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INTRODUCTION TO ACCOUNTING

The function of accounting is to communicate useful information to people to assist them in making rational investment, credit and similar business decisions.

The decision makers and the questions they ask are generally grouped as follows:

Owners and Managers

What resources does the business have?
What debts does it owe?
How much income is the company earning?
Are the expenses in line with the level of sales?
Is the level of inventory too high or too low?
Are customer accounts collected promptly?
Can the company's debt be paid on time?
Should we expand operations?
Should we introduce a new product?
Should we increase our selling price?

Banks and Suppliers

Should we extend additional credit?
Do future earnings look good?
Can the company pay its current debts?
Has the company paid its debts promptly in the past?

Accounting, being the support of the production and marketing functions will assist in answering these questions.

It should be noted at this point that accounting and bookkeeping are not the same.

Bookkeeping

The act of recording transactions that pertain to a business entity.

Accounting

Identification of how transactions should appear on financial reports.
Design of bookkeeping systems to produce useful reports to control operations.
Analysis of complex and unusual events.
Interpretation of information contained in financial reports.

Fields of Accounting
There are three major field of accounting: Financial Accounting, Managerial Accounting and Tax Accounting

Financial Accounting: Provides information to decision makers **not** involved in the day-to-day operations such as investors and lenders. This information is presented on general purpose financial statements, the Statement of Earnings (Income Statement), the Statement of Change in Owner / Shareholder Equity, the Statement of Financial Position (Balance Sheet) and the Statement of Change in Financial Position.

Managerial Accounting: Provides information to decision makers involved in the day-to-day operations such as the managers. This field involves information not reported outside the organization and can be broken down into three components who's purposes are as follows:

General Accounting: Record transactions, process data and prepare financial statements and management reports.

Cost Accounting: Assist managers in the identification, measure and control of operating costs, and, provide a basis for evaluating management performance.

Budgeting: Provide managers with a clear understanding of the activities required to accomplish the company's objectives, and, provide a basis for evaluating actual performance.

Tax Accounting: Knowledge of the varies levels of government and the taxes applicable to companies and individuals.

We will now take a more in depth look at Bookkeeping, the art of recording transactions for a company as they occur. The following page contains a graphical representation of the accounting theory and the two main financial reports. Think of it as the picture on top of a puzzle box with each piece of the puzzle being an account used to accumulate numbers.

The Accounting Puzzle

	DEBITS	CREDITS
	Debits increase the value of these accounts. Credits decrease the value of these accounts.	**Credits increase the value of these accounts. Debits decrease the value of these accounts.**
STATEMENT OF FINANCIAL POSITION **The value of these accounts represent the financial position of the company at a particular point in time, usually at the end of a month or year**	**ASSETS** Cash in Bank Customer Receivable Office Supplies Prepaid Rent Computer Equipment Office Equipment	**LIABILITIES** Bank Loan Supplier Payable Mortgage Payable **EQUITY** Owner Capital Owner Withdrawals
STATEMENT OF EARNINGS **The value of these accounts represents the earnings of the company for a particular length of time, usually for a month or a year.**	**EXPENSES** Advertising Bank charges Office supplies Rent	**REVENUE** Bookkeeping Services Consulting Services

Note: Owner Withdrawals, although in the Credit column, is considered a "Contra" account because it contradicts the column heading. Its "normal" balance is a Debit so debits increase its balance and credits decrease its balance. You will be introduced to other contra accounts later.

The Accounting Puzzle Explained

The accounting puzzle is made up of four squares, which contain words used to describe the accounts they include as follows:

ASSETS
The accounts in the top left corner of the puzzle are considered to be asset accounts. They represent things that the company owns at a particular point in time. (NOTE: The company may not have paid for the items, but the company controls them and therefore is considered to have ownership.)

In our example the company owns/controls the Cash in the Bank, the Customer Receivables, the Office Supplies on Hand, the Prepaid Rent, the Computer Equipment and the Office Equipment.

LIABILITIES AND EQUITY
The accounts in the top right corner of the puzzle are considered to be liability and equity accounts. The liabilities represent things that the company owes at a particular point in time. The equities represent the difference between the assets and liabilities or the company's net worth at a particular point in time.

In our example the company owes the bank for a Bank Loan, its Suppliers and a financial institution for the Mortgage. The company has net worth that is represented by the value of the accounts Owner Capital less Owner Withdrawals. (A corporation would use Common Stock and Retained Earnings.)

REVENUE
The accounts in the bottom right corner of the puzzle are considered to be revenue accounts. Revenue accounts represent money that the company has earned over a period of time.

In our example the company has earned revenue from Bookkeeping Services and Consulting Services.

EXPENSES
The accounts in the bottom left corner of the puzzle are considered to be expense accounts. Expense accounts represent costs that the company has incurred over a period of time to generate revenue.

In our example the company has incurred costs for Advertising, Bank charges, Office Supplies, and Rent.

The top row in the puzzle represents accounts that belong on the Statement of Financial Position (Balance Sheet).

The bottom row in the puzzle represents accounts that belong on the Statement of Earnings (Income Statement).

Now that we have a basic understanding of each corner of the puzzle and the accounts that are included in each square, we will look at the theory behind why and how bookkeeping transactions are recorded.

A company conducts business by entering into legal binding contracts. These contracts consist of an OFFER and an ACCEPTANCE. Bookkeeping is the act of recording these contracts (transactions) in such a way that the entries can be checked to ensure they are recorded correctly. This is called double entry bookkeeping and in essence states that for every transaction, the value of the one side of the entry must equal the value of the other side of the entry. This is done by recording the parts of the transaction as either DEBITS or CREDITS.

It should be noted here that neither Debits nor Credits are good or bad. They are just opposites of each other as in "positive and negative" or "left and right".

In our puzzle you should note that the left hand column consists of Debit accounts where the right hand side consists of Credit accounts. If the transaction requires us to increase an account in the left column we would Debit that account. If the transaction requires us to decrease an account in the left column we would Credit that account. If the transaction requires us to increase an account in the right column we would Credit that account. If the transaction requires us to decrease an account in the right column we would Debit that account. With this setup every business transaction can be recorded and Debits will always equal Credits. As a result we can now understand the two most crucial Accounting Equations:

ASSETS = LIABILITIES + EQUITY
REVENUE – EXPENSES = NET INCOME

NOTE: Although the puzzle works for almost every account there are some accounts that contradict this rule. These "Contra" accounts appear in either column but their "normal" balance is not the same as the column they are in. For example, the account "Owner Withdrawals" is in the CREDIT column but its normal balance is a Debit. For this account, Debits would increase the balance and Credits would decrease the balance.

LET'S TRY SOME EXAMPLES

Transaction 1:
You are starting a new business and you put into the business $50,000 of your own money.

Entry 1:

ACCOUNT NAME	PUZZLE	DEBIT	CREDIT
Cash in Bank (increase)	Asset	50,000	
Owner's Capital (increase)	Equity		50,000

Transaction 2:
You need to buy a computer to help manage all the information necessary to operate a successful business.

Entry 2:

ACCOUNT NAME	PUZZLE	DEBIT	CREDIT
Computer Equipment (increase)	Asset	2,000	
Cash in Bank (decrease)	Asset		2,000

Transaction 3:
You need a desk and chair to put the computer on and do you office work.

Entry 3:

ACCOUNT NAME	PUZZLE	DEBIT	CREDIT
Office Equipment (increase)	Asset	1,000	
Cash in Bank (decrease)	Asset		1,000

Transaction 4:
You need a place to set up shop so you rent the space.

Entry 4:

ACCOUNT NAME	PUZZLE	DEBIT	CREDIT
Rent (increase)	Expense	500	
Cash in Bank (decrease)	Asset		500

Transaction 5:
You do some advertising in the local paper (they want to be paid immediately)

Entry 5:

ACCOUNT NAME	PUZZLE	DEBIT	CREDIT
Advertising (increase)	Expense	400	
Cash in Bank (decrease)	Asset		400

Transaction 6:
You bought some pens and paper and paid for them immediately

Entry 6:

ACCOUNT NAME	PUZZLE	DEBIT	CREDIT
Office supplies (increase)	Expense	50	
Cash in Bank (decrease)	Asset		50

Transaction 7:
You perform some bookkeeping work and get paid immediately

Entry 7:

ACCOUNT NAME	PUZZLE	DEBIT	CREDIT
Cash in Bank (increase)	Asset	500	
Bookkeeping Services (increase)	Revenue		500

Transaction 8:
You perform some consulting work and get paid immediately

Entry 8:

ACCOUNT NAME	PUZZLE	DEBIT	CREDIT
Cash in Bank (increase)	Asset	3,000	
Consulting Services (increase)	Revenue		3,000

Transaction 9:
Your bank charges you for using their services.

Entry 9:

ACCOUNT NAME	PUZZLE	DEBIT	CREDIT
Bank Charges (increase)	Expense	25	
Cash in Bank (decrease)	Asset		25

Transaction 10:
You withdraw money for personal use

Entry 10:

ACCOUNT NAME	PUZZLE	DEBIT	CREDIT
Owner Withdrawals (increase)	Equity	300	
Cash in Bank (decrease)	Asset		300

Transaction 11:
You get a bank loan for future purchases you expect to make

Entry 11:

ACCOUNT NAME	PUZZLE	DEBIT	CREDIT
Cash in Bank (increase)	Asset	1,000	
Bank Loan (increase)	Liability		1,000

The above is referred to as **Journalizing** transactions. Once the transactions are journalized they must be **Posted**.

Posting the above transactions involves finding the applicable Ledger Card and recording the result of the transaction. The following is an example of a Ledger card for the **Cash in Bank** account:

Cash in Bank				
Entry	**Description**	**DEBIT**	**CREDIT**	**BALANCE**
	Beginning Balance			0
1	Received from Owner	50,000		50,000
2	Paid for Computer		2,000	48,000
3	Paid for Office Equipment		1,000	47,000
4	Paid for Rent		500	46,500
5	Paid for Advertising		400	46,100
6	Paid for Office Supplies		50	46,050
7	Received from Customer	500		46,550
8	Received from Customer	3,000		49,550
9	Paid for Bank Charges		25	49,525
10	Paid to Owner (personal)		300	49,225
11	Borrowed from the Bank	1,000		50,225

As you can see from the Ledger Card, the company started with no money in the bank, but ended up the period with $50,225

After posting all the transactions to each Ledger card (one exists for each account), the following Trial Balance would be prepared using the ending balances:

Sample Company
Trial Balance
As at (Period end date)

	DEBIT	**CREDIT**
Cash in Bank	50,225	
Customer Receivable	0	
Office Supplies	50	
Prepaid Rent	0	
Computer Equipment	2,000	
Office Equipment	1,000	
Bank Loan		1,000
Supplier Payable		0
Mortgage Payable		0
Owner Capital		50,000
Owner Withdrawals	300	
Bookkeeping Service		500
Consulting Services		3,000
Advertising	400	
Bank Charges	25	
Office Supplies	0	
Rent	500	
TOTALS	54,500	54,500

The above Trial Balance would be used to create the three financial statements in the following order:

STATEMENT OF EARNINGS
STATEMENT OF CHANGES IN OWNER EQUITY
STATEMENT OF FINANCIAL POSITION

Sample Company
Statement of Earnings
For the Period (Month or Year-to-Date) Ended (Period end date)

REVENUE:		
Bookkeeping Services	500	
Consulting Services	3,000	

TOTAL REVENUE		3,500
EXPENSES:		
Advertising	400	
Bank Charges	25	
Rent	500	

TOTAL EXPENSES		925

NET INCOME (before taxes)		2,575
		======

NOTE: The $2,575 will be used on the next statement.

Sample Company
Statement of Change in Owner Equity
For the Period (Month or Year-to-Date) Ended (Period end date)

Owner Equity at the beginning of the period			0
Plus:	Investment by Owner	50,000	
	Net Income	2,575	52,575
		---------	---------
			52,575
Less:	Owner Withdrawals		300

Owner Equity at the end of the period			52,275
			======

NOTE: The $52,275 will be used on the next statement.

Sample Company
Statement of Financial Position
As at (Period end date)

CURRENT ASSETS:		
Cash in Bank	50,225	
Office Supplies	50	

TOTAL CURRENT ASSETS		50,275
CAPITAL ASSETS:		
Computer Equipment	2,000	
Office Equipment	1,000	

TOTAL CAPITAL ASSETS		3,000

TOTAL ASSETS		53,275
		=====
CURRENT LIABILITIES:		
Bank Loan	1,000	

TOTAL CURRENT LIABILITIES		1,000
EQUITY:		
Owner Equity		52,275

TOTAL LIABILITIES AND OWNER EQUITY		53,275
		======

NOTE 1: The amount for “Total Assets” equals the amount for “Total Liabilities and Owner Equity”. This shows that the books are in balance but does not suggest that no errors have been made.

NOTE 2: The ASSETS have been broken down between CURRENT ASSETS and CAPITAL ASSETS. The same is true with LIABILITIES as there are CURRENT LIABILITIES and LONG TERM LIABILITIES.

Now that we have covered the very basics of bookkeeping there are a couple of other items that need to be understood.

Types of Business Entities

Proprietorship:	This business form consists of a sole owner who is personally liable for the actions of the company.
Partnership:	This business form consists of two or more owners who jointly operate the business and are personally responsible for the actions of the company.
Corporation:	This business form is a separate legal entity and the owners (shareholders) are not personally responsible for the actions of the company.

Generally Accepted Accounting Principles (GAAP)
There are rules and principles that govern the individual in their action and the handling of the transactions of a business entity. The governing body varies from country to country. Following are some of those principles:

Objectivity:	Accounting should be objective and unbiased (stick to the same rules for every business).
Consistency:	Accounting should be consistent from year to year (i.e.: depreciate your assets at the same rate every year so comparisons are possible).
Materiality:	Treat transactions in light of their effect on the financial statements (i.e.: if annual sales are over a million dollars, you need not spend hours finding 5 cents. This is a judgment call).
Cost:	Initial accounting recognition is based on the cash equivalent cost (what you paid or received in a transaction is the amount to be used to record the transaction).
Full Disclosure:	The financial statements of a business should clearly report all of the relevant information about the economic affairs of the enterprise. (Notes to the Financial Statements)
Realization:	Revenue recognition is only possible when it can be defined (what is it for), it is measurable (how much), it is relevant (our income) and it is reliable (we will receive the cash).
Matching:	For the revenue of a reporting period, all expenses that were incurred in earning that revenue should be recognized.

Conservatism: Be conservative in making judgments under conditions of uncertainty. (When in doubt, Underestimate Assets and Revenue and Overestimate Liabilities and Expenses.)

Business Entity: Transactions concerning the company should be kept separate from personal transactions.

Going Concern: Transactions should be recorded as if the company intends to stay in business indefinitely.

Finally, we should be aware of a concept called “T” accounts. The following is part of the Ledger card you were introduced to earlier:

Cash in Bank	**DEBIT**	**CREDIT**	**BALANCE**
Beginning Balance			0
Received from Owner	50,000		50,000
Paid for Computer		2,000	48,000
Paid for Office Equipment		1,000	47,000
Paid for Rent		500	46,500
Paid for Advertising		400	46,100
Paid for Office Supplies		50	46,050

A “T” account for “Cash in Bank” would be as follows:

CASH IN BANK

DEBIT	**CREDIT**
50,000	
	2,000
	1,000
	500
	400
	50
50,000	3,950
- 3,950	←-------------|
46,050	

“T” accounts are very useful when explaining the affects of journal entries on specific accounts and will be used again and again in later chapters.

SUPPLEMENTAL INFORMATION

Finding Errors
Many arithmetic errors (where total Debits do not equal total Credits) can be found quickly by using the following logic to locate the error:

Type 1: Debit entered as a Credit or Credit entered as a Debit

Calculate the difference between the Debits and the Credits
Divide the difference by 2
Locate the new amount and check for the error

Type 2: Transposition of numbers

Calculate the difference between total Debits and total Credits
Divide the difference by 9
The result must be a whole number (ie: 1, 2, 3, 4, etc.)

Examples:

Number should be	521	5210	52100
Number is	512	5120	51200
Difference	9	90	900
Divide by 9	1	10	100

Number should be	531	5310	53100
Number is	513	5130	51300
Difference	18	180	1800
Divide by 9	2	20	200

Number should be	541	5410	54100
Number is	514	5140	51400
Difference	27	270	2700
Divide by 9	3	30	300

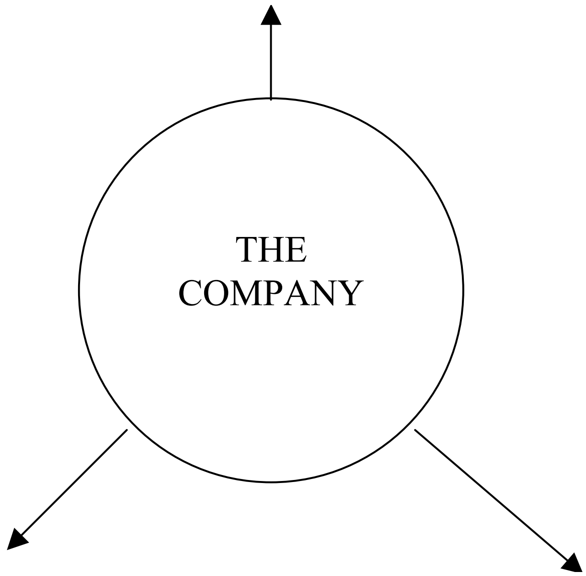
Number should be	551	5510	55100
Number is	515	5150	51500
Difference	36	360	3600
Divide by 9	4	40	400

The final number will tell you the difference between the two numbers that are transposed. The number of zeros after the final number will tell you the position of the transformation.

External Transactions

BUSINESS OWNER

Investments by Owner	→	Credit Owner Capital
Withdrawals by Owner	→	Debit Owner Withdrawals



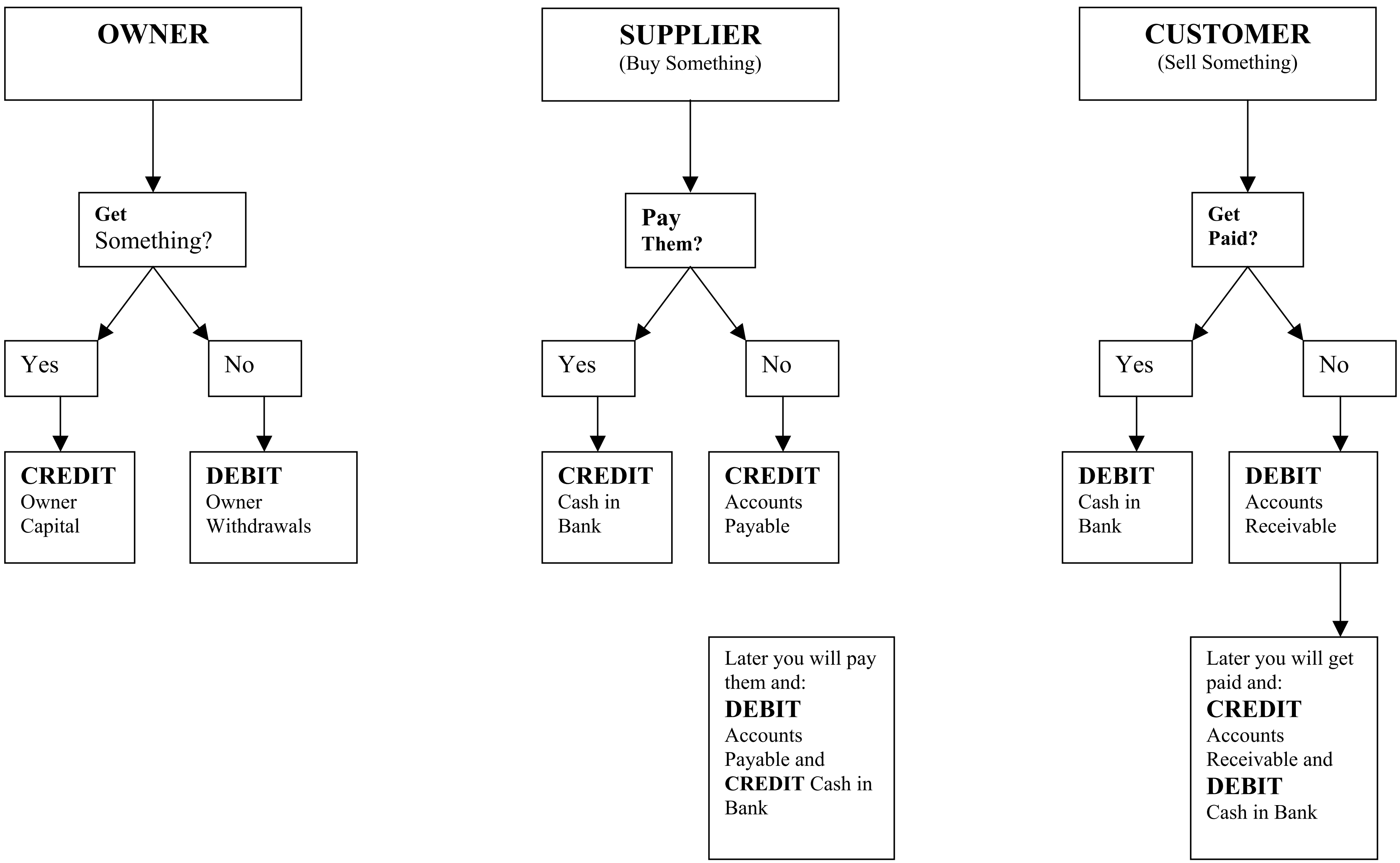
SUPPLIERS

Purchase and Pay Now	→	CR Cash
Purchase and Pay Later	→	CR Accounts Payable
Pay for Prior Purchase	→	CR Cash and DR Accounts Payable

CUSTOMERS

Sell and Get Paid Now	→	DR Cash
Sell and Get Pay Later	→	DR Accounts Receivable
Get Paid for Prior Sale	→	DR Cash and CR Accounts Receivable

BOOKKEEPING DECISION TREE



Internal Transactions

UNRECORDED EXPENSES

Expenses Incurred because the Asset has decreased in value (Office Supplies / Prepaid Expenses / Amortization)

Assets	Liabilities
CREDIT ↓	
Expenses	Revenue
DEBIT ↑	

Expenses Incurred, but not paid (Accounts Payable / Wages Payable / Interest Payable / Property Tax Payable)
(Accrued Expenses)

Assets	Liabilities
	CREDIT ↑
Expenses	Revenue
DEBIT ↑	

UNRECORDED REVENUE

Unearned Fees now Earned

Assets	Liabilities
	DEBIT ↓
Expenses	Revenue
	CREDIT ↑

Fees Earned, but not collected (Accounts Receivable)
(Accrued Revenue)

Assets	Liabilities
DEBIT ↑	
Expenses	Revenue
	CREDIT ↑

PERIOD ENDS

At the end of an accounting period, after all journals are posted to the General Ledger, some of the accounts in the ledger may not have the proper balance. This is not caused by errors, but by the passage of time.

Types of Period Ends

Month End: To record information not previously recorded for the month.

Year End: To record information not previously recorded in the year and to reset (close) the revenue, expense and, if applicable, Owner Withdrawals accounts to zero to start a new year.

Month-End Adjustments

Month end adjustments take in to consideration "Accrued Revenues" and "Accrued Expenses". These are revenues and expenses that have not, but should have, been recorded, in order to create correct financial statements.

There are four types of Month End adjustments as follows:

Accrued Expenses:

1. Debit an Expense account — Credit an Asset account
2. Debit an Expense account — Credit a Liability account

Accrued Revenues:

3. Credit a Revenue account — Debit a Liability account
4. Credit a Revenue account — Debit an Asset account

The following illustrates typical transactions and their required Month End entries:

Example 1:
On January 1, you purchase 12 months worth of insurance for $1,200.

DATE	ACCOUNT NAME	PUZZLE	DEBIT	CREDIT
Jan 1/95	Prepaid Insurance	Asset	1,200	
	Cash in Bank	Asset		1,200

The Prepaid Insurance account is a Current asset. Because of the matching principle all of the $1,200 cannot be expensed in January because the benefit from this expenditure happens in each month for 12 months. At the end of each month the following Period End entry would be required.

DATE	ACCOUNT NAME	PUZZLE	DEBIT	CREDIT
Jan 31/95	Insurance expense	Expense	100	
	Prepaid Insurance	Asset		100

This is a Type 1 month end adjustment. By following the above procedure, each month would receive an expense of $100 for the cost of insurance ($1,200 divided by 12)

Example 2:
On January 1, you purchase $500 worth of Office Supplies that are expected to last for 5 months.

DATE	ACCOUNT NAME	PUZZLE	DEBIT	CREDIT
Jan 1/95	Office Supplies	Asset	500	
	Cash in Bank	Asset		500

The Office Supplies account is a Current asset. Because of the matching principle all of the $500 cannot be expensed in January because the supplies will last for more than one month. At the end of each month the supplies must be counted and valued and (for example) you find that , on January 31st there is $350 worth of supplies left. The following Period End entry would be required.

DATE	ACCOUNT NAME	PUZZLE	DEBIT	CREDIT
Jan 31/95	Office Supplies Expense	Expense	150	
	Office Supplies	Asset		150

This is also a Type 1 month end adjustment. By determining the value of the supplies on hand at month end and comparing this number with the value in the accounting books, the amount of the adjustment can be determined.

Example 3:
On January 1, you purchase a piece of equipment for $6,000 and you expect it to have no salvage value after 5 years.

DATE	ACCOUNT NAME	PUZZLE	DEBIT	CREDIT
Jan 1/95	Machinery & Equipment	Asset	6,000	
	Cash in Bank	Asset		6,000

The Machinery & Equipment account is a Capital asset. Because of the matching principle all of the $6,000 cannot be expensed in January because the benefit from this expenditure happens in each month for 5 years. At the end of each month the following Period End entry would be required.

DATE	ACCOUNT NAME	PUZZLE	DEBIT	CREDIT
Jan 31/95	Amortization expense	Expense	100	
	Accumulated Amortization	Asset		100

This is also a Type 1 month end adjustment. By following the above procedure each month would receive an expense of $100 for the cost of the Machinery & Equipment ($6,000 divided by 5 years divided by 12 months).

Example 4:
You know that your accountant will charge you $2,400 to prepare your year-end financial statements and tax return.

DATE	ACCOUNT NAME	PUZZLE	DEBIT	CREDIT
Jan 31/95	Professional fees	Expense	200	
	Accrued Liabilities	Liability		200

This is a Type 2 month end adjustment. The Accrued Liabilities account is a Current liability. Because of the matching principle all of the $2,400 cannot be expensed in December because the benefit from this expenditure happens in each month for 12 months. By following the above procedure each month would receive an expense of $200 for the cost of the Professional fees ($2,400 divided by 12 months).

Example 5:
On January 1, you receive, from a customer, 3 months fees ($100 per month) in advance.

DATE	ACCOUNT NAME	PUZZLE	DEBIT	CREDIT
Jan 1/95	Cash in Bank	Asset	300	
	Unearned Revenue	Liability		300

The Unearned Revenue account is a Current liability. Because of the revenue recognition principle all of the $300 has not been earned in January. At the end of each month the following Period End entry would be required.

DATE	ACCOUNT NAME	PUZZLE	DEBIT	CREDIT
Jan 31/95	Unearned Revenue	Liability	100	
	Fees Earned	Revenue		100

This is a Type 3 month end adjustment. By following the above procedure each month would receive revenue of $100 for the fees ($300 divided by 3 months).

Example 6:
By January 31 you have completed $1,000 worth of work for a customer, but the customer has not been invoiced for the work.

DATE	ACCOUNT NAME	PUZZLE	DEBIT	CREDIT
Jan 31/95	Accounts Receivable	Asset	1,000	
	Fees Earned	Revenue		1,000

This is a Type 4 month end adjustment. The Accounts Receivable account is a Current asset. Because of the revenue recognition principle the $1,000 must be recognized in January.

The above four types of month end adjustments deal with specific accounts and their related accounts as follows:

	ACCOUNT TO DEBIT		**RELATED ACCOUNT TO CREDIT**	
TYPE	**NAME**	**PUZZLE**	**NAME**	**PUZZLE**
Type 1	Insurance Expense	Expense	Prepaid Insurance	Asset
	Office Supplies Expense	Expense	Office Supplies	Asset
	Amortization Expense	Expense	Accumulated Amortization	Asset
Type 2	Professional Fees	Expense	Accrued Liabilities	Liability
Type 3	Unearned Fees	Liability	Fees Earned	Revenue
Type 4	Accounts Receivable	Asset	Fees Earned	Revenue

As you may notice, each type of adjustment Debits an Expense account or Credits a Revenue account. This may not always be the case as errors in recording the original entries could cause different adjustments, but if transactions are recorded correctly when first entered into a set of books, these four types of adjustments (but not specifically the above adjustments) are all that are needed to record Accrued Revenues and Accrued Expenses.

Once these month end entries are posted to the General Ledger a new or Adjusted Trial Balance should be prepared. This Adjusted Trial Balance would be used to create the Financial Statements of the company.

At the end of the year, after the Financial Statements are prepared, the year-end adjustments (Closing Entries) finalize the accounting for the year.

Year-End Closing Entries

Year-end entries are necessary to reset (close) the revenue, expense and, if applicable, Owner Withdrawals accounts to zero to start a new year. For an unincorporated company, there are four "Closing" entries. The following is an example of these entries:

Entry 1 – To Close Revenue accounts out to Income Summary account:

	DEBIT	**CREDIT**
Bookkeeping Fees Earned	5,000	
Consulting Fees Earned	10,000	
Income Summary		15,000

Entry 2 – To Close Expense accounts out to Income Summary account:

	DEBIT	**CREDIT**
Advertising		500
Office Supplies		100
Insurance		1,000
Professional Fees		2,000
Income Summary	3,600	

Entry 3 – To Close Income Summary out to Owner Capital:

	DEBIT	**CREDIT**
Income Summary	11,600	
Owner Capital		11,600
(15,000-3,600 = 11,600)		

Entry 4 – To Close Owner Withdrawals out to Owner Capital:

	DEBIT	**CREDIT**
Owner Withdrawals		2,000
Owner Capital	2,000	

Once these Year End entries have been completed, the company is ready to begin a new year.

THE WORKSHEET

When the bookkeeper has completed recording transactions for the year an "Unadjusted Trial Balance" is created using the ending balance for each General Ledger Account. The accountant would use this "Unadjusted Trial Balance" to begin the "Worksheet".

The steps involved are as follows:

1. Put the information from the Unadjusted Trial Balance onto the Worksheet
2. Prepare "Adjusting" journal entries for any adjustments needed to correct any balances and record any unrecorded revenues or expenses.
3. Post the adjusting entries onto the Worksheet
4. Calculate the "Adjusted Trial Balance" information based on the Unadjusted Trial Balance plus (or minus) any adjustments.
5. Sort the amounts in the Adjusted Trial Balance columns to either the "Income Statement" (for revenue and expense accounts) or "Balance Sheet" (for assets, liabilities and equity accounts) columns.
6. Complete the Worksheet to ensure that it is balanced.

When the worksheet has been completed, it becomes the source of the information needed to create the following:

1. Income Statement
2. Statement of Change in Owner's Equity
3. Balance Sheet.
4. Closing Entries

The "Closing Entries" prepare the General Ledger cards for the beginning of a new year by adjusting, to zero, the Revenue, Expense and Owner's Withdrawal accounts. There are four closing entries in all as follows:

1. Close the Revenue accounts to the Income Summary account
2. Close the Expense accounts to the Income Summary account
3. Close the Income Summary account to the Owner's Capital account
4. Close the Owner's Withdrawals account to the Owner's Capital account

Following is the Unadjusted Trial Balance of ABC Company as at December 31, 2002:

Cash	3,000	
Office Supplies	3,800	
Prepaid Insurance	2,650	
Equipment	48,000	
Accumulated Amortization – Equipment		
Accounts Payable		12,000
Wages Payable		
John Doe, Capital		30,000
John Doe, Withdrawals	15,000	
Fees Earned		77,750
Amortization Expense – Equipment		
Wages Expense	36,000	
Insurance Expense		
Rent Expense	9,600	
Office Supplies Expense		
Utilities Expense	1,700	
	----------	----------
Totals	119,750	119,750
	======	======

The above Unadjusted Trial Balance amounts came from the ending balances on the General Ledger cards. Following are the procedures to complete a company's year and prepare the books for a new year:

1. Put the Unadjusted Trial Balance on the worksheet
2. Journalize the Adjusting Entries (i.e.: as follows)
   a. There was really only $700 of Office Supplies on hand.
   b. Expired insurance was $660
   c. Estimated amortization on the Office Equipment was $4,000
   d. Wages owing to one employee was $500
3. Post the Adjusting Entries to the Worksheet
4. Complete the Worksheet
5. Journalize the Year-End Closing Entries.

GENERAL JOURNAL

Adjusting Entries:

ADJ #	ACCOUNT	TYPE	DEBIT	CREDIT
a)	Office Supplies Expense	EX	3,100	
	Office Supplies	A		3,100
	Explain: Adjust supplies to actual			
b)	Insurance Expense	EX	660	
	Prepaid Insurance	A		660
	Explain: Record expired insurance			
c)	Amortization Expense, Equipment	EX	4,000	
	Accumulated Amortization – Equipment	A		4,000
	Explain: Record estimated amortization			
d)	Wages Expense	EX	500	
	Wages Payable	L		500
	Explain: Record wages owed employee			

Closing Entries:

#	ACCOUNT	TYPE	DEBIT	CREDIT
1.	Fees Earned	R	77,750	
	Income Summary	Temp		77,750
	Explain: Close Revenue account			
2.	Income Summary	Temp	55,560	
	Amortization Expense – Equipment	EX		4,000
	Wages Expense	EX		36,500
	Insurance Expense	EX		660
	Rent Expense	EX		9,600
	Office Supplies Expense	EX		3,100
	Utilities Expense	EX		1,700
	Explain: Close Expense accounts			
3.	Income Summary	Temp	22,190	
	John Doe, Capital	EQ		22,190
	Explain: Close Income Summary to Capital			
4.	John Doe, Capital	EQ	15,000	
	John Doe, Withdrawals	EQ		15,000
	Explain: Close Withdrawals to Capital			

ABC COMPANY
WORKSHEET
DECEMBER 31, 2002

	Unadjusted T/Bal		**Adjustments**		**Adjusted T/Bal**		**Income Statement**		**Balance Sheet**	
	Debit	Credit	Debit	Credit	Debit	Credit	Debit	Credit	Debit	Credit
Cash	3,000				3,000				3,000	
Office Supplies	3,800		a)	3,100	700				700	
Prepaid Insurance	2,650		b)	660	1,990				1,990	
Equipment	48,000				48,000				48,000	
Acc. Amort – Equip			c)	4,000		4,000				4,000
Accounts Payable		12,000				12,000				12,000
Wages Payable			d)	500		500				500
J. Doe, Capital		30,000				30,000				30,000
J, Doe, Withdrawals	15,000				15,000				15,000	
Fees Earned		77,750				77,750		77,750		
Amortization Exp.			4,000	c)	4,000		4,000			
Wages Expense	36,000		500	d)	36,500		36,500			
Insurance Expense			660	b)	660		660			
Rent Expense	9,600				9,600		9,600			
Office Supp Expense			3,100	a)	3,100		3,100			
Utilities Expense	1,700				1,700		1,700			
	119,750	119,750	8,260	8,260	124,250	124,250	55,560	77,750	68,690	46,500
Net Income							22,190			22,190
							77,750	77,750	68,690	68,690

NOTE: **The $22,190 is calculated as the difference between the Debits and Credits for the Income Statement columns. Since we put the $22,190 in the Debit column of the Income Statement, we must put the same amount in the Credit column of the Balance Sheet and total Debits equals total Credits.**

FINANCIAL STATEMENTS

Financial Statements convey information about the company. The four financial statements in order of their creation are:

Statement of Earnings (Income Statement)
Statement of Change in Owner's Equity (or Retained Earnings)
Statement of Financial Position (Balance Sheet)
Statement of Change in Financial Position

The Statement of Change in Financial Position is covered on its own in another chapter so the following will only cover the first three financial statements.

Statement of Earnings
This financial statement is often referred to as the Income Statement. It is the first statement to be created as its final amount is needed for the next statement. The format of this statement would vary depending on the type of business (service, merchandising or manufacturing) and the type of inventory control (periodic or perpetual), but its main purpose is to report the Revenue, Expenses and Net Income of an organization.

Example of a Statement of Earnings for a Service Company

Service Company
Statement of Earnings
For the Month Ended January 31, 2000

REVENUE:		
Bookkeeping Fees Earned	2,000	
Consulting Fees Earned	5,000	
TOTAL REVENUE		7,000
EXPENSES:		
Advertising	170	
Amortization on Computer Equipment	50	
Bank Charges	25	
Insurance	20	
Office Supplies	30	
Rent	500	
Telephone	55	
Vehicle Lease	150	
Wages	4,000	
TOTAL EXPENSES		5,000
NET INCOME (before tax)		2,000

Example of a Statement of Earnings for a Merchandising Company using a Perpetual Inventory system.

Perpetual Inventory Merchandising Company
Statement of Earnings
For the Month Ended January 31, 2000

REVENUE:				
Sales				32,000
Less:	Sales Returns & Allowances		500	
	Sales Discounts		1,500	2,000
Net Sales				30,000
COST OF GOODS SOLD				22,000
GROSS PROFIT				8,000
OPERATING EXPENSES:				
Selling Expenses:				
	Advertising	200		
	Store Rent	1,000		
	Store Supplies	100		
	Store Telephone	70		
	Sales Salaries	3,000	4,370	
General Expenses:				
	Office Supplies	50		
	Telephone	80		
	Office Salaries	1,500	1,630	
TOTAL OPERATING EXPENSES				6,000
NET INCOME FROM OPERATIONS				2,000

Sales
Credit this account when you sell merchandise to a customer.
Debit (or Credit) this account for errors on a sales invoice.

Sales Returns & Allowances

Returns — Debit this account for merchandise returned by customers. If the returned items are in good condition and can be returned to inventory you must Debit the Inventory account and Credit the Cost of Goods Sold account. If the returned items are no good, do not do the Inventory / Cost of Goods Sold entry.

Allowances — If a customer argues about the price after being invoiced and is given a reduced price, Debit this account.

Sales Discounts
When a customer pays within the discount period (ie: 2/10, N/30) the cash received is less than the amount Receivable. The cash discount amount is a Debit to this account. Example using a Periodic Inventory system.

REVENUE:				
Sales				32,000
Less: Sales Returns			500	
Sales Discounts			1,500	2,000
Net Sales				30,000
COST OF GOODS SOLD:				
Beginning Inventory			5,000	
Purchases		25,000		
Less: Purchase Returns	500			
Purchase Discounts	100	600		
Net Purchases		24,400		
Add Transportation In		1,000		
Cost of Goods Purchased			25,400	
Goods Available for Sale			30,400	
Less Ending Inventory			8,400	
COST OF GOODS SOLD				22,000
GROSS PROFIT				8,000
OPERATING EXPENSES:				
Selling Expenses:				
Advertising		200		
Store Rent		1,000		
Store Supplies		100		
Store Telephone		70		
Sales Salaries		3,000	4,370	
General Expenses:				
Office Supplies		50		
Telephone		80		
Office Salaries		1,500	1,630	
TOTAL OPERATING EXPENSES				6,000
NET INCOME FROM OPERATIONS				2,000

Purchases
Debit this account when you buy merchandise from a supplier.
Credit (or Debit) this account for errors on a purchase invoice.

Purchase Returns & Allowances

Returns	Credit this account for merchandise returned to suppliers.
Allowances	If we argue about the price after being invoiced and are given a reduced price, Credit this account.

Purchase Discounts
When a supplier is paid within the discount period (ie: 2/10, N/30) the cash paid is less than the amount Payable. The cash discount amount is a Credit to this account.

Statement of Change in Owner's Equity

This financial statement is the second statement to be created. Its final amount is needed for the next statement and the Net Income from the previous statement is required. The wording of this statement would vary depending on the equity structure of the business (Proprietorship, Partnership or Corporation), but its main purpose is to report the beginning, change and ending equity position of an organization.

Example of a Statement of Change in Owner's Equity

Service Company
Statement of Change in Owner's Equity
For the Month Ended January 31, 2000

Owner's Capital January 1, 2000			10,000
Plus:	Net Income	2,000	
	Owner Investments	5,000	7,000
			17,000
Less:	Net Loss	0	
	Owner Withdrawals	1,000	1,000
Owner's Capital January 31, 2000			16,000

We have included the four possible causes of changes in the total amount of owner's equity (Net Income, New Investments by the Owner, Net Loss and Withdrawals by the Owner). In all cases you would either have a Net Income or a Net Loss so the lines that are not applicable would be removed.

Owner Investments is the dollar value of anything given to the company by the owner where Owner Withdrawals is the dollar value of anything taken from the company by the owner. This includes cash paid to the owner even if it appears to be a salary or wage.

Statement of Financial Position
This financial statement is the third statement to be created and its main purpose is to report the financial position of an organization at the end of a specified period.

Example of a Statement of Financial Position

Service Company
Statement of Financial Position
January 31, 2000

ASSETS			
CURRENT ASSETS:			
Cash in Bank		17,600	
Accounts Receivable		16,000	
Office Supplies		600	
Prepaid Insurance		1,100	
TOTAL CURRENT ASSETS			35,300
CAPITAL ASSETS:			
Automobile	20,000		
Less Accumulated Amortization	6,000	14,000	
Office Equipment	5,000		
Less Accumulated Amortization	1,000	4,000	
TOTAL CAPITAL ASSETS			18,000
TOTAL ASSETS			53,300
LIABILITIES			
CURRENT LIABILITIES			
Accounts Payable		8,000	
GST Charged to Customers		1,000	
GST Paid to Suppliers		800	
PST Charged to Customers		1,100	
EI Payable		200	
CPP Payable		300	
Employee Tax Payable		900	
Current Portion of Long Term Note		1,200	
TOTAL CURRENT LIABILITIES			13,500
LONG TERM LIABILITIES:			
Long Term Note Payable		25,000	
Less Current Portion		1,200	
TOTAL LONG TERM LIABILITIES			23,800
TOTAL LIABILITIES			37,300
OWNER'S EQUITY JANUARY 31, 2000			16,000
TOTAL LIABILITIES & OWNER EQUITY			53,300

Note that Total Assets = Total Liabilities & Owner Equity

PERPETUAL INVENTORY ENTRIES

In previous chapters, all the entries were dealing with a Service Company type of organization. When dealing with a Merchandising Company (a company that buys product, puts it on the shelf and then sells it) there are considerations not applicable to the Service Company. One of the main differences is dealing with Credit Terms and FOB Terms.

Credit Terms:
An example of credit terms extended from a seller to a buyer is 2/10, N/30. These terms mean the buyer does not have to pay for 30 days, but if they choose to pay in 10 days they can take a cash discount of 2%. If possible a buyer should always take advantage of this discount. Other examples of credit terms might be 1/15, N/30 or 2/15, N/60.

FOB Terms:
Freight-On-Board (FOB) determines when title to the product passes from the seller to the buyer. The main two options are FOB Shipping Point (when the product leaves the supplier's premises) and FOB Destination (when the product arrives at the customer's premises).

Supplier Transactions in a Perpetual Inventory System:

DATE	ACCOUNT	PUZZLE	DEBIT	CREDIT
Jan 1/95	Inventory	Asset	6,000	
	A/P – Supplier	Liability		6,000
	Terms: 2/10, N/30 - Purchase and increase in Inventory			

DATE	ACCOUNT	PUZZLE	DEBIT	CREDIT
Jan 2/95	A/P – Supplier	Liability	2,000	
	Inventory	Asset		2,000
	Return and decrease in Inventory			

DATE	ACCOUNT	PUZZLE	DEBIT	CREDIT
Jan 11/95	A/P – Supplier	Liability	4,000	
	Inventory	Asset		80
	Cash in Bank	Asset		3,920
	Payment to Supplier with discount (6,000 – 2,000) X .02 = 80			

DATE	ACCOUNT	PUZZLE	DEBIT	CREDIT
Jan 2/95	Inventory	Asset	100	
	Cash in Bank	Asset		100
	Paid Freight on incoming inventory			

Customer Transactions in a Perpetual Inventory System:

DATE	ACCOUNT	PUZZLE	DEBIT	CREDIT
Jan 1/95	A/R – Customer	Asset	10,000	
	Sales	Revenue		10,000
	Cost of Goods Sold	Expense	6,000	
	Inventory	Assets		6,000
	Terms: 2/10, N/30 - Sale and decrease in Inventory			

DATE	ACCOUNT	PUZZLE	DEBIT	CREDIT
Jan 2/95	Sales Returns	Revenue	4,000	
	A/R – Customer	Asset		4,000
	Inventory	Asset	2,400	
	Cost of Goods Sold	Expense		2,400
	Return and increase in Inventory			

DATE	ACCOUNT	PUZZLE	DEBIT	CREDIT
Jan 2/95	Sales Returns	Revenue	4,000	
	A/R – Customer	Asset		4,000
	Return without an increase in Inventory			

DATE	ACCOUNT	PUZZLE	DEBIT	CREDIT
Jan 11/95	Cash in Bank	Asset	5,880	
	Sales Discount	Revenue	120	
	A/R – Customer	Asset		6,000
	Receipt from Customer with discount (10,000 – 4,000) X .02 = 120			

DATE	ACCOUNT	PUZZLE	DEBIT	CREDIT
Jan 2/95	Sales Returns	Revenue	100	
	A/R – Customer	Asset		100
	Reduction in price (Sales Allowance)			

DATE	ACCOUNT	PUZZLE	DEBIT	CREDIT
Jan 2/95	Sales	Revenue	500	
	A/R – Customer	Asset		500
	Error on original invoice			

TRANSACTIONS FOR A MERCHANDISING CONCERN THAT USES A PERPETUAL INVENTORY SYSTEM.

TRANSACTIONS WITH SUPPLIERS	TRANSACTIONS WITH CUSTOMERS
1. **Purchase inventory on account** DEBIT Inventory (A) CREDIT Accounts Payable (L)	1. **Sell inventory on account** DEBIT Accounts Receivable (A) CREDIT Sales (R) DEBIT Cost of Goods Sold (EX) CREDIT Inventory (A)
2. **Return inventory on account** DEBIT Accounts Payable (L) CREDIT Inventory (A)	2. **Customer return - product in good condition** DEBIT Sales Returns & Allowances (R) CREDIT Accounts Receivable (A) DEBIT Inventory (A) CREDIT Cost of Goods Sold (EX)
3. **Payment to supplier (no discount)** DEBIT Accounts Payable (L) CREDIT Cash (A)	3. **Customer return - product in bad condition** DEBIT Sales Returns & Allowances (R) CREDIT Accounts Receivable (A)
4. **Payment to supplier (with discount)** DEBIT Accounts Payable (L) CREDIT Inventory (A) CREDIT Cash (A)	4. **Error on invoice after invoice is issued** DEBIT Sales (R) CREDIT Accounts Receivable (A)
5. **Payment for incoming freight** DEBIT Inventory (A) CREDIT Cash (A)	5. **Argument over price after invoice is issued** DEBIT Sales Returns & Allowances (R) CREDIT Accounts Receivable (A)
	6. **Receipt from customer (no discount)** DEBIT Cash (A) CREDIT Accounts Receivable (A)
	7. **Receipt from customer (with discount)** DEBIT Cash (A) DEBIT Sales Discounts (R) CREDIT Accounts Receivable (A)

SPECIAL JOURNALS & SUBIDIARY LEDGERS

Journals: Accounting books used to record business transactions as they occur.

Ledgers: Accounting book where each page records the increase, decrease and new balance of a specific account.

Business transactions affect specific accounts (Cash in Bank, Advertising expense, etc.) to increase or decrease their value. These transaction are recorded in a **JOURNAL** as they occur. Each line of these transactions are then posted (copied) to a **LEDGER** which is used to keep track of the increases, decreases and balances of these accounts.

To illustrate we will record the business transaction for starting a business with $50,000. The entry would appear in the Journal as follows:

DATE	ACCOUNT	PUZZLE	DEBIT	CREDIT
Jan 1/95	Cash in Bank	Asset	50,000	
	Owner Capital	Equity		50,000

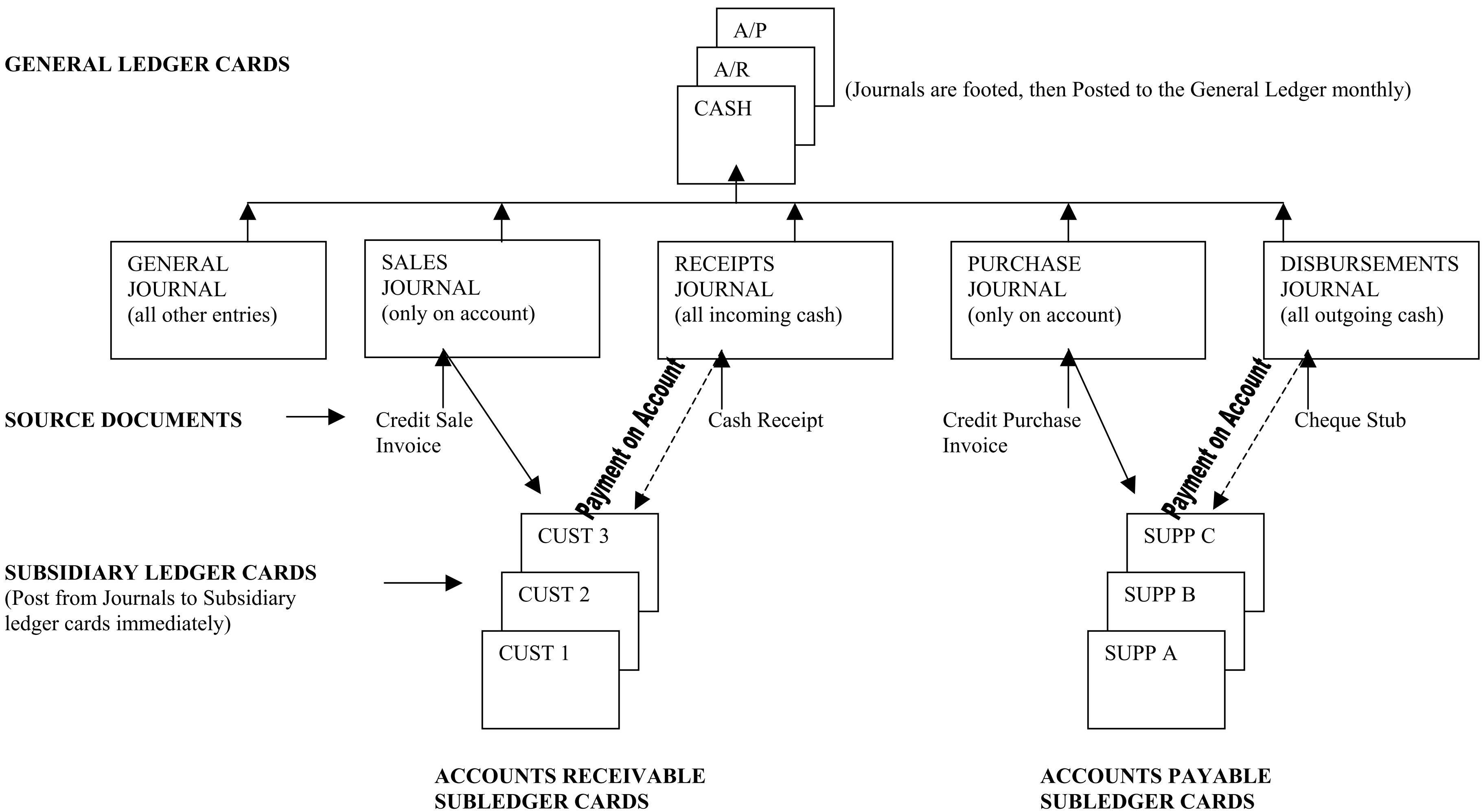
The affect on the Ledger accounts would be as follows:

ACCOUNT NAME: Cash in Bank					
DATE	**EXPLANATION**	**REF**	**DEBIT**	**CREDIT**	**BALANCE**
Jan 1/95	Start new business	GJ	50,000		50,000

ACCOUNT NAME: Owner Capital					
DATE	**EXPLANATION**	**REF**	**DEBIT**	**CREDIT**	**BALANCE**
Jan 1/95	Start new business	GJ		50,000	50,000

The above is an illustration of a General Journal and its effect on the General Ledger.

Notice that we have classified the Journal and Ledger as General Journal and General Ledger. This is because a set of accounting books consists of many journals and many ledgers. Let's first look at the overall picture and then analyze its parts. For simplicity sake we will assume that all sales and purchases are on account and paid at a later date.



NOTE: **At month end the sum of the A/R subledger cards ending balances must equal the balance on the G/L card for Accounts Receivable and the sum of the A/P subledger cards ending balances must equal the balance on the G/L card for Accounts Payable.**

As the above illustration shows, a set of accounting books (excluding payroll) is made up of five journals as follows:

General Journal:	Record transactions that do not fit in the other journals.
Sales Journal:	Record credit invoices to customers.
Receipts Journal:	Record all cash received.
Purchase Journal:	Record credit invoices from suppliers.
Disbursements Journal:	Record all cash paid out.

All transactions for a business can be recorded in one of the journals. Except for the General Journal, all other journals have columns which contain information pertinent to the particular type of transaction. At month end the amounts in a column are added together (footed) to create a total for each column. These totals (after cross-footing which ensures total Debits equals total Credits) are then posted to the General Ledger.

You have been shown a General Journal entry previously. We will now explore each of the other journals and how information is entered in each one of them.

Note: Some companies use the Sales Journal to record all sales whether for cash or on account (credit). For simplicity sake the following examples will assume all sales are on account and all purchases are on account.

SALES JOURNAL

The Sales Journal is used to record credit invoices to customers. In reality, all sales are made on credit, but some customers pay us immediately (cash sale) and some customers pay us later (credit sale). For simplicity we will ignore sales taxes.

			DEBIT	CREDIT
DATE	**INVOICE #**	**CUSTOMER**	**A/R**	**SALES**
Jan 1/95	1005	ABC Company	117.70	117.70
Jan 2/95	1006	DEF Company	58.85	58.85
Jan 31/95		Totals	176.55	176.55

As you can see, the journal is made up of various columns whose rows contain information about a specific sale transaction for a company. When all the transactions for a particular month are complete a total for each column is recorded (footing).

There are three things that are of particular importance:

1. Certain columns are designated as DEBIT or CREDIT columns. This makes it easier to know whether the entry in the General Ledger account should be a debit or a credit.
2. We have numerical control and can easily track if there is a missing invoice.
3. We can convert the totals into a General Journal entry and debits equal credits as follows:

DATE	ACCOUNT	PUZZLE	DEBIT	CREDIT
Jan 31/95	Accounts Receivable	Asset	176.55	
	Sales	Revenue		176.55

The conversion of the totals to a General Journal entry is not normally done, but we do it here only to illustrate that the debits equal the credits in all journals (cross-footing).

RECEIPTS JOURNAL

The Receipts Journal is used to record payments from customers. Some payments are for sales that have just been made (cash sales) and some are for sales made prior to this date (credit sales).

			DEBIT	CREDIT
DATE	**RECEIPT #**	**CUSTOMER**	**CASH**	**A/R**
Jan 10/95	240	ABC Company	117.70	117.70
Jan 20/95	241	DEF Company	58.85	58.85
Jan 31/95		Totals	176.55	176.55

As you can see the journal is made up of various columns whose rows contain information about a specific receipt transaction for a company. When all the transactions for a particular month are complete a total for each column is recorded (footing).

There are three things that are of particular importance:

1. Certain columns are designated as DEBIT or CREDIT columns. This makes it easier to know whether the entry in the General Ledger account should be a debit or a credit.
2. We have numerical control and can easily track if there is a missing receipt.
3. We can convert the totals into a General Journal entry and debits equal credits as follows:

DATE	ACCOUNT	PUZZLE	DEBIT	CREDIT
Jan 31/95	Cash	Asset	176.55	
	Accounts Receivable	Asset		176.55

The conversion of the totals to a General Journal entry is not normally done, but we do it here only to illustrate that the debits equal the credits in all journals (cross-footing).

PURCHASES JOURNAL

The Purchases Journal is used to record credit invoices from suppliers. In reality, all purchases are made on credit, but we pay some suppliers immediately (cash purchase) and some suppliers later (credit purchase).

			CREDIT	DEBITS	
DATE	**INVOICE #**	**SUPPLIER**	**A/P**	**RENT**	**ADV.**
Jan 1/95	010195	Property Mgmt.	535.00	535.00	
Jan 2/95	6546	Daily News	107.00		107.00
Jan 31/95		Totals	642.00	535.00	107.00

As you can see the journal is made up of various columns whose rows contain information about a specific purchase transaction for a company (I.T.C. represents “Input Tax Credit”, the GST Paid on a transaction and is recoverable). When all the transactions for a particular month are complete a total for each column is recorded (footing).

There are two things that are of particular importance:

1. Certain columns are designated as DEBIT or CREDIT columns. This makes it easier to know whether the entry in the General Ledger account should be a debit or a credit.
2. We can convert the totals into a General Journal entry and debits equal credits as follows:

DATE	ACCOUNT	PUZZLE	DEBIT	CREDIT
Jan 31/95	Accounts Payable	Liability		642.00
	Rent expense	Expense	535.00	
	Advertising expense	Expense	107.00	

The conversion of the totals to a General Journal entry is not normally done, but we do it here only to illustrate that the debits equal the credits in all journals (cross-footing)..

DISBURSEMENTS JOURNAL

The Disbursements Journal is used to record cash paid out. Some payments are for purchases that have just been made (cash purchases) and some are for purchases made prior to this date (credit purchases).

			CREDIT	DEBIT
DATE	**CHEQUE #**	**SUPPLIER**	**CASH**	**A/P**
Jan 1/95	45	Property Mgmt.	535.00	535.00
Jan 20/95	46	Daily News	107.00	107.00
Jan 31/95		Totals	642.00	642.00

As you can see the journal is made up of various columns whose rows contain information about a specific payment transaction for a company. When all the transactions for a particular month are complete a total for each column is recorded (footing).

There are three things that are of particular importance:

1. Certain columns are designated as DEBIT or CREDIT columns. This makes it easier to know whether the entry in the General Ledger account should be a debit or a credit.
2. We have numerical control and can easily track if there is a missing cheque.
3. We can convert the totals into a General Journal entry and debits equal credits as follows:

DATE	ACCOUNT	PUZZLE	DEBIT	CREDIT
Jan 31/95	Cash	Asset		642.00
	Accounts Payable	Liability	642.00	

The conversion of the totals to a General Journal entry is not normally done, but we do it here only to illustrate that the debits equal the credits in all journals (cross-footing).

PAYROLL JOURNAL
The Payroll Journal is used to record wages to employees

			DEBIT	CREDITS			
DATE	CHQ#	EMP.	WAGE	C.P.P.	E.I.	TAX	NET
Jan 10/95	151	John Doe	500.00	10.00	12.00	100.00	378.00
Jan 10/95	152	Jane Doe	500.00	10.00	12.00	100.00	378.00
Jan 31/95		Totals	1,000.00	20.00	24.00	200.00	756.00

As you can see the journal is made up of various columns whose rows contain information about a specific payroll transaction for a company. When all the transactions for a particular month are complete a total for each column is recorded (footing).

There are three things that are of particular importance:

1. Certain columns are designated as DEBIT or CREDIT columns. This makes it easier to know whether the entry in the General Ledger account should be a debit or a credit.
2. We have numerical control and can easily track if there is a missing cheques.
3. We can convert the totals into a General Journal entry and debits equal credits as follows:

DATE	ACCOUNT	PUZZLE	DEBIT	CREDIT
Jan 31/95	Wage expense	Expense	1,000.00	
	C.P.P. Payable	Liability		20.00
	E.I. Payable	Liability		24.00
	Employee Tax Payable	Liability		200.00
	Cash in Bank	Asset		756.00

The conversion of the totals to a General Journal entry is not normally done, but we do it here only to illustrate that the debits equal the credits in all journals (cross-footing). Although the previous illustrations are oversimplifications of the specific journals they are very useful in understanding the basic layout and usefulness of each journal.

GENERAL LEDGER AND SUBLEDGERS

The journals are the accounting books that keep track of transactions for a company. As illustrated above, the total of these transactions are posted to the General Ledger. The General Ledger contains the current balance of specific accounts such as Accounts Receivable and Accounts Payable.

Unfortunately, the General Ledger does not contain sufficient information about the balance of the above accounts as illustrated below:

ACCOUNT NAME: Accounts Receivable					
DATE	**EXPLANATION**	**REF**	**DEBIT**	**CREDIT**	**BALANCE**
Jan 1/95	Opening Balance				0.00
Jan 31/95	From Sales Journal	SJ	176.55		176.55

ACCOUNT NAME: Accounts Payable					
DATE	**EXPLANATION**	**REF**	**DEBIT**	**CREDIT**	**BALANCE**
Jan 1/95	Opening Balance				0.00
Jan 31/95	From Purchase Journal	PJ		642.00	642.00

As you can see we only know that customers owe us a total of $176.55 and we owe suppliers a total of $642.00. We don’t know the name of the customers or suppliers or how much each customer owes us or how much we owe each supplier.

For this reason there exists Subledgers. These subledgers would contain transactions for a particular customer or supplier.

The combined total of the ending balances of all customers would be equal to the ending balance in the General Ledger for Accounts Receivable.

The combined total of the ending balances of all suppliers would be equal to the ending balance in the General Ledger for Accounts Payable.

A set of accounting books would contain an Accounts Receivable subledger and an Accounts Payable subledger as follows:

SUBLEDGERS FOR ACCOUNTS RECEIVABLE AND ACCOUNTS PAYABLE

ACCOUNTS RECEIVABLE: ABC Company					
DATE	**EXPLANATION**	**REF**	**DEBIT**	**CREDIT**	**BALANCE**
Jan 1/95	Opening Balance				0.00
Jan 1/95	Invoice # 1005	SJ	117.70		117.70

ACCOUNTS RECEIVABLE: DEF Company					
DATE	**EXPLANATION**	**REF**	**DEBIT**	**CREDIT**	**BALANCE**
Jan 1/95	Opening Balance				0.00
Jan 2/95	Invoice # 1006	SJ	58.85		58.85

ACCOUNTS PAYABLE: Property Management Company					
DATE	**EXPLANATION**	**REF**	**DEBIT**	**CREDIT**	**BALANCE**
Jan 1/95	Opening Balance				0.00
Jan 1/95	Invoice # 010195	PJ		535.00	535.00

ACCOUNTS PAYABLE: Daily News					
DATE	**EXPLANATION**	**REF**	**DEBIT**	**CREDIT**	**BALANCE**
Jan 1/95	Opening Balance				0.00
Jan 2/95	Invoice # 6546	PJ		107.00	107.00

With these subledgers we are able to have a break down of the balances carried in the General Ledger. Subledgers can be maintained for any account on the balance sheet, but the most common are Accounts Receivable, Merchandise Inventory, Fixed Assets (Land, Buildings, Computer Equipment, Office Equipment, Vehicles, Machinery & Equipment, etc.) and Accounts Payable.

It should be noted that there is one other subledger that is maintained and that is the Employee Subledger. This subledger keeps track of the wage expenses and deductions by employee. The purpose of this subledger is to allow the company to quickly produce Records of Employment and T4 Slips.

FROM SALES JOURNAL TO LEDGERS

SALES JOURNAL

DATE	INVOICE #	CUSTOMER	DEBIT A/R	CREDIT SALE
Jan 1/95	1005	ABC Company	117.70	117.70
Jan 2/95	1006	DEF Company	58.85	58.85
Jan 31/95		Totals	176.55	176.55

ACCOUNTS RECEIVABLE SUBLEDGER

CUSTOMER NAME: ABC Company

DATE	EXPLANATION	REF	DEBIT	CREDIT	BALANCE
Jan 1/95	Opening Balance				0.00
Jan 1/95	Invoice # 1005	SJ	117.70		117.70

CUSTOMER NAME: DEF Company

DATE	EXPLANATION	REF	DEBIT	CREDIT	BALANCE
Jan 1/95	Opening Balance				0.00
Jan 2/95	Invoice # 1006	SJ	58.85		58.85

GENERAL LEDGER

ACCOUNT NAME: Accounts Receivable

DATE	EXPLANATION	REF	DEBIT	CREDIT	BALANCE
Jan 1/95	Opening Balance				0.00
Jan 31/95	From Sales Journal	SJ	176.55		176.55

FROM RECEIPTS JOURNAL TO LEDGERS

RECEIPTS JOURNAL

			DEBIT	CREDITS
DATE	**RECEIPT #**	**CUSTOMER**	**CASH**	**A/R**
Jan 10/95	240	ABC Company	117.70	117.70
Jan 20/95	241	DEF Company	58.85	58.85
Jan 31/95		Totals	176.55	176.55

ACCOUNTS RECEIVABLE SUBLEDGER

CUSTOMER NAME: ABC Company

DATE	EXPLANATION	REF	DEBIT	CREDIT	BALANCE
Jan 1/95	Opening Balance				0.00
Jan 1/95	Invoice # 1005	SJ	117.70		117.70
Jan 10/95	Receipt # 240	RJ		117.70	0.00

CUSTOMER NAME: DEF Company

DATE	EXPLANATION	REF	DEBIT	CREDIT	BALANCE
Jan 1/95	Opening Balance				0.00
Jan 2/95	Invoice # 1006	SJ	58.85		58.85
Jan 20/95	Receipt # 241	RJ		58.85	0.00

GENERAL LEDGER

ACCOUNT NAME: Accounts Receivable

DATE	EXPLANATION	REF	DEBIT	CREDIT	BALANCE
Jan 1/95	Opening Balance				0.00
Jan 31/95	From Sales Journal	SJ	176.55		176.55
Jan 31/95	From Receipts Journal	RJ		176.55	0.00

FROM PURCHASES JOURNAL TO LEDGERS

PURCHASES JOURNAL

			CREDIT	DEBIT	
DATE	INVOICE #	SUPPLIER	A/P	RENT	ADV.
Jan 1/95	010195	Property Mgmt.	535.00	535.00	
Jan 2/95	6546	Daily News	107.00		107.00
Jan 31/95		Totals	642.00	535.00	107.00

ACCOUNTS PAYABLE SUBLEDGER

SUPPLIER NAME: Property Management Company

DATE	EXPLANATION	REF	DEBIT	CREDIT	BALANCE
Jan 1/95	Opening Balance				0.00
Jan 1/95	Invoice # 010195	PJ		535.00	535.00

SUPPLIER NAME: Daily News

DATE	EXPLANATION	REF	DEBIT	CREDIT	BALANCE
Jan 1/95	Opening Balance				0.00
Jan 2/95	Invoice # 6546	PJ		107.00	107.00

GENERAL LEDGER

ACCOUNT NAME: Accounts Payable

DATE	EXPLANATION	REF	DEBIT	CREDIT	BALANCE
Jan 1/95	Opening Balance				0.00
Jan 31/95	From Purchases Journal	PJ		642.00	642.00

FROM DISBURSEMENTS JOURNAL TO LEDGERS

DISBURSEMENTS JOURNAL

			CREDIT	DEBIT
DATE	**CHEQUE #**	**SUPPLIER**	**CASH**	**A/P**
Jan 1/95	45	Property Mgmt.	535.00	535.00
Jan 20/95	46	Daily News	107.00	107.00
Jan 31/95		Totals	642.00	642.00

ACCOUNTS PAYABLE SUBLEDGER

SUPPLIER NAME: Property Management Company

DATE	EXPLANATION	REF	DEBIT	CREDIT	BALANCE
Jan 1/95	Opening Balance				0.00
Jan 1/95	Invoice # 010195	PJ		535.00	535.00
Jan 1/95	Cheque # 45	DJ	535.00		0.00

SUPPLIER NAME: Daily News

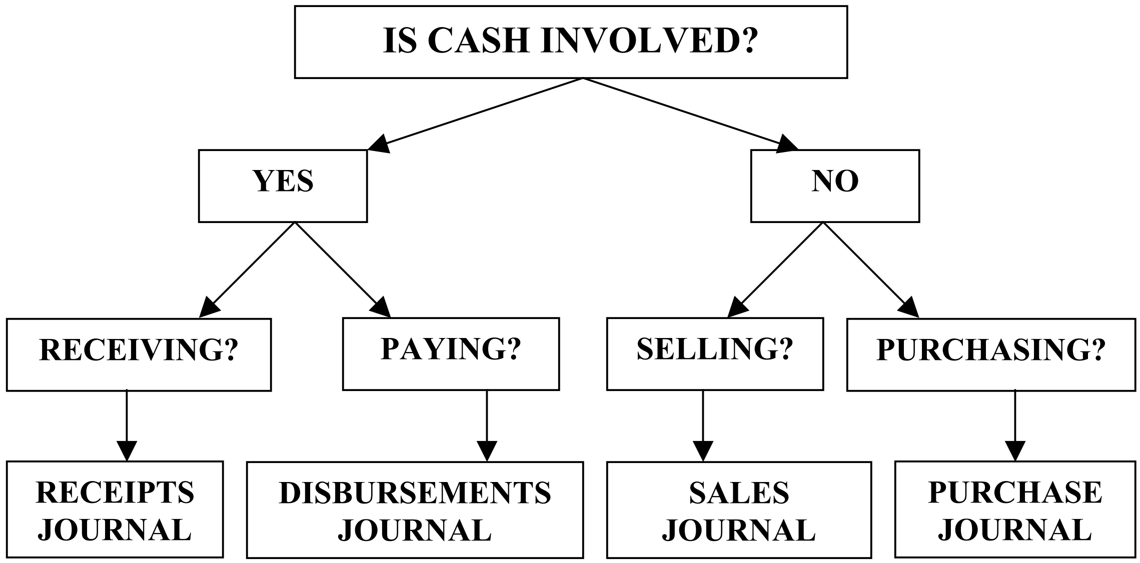
DATE	EXPLANATION	REF	DEBIT	CREDIT	BALANCE
Jan 1/95	Opening Balance				0.00
Jan 2/95	Invoice # 6546	PJ		107.00	107.00
Jan 20/95	Cheque # 46	DJ	107.00		0.00

GENERAL LEDGER

ACCOUNT NAME: Accounts Payable

DATE	EXPLANATION	REF	DEBIT	CREDIT	BALANCE
Jan 1/95	Opening Balance				0.00
Jan 31/95	From Purchases Journal	PJ		642.00	642.00
Jan 31/95	From Payments Journal	DJ	642.00		0.00

Special Journal Decision Tree



NOTE: Sales Returns and Purchase Returns are entered in the General Journal