 138.

2. Enter the transactions in the Journal.

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* * *

Cash Payments Journal

Date	197*	Acct Debited	LP	General Debit	Accts Pay Debit		Cash Debit
Oct	10	Rent Expense		1150.00			1150.00
	12	Phoenix Mfg. Co.			1200.00		1200.00
	15	Land		6000.00			6000.00
	31	Salaries Expense		1000.00			1000.00
				8150.00	1200.00		9350.00

* * *

79

SALES JOURNAL. In a mercantile business, sales are recurring transactions which are easily adaptable to a special journal. (Cash sales, it has been learned, are recorded in the Cash Receipts Journal.) Sales on account are recorded in a special journal which may have one of several titles - Sales Journal, Sales Register, Sales Book, or Sales Record. The title Sales Journal is used in this text.

In recording sales on account, it is desirable to record all the necessary information pertaining to a charge sale when entering the sale in the Sales Journal. Information that might be shown in a Sales Journal includes but is not limited to the date of the sale, the sale number, the name of the customer whose account is to be debited, the address of the customer, the posting reference for individual accounts, and the amount of the sale. A Sales Journal which shows this information appears on the next page.

(cont)

79 (Cont)

Sales Journal

Page 1

Date 19--		S. No.	Account Debited	Address	LP	Amount
Nov	1	1	John Doe	10 S. Pine St.	✓	15 00
	3	2	E. Clinton	112 Main St.	✓	5 00
	6	3	M. Graff	320 S. Broad St.	✓	30 00
	10	4	Ace Laundry Co.	400 Front St.	✓	50 00
	15	5	J. Brown	215 Main St.	✓	10 00
	30	6	W. Kunkle	13 W. Oak St.	✓	15 00
	30		Accts Rec. Debit	Sales Credit	✓	125 00
						(5) (12)

The entry of 1 November records the sale on account of $15 worth of merchandise to John Doe. The bookkeeper, after recording the information in the Sales Journal, locates the customer's account in the Accounts Receivable Subsidiary Ledger and debits the account for $15 and enters S1 in the folio column. A check mark is placed in the folio column of the Sales Journal to indicate that the amount has been debited to the customer's account in the Subsidiary Ledger. At the end of the period, the total amount in the journal will be debited to the Accounts Receivable control account in the General Ledger and credited to the Sales account in the General Ledger. The $15 purchase made by Doe and debited to his account in the Subsidiary Ledger is included in the journal total debited to the Accounts Receivable control account at the end of the period. The subsidiary total will be in agreement with the control account at the end of the period. The subsidiary total will be in agreement with the control account at the end of the period. The control account balance will be shown on the Balance Sheet.

The remaining entries are similar to the first. Each customer's account in the Subsidiary Ledger is debited for the amount of the sale and a check mark is placed in the folio column of the Sales Journal to indicate no further recording of that information is necessary.

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(Cont)

At the end of the period, the column total is posted as a debit to Accounts Receivable control account and a credit to Sales. The charge sales of the entire period are thereby recorded with one entry. To indicate that the posting has been accomplished, the account numbers of the Accounts Receivable and Sales accounts are shown in parentheses below the column total.

The Sales Journal may be given a variety of forms depending on the needs of the business. The principal function of the journal has been discussed here and must be kept in mind when rearranging the form or content of the journal.

Referring again to the Rainbow Sales Company, below is listed the following transactions:

Oct	3	Sold merchandise on credit to Gary Bell, Sale No. 1, $650.
	6	Sold merchandise on credit to John Evans, Sale No. 2, $700.
	11	Sold merchandise on credit to Walter Ashby, Sale No. 3, $900.
	22	Sold $15 of unneeded store equipment for cash.

REQUIRED:

1. Using a sheet of paper, prepare a Sales Journal - illustration in frame 79, page 143.

2. Enter the transaction in the Journal.

* * *

Sales Journal

Date 197*		Sale No.	Account Debited	Address	LP	Amount
Oct	3	1	Gary Bell			650.00
	6	2	John Evans			700.00
	11	3	Walter Ashby			900.00
						$2,250.00

* * *

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PURCHASES JOURNAL. Another recurring transaction in a mercantile business is purchases of merchandise for resale. Because purchases made with cash are recorded in the Cash Payments Journal, a special journal which records purchases contains only purchases made on account. Purchases on account are recorded in a special journal which may have one of several titles - Purchases Journal, Purchases Register, Purchases Book, Invoice Register, or Purchases Record. Though any of these titles would be correct, the title Purchases Journal is used in this text.

In recording purchases on account, it is desirable to record all the necessary information in the journal. Information that might be shown includes but is not limited to the date of the purchase, the purchase number, the name of the creditor whose account is to be credited, the address of the creditor, the posting reference for individual accounts, and the amount of the purchase. A Purchase Journal which shows this information appears on the next page.

80 (Cont)

Purchases Journal

Page 1

Date 19--	Pur No.	Account Credited	Address	LP	Amount
Nov 2	1	B. Mueller Co.	2510 Florence Ave.	✓	300 00
6	2	Smith Bros.	1130 Main St.	✓	10 00
10	3	P. Selby Co.	600 Park St.	✓	150 00
15	4	A. Rawlings Co.	2020 Main St.	✓	20 00
30	5	Brocker Co.	230 Blair St.	✓	100 00
30		Accts Payable Cr.	Purchases Debit	✓	580 00
					(10) (14)

The entry of 2 November records the purchase on account of merchandise for resale worth $300 from B. Mueller Company. The bookkeeper, after recording the information in the Purchases Journal, locates the creditor's account in the Accounts Payable Subsidiary Ledger and credits the account for $300 entering P1 in the folio column. A check mark is placed in the folio column of the Purchases Journal to indicate that the amount has been credited to the creditor's account in the Subsidiary Ledger. At the end of the period, the total amount of the journal will be debited to the Purchases account and credited to the Accounts Payable control account in the General Ledger. The $300 purchase made from the Mueller Company and credited to their account in the Subsidiary Ledger is included in the journal total credited to the Accounts Payable control account at the end of the period. The purchase of merchandise for resale will then be recorded in two places - the account in the Subsidiary Ledger and the control account in the General Ledger. As this is done with each creditor for each purchase, the subsidiary total will be in agreement with the control account at the end of the period and the control account balance will be shown in the Balance Sheet as representative of all amounts due to creditors.

80 (Cont)

The remaining entries are similar to the first. Each creditor's account in the Subsidiary Ledger is credited for the amount of the purchase and a check mark is placed in the folio column of the Purchases Journal to indicate no further recording of that information is necessary until the end of the period.

At the end of the period, the column total is posted as a credit to the Accounts Payable control account and a debit to Purchases. The purchases on account of the entire period are thereby recorded with one entry. To indicate that the posting has been accomplished, the account numbers of the Accounts Payable and Purchases accounts are shown in parentheses below the column total.

Using a sheet of paper, record the following transactions in a Purchase Journal -- illustration on page 146.

Oct	4	Received merchandise on Purchase Order No. 1 from Phoenix Manufacturing Company, $675.
	10	Received merchandise on Purchase Order No. 2 from Red Spot Paint Company, $1,140.
	12	Paid Red Spot Paint Company, $1,140.

* * *

Purchase Journal

Date 197*		Pur No.	Accounts Credited	Address	LP	Amount
Oct	4	1	Phoenix Mfg. Co.			675.00
	10	2	Red Spot Paint Co.			1,140.00
						$1,815.00

* * *

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<u>THE GENERAL JOURNAL.</u> By using special journals for <u>recurring transactions</u>, the General Journal is relieved of the bulk of repetitive transactions. It is necessary, however, to use the General Journal for those special transactions which cannot be recorded in the special journals for reasons of complexity or bulk. The entries which will be placed in the General Journal are as follows:

a. <u>Opening entries</u> made to record the investment of the proprietor.

b. <u>Correcting entries</u> made to correct erroneous entries <u>previously made</u> in the General Journal or special journals and posted to the ledgers.

c. <u>Current entries</u> which are unusual in nature and not <u>provided for in</u> any of the special journals in use.

d. <u>Adjusting, closing, and reversing entries</u> which are <u>made in the normal adjustment and closing</u> of the records.

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(Cont)

Listed below are transactions that offset B. Black Company. State whether they will be entered in the Cash Receipts, Cash Disbursements, Sale, Purchase or General Journal.

1. Invested $5, 000 in a business.
2. Purchased merchandise for resale on account.
3. Sold merchandise on account.
4. Transaction #2 was paid for by check.
5. Transaction #3 was collected.
6. Closing entries for the month were recorded.

* * *

1. General
2. Purchase
3. Sales
4. Cash Disbursement
5. Cash Reçeipts
6. General

* * *

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APPLIANCE REPAIR SHOP
Work Sheet
December 31, 197*

	Trial Balance Dr.	Trial Balance Cr.	Adjustments Dr.	Adjustments Cr.	Adjusted Trial Balance Dr.	Adjusted Trial Balance Cr.
Cash	1125 —				1125 —	
Prepaid Insurance	215 —			(a) 165 —	50 —	
Repair Supplies	1550 —			(b) 1170 —	380 —	
Repair Equipment	4220 —				4220 —	
Ajax Supply Company		250 —				250 —
Dale Howard, Capital		4545 —				4545 —
Dale Howard, Withdrawals	5200 —				5200 —	
Revenue from Repairs		13475 —				13475 —
Wages Expense	4775 —				4775 —	
Rent Expense	960 —				960 —	
Advertising Expense	225 —				225 —	
Total	18270 —	$18270 —				
Insurance Expense			(a) 165 —		165 —	
Repair Supplies Expense			(b) 1170 —		1170 —	
Total			$1335	$1335 —	$18270 —	$18270 —
Net Income						
Total						

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APPLIANCE REPAIR SHOP
Work Sheet
December 31, 197*

	Income Statement Dr.	Income Statement Cr.	Balance Sheet Dr.	Balance Sheet Cr.
Cash			1125 —	
Prepaid Insurance			50 —	
Repair Supplies			380 —	
Repair Equipment			4220 —	
Ajax Supply Company				250 —
Dale Howard, Capital				4545 —
Dale Howard, Withdrawals			5200 —	
Revenue from Repairs		13475 —		
Wages Expense	4775 —			
Rent Expense	960 —			
Advertising Expense	225 —			
Total				
Insurance Expense	165 —			
Repair Supplies Expense	1170 —			
Total				
	7295 —	13475 —		
Net Income	6180 —			6180 —
Total	$13475 —	$13475 —	$10975 —	$10975 —

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