# ACCOUNTING SCHOLAR.COM – GENERAL ACCOUNTING CHEAT SHEET©



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# The Balance Sheet

- Used to show the financial position of a business entity on a specific date.
- They are always prepared at the end of the year and often more often.
- A balance sheet lists the businesses' assets, liabilities and owner's equity.
- The balance sheet is dated because the financial position can change quickly.

Features:
Heading
Three Sections: assets, liabilities and owner's equity.

**Business Entity** - business finances must be kept separate from personal affairs of the owner.

**<u>Assets</u>**

- Assets are economic resources that are owned by a business and are expected to benefit future operations.
- Examples: buildings, machinery, accounts receivable.
- Valued at cost value... that is what you paid for the asset, not what it is worth today.

**<u>Generally Accepted Accounting Principles (GAAP)</u>**

**<u>Cost Principle</u>**
Valued at cost value... that is what you paid for the asset, not what it is worth today.

**Going-Concern Assumption** (assets are acquired for use not resale) Objectivity Principle

**Objective** - factual and can be verified by others.
**Stable Dollar Assumption** - even though inflation may have changed value of old dollars, they are thought of as new dollars.

**Liabilities**

- Debts of a business
- All businesses have debts. It is convenient to buy with credit
- The purchase of goods of services for credit is an **account payable**
- When money is borrowed it is a **note payable**

**Owner's Equity**

- Represents the resources  invested by the owner
- Residual claim because claims of creditors come first
- Equal to the total assets minus the total liabilities
- Increase in Owner's Equity comes from 1) Investment and 2) Earnings
- Decreases come from 1) Withdrawals and 2) Losses

**The Accounting Equation**

Assets = Liabilities + Owner's Equity

- Always
- One side shows what a business owns and the other side shows who supplied these resources. All assets have been supplied by creditors or the owner

# Forms of Business Organization

**Sole Proprietorship**

- A business owned by one person.
- The most common form of ownership in our economy.
- E.g stores, farms, service businesses.
- From an accounting viewpoint, it is a business entity separate from the affairs of the owner.
- From a legal standpoint, they are not separate entities and the owner is personally liable for the debts of a business.
- If the business fails, creditors may force the owner to sell personal assets to pay off debts.

**Partnerships**

- an unincorporated business owned by two or more persons.
- not legally an entity separate from its owners (owners are personally responsible for debts of the business).
- accounting practices sees the business as separate from personal affairs.

**Corporations**

- the only type of business recognized legally as separate from its owners (owners are not personally responsible for debts).
- limited liability - you can only lose what you have invested in the business.
- owners are shareholders and hold transferable shares of capital stock (the stock can be sold).
- most large businesses are organized as corporations.

**Reporting Ownership Equity in the Balance Sheet**

**Sole Proprietorship** - the equity section contains only the equity of the proprietor.

**Partnership -** Partner's Equity is used instead of Owner's Equity and the amount of each partner's equity is listed separately.

**Corporation** - use the title Shareholders Equity
Shareholders equity is divided into capital stock (amount originally invested in the business) and retained earnings (the amount of increase in shareholder's equity that has resulted from profitable business transactions).

# The Use of Financial Statements by Outsiders

- financial statements are used outside of the business to make investment decisions.
- creditors and investors are concerned with the solvency and profitability of the business.

**Solvency** - the ability of a business to pay debts when they come due. If a business can meet its obligations it is called solvent. If a business cannot pay debts, it is insolvent and may face bankruptcy. A bankrupt business may have to stop operations, sell its assets to pay creditors and end its existence.

**Profitability** - a business is profitable when revenue exceeds expenses for an accounting period. This increases the value of the owner's equity.

# The Simple Ledger

**Account** - A form in which changes caused by transactions are recorded.

- There is one account for each item affecting the financial position (each asset, liability, and owner's equity)

**Ledger -** All of the accounts together also called a group of accounts

- the data from the balance sheet is used to set up the accounts.
- the dollar figure for the account is written on the first line. This is the beginning value of the account.
- the dollar figure must be recorded on the side that the account appears in the balance sheet.

**Debit/Credit**

Debit refers to the left side of any account. Credit refers to the right side of any account.

| Any Account | |
|---|---|
| Debit | Credit |

1. The normal balance of any account goes on the same side that it appears on the balance sheet i.e (Asset - Left)
2. Increase on the balance side.
3. Decrease on the side opposite the balance.

**Analyzing Transactions**

1. What accounts?
2. Classification
3. Increase/ Decrease
4. Debit/Credit
5. How much?

# Cash Control & Management

- cash is money on deposit or any items that a bank will accept for deposit. The cash account is a controlling account for perhaps many bank accounts.

**Cash on the balance sheet**

- listed first because it is available to meet obligations.
- it is the most liquid asset, assets are listed in order of liquidity.
- some short term investments are so liquid that they are combined with cash on the balance sheet.
- creditors are interested in how cash compares with accounts payable. Is the company able to pay debts as they become due? This is called **solvency.**

**Statement of Changes in Financial Position**

- this statement summarizes all of the cash activity during the accounting period.

**Cash Management**

- planning, controlling, and accounting for cash transactions and cash balances.
- the objectives of cash management include:

1. provide accurate accounting for cash receipts, cash disbursements, and cash balances.
2. prevent losses from theft or fraud.
3. anticipate the need for borrowing and make sure there is enough cash to conduct business operations.
4. make sure large amounts of cash are not left idle but instead are generating revenue.

**Internal Control of Cash**

- Those who handle cash should not have access to accounting records. These jobs should be separate.
- A cash budget with planned cash receipts, cash payments and cash balances should be prepared for each department.
- A control listing should be prepared for all cash receipts at the time and place money is received.
- All cash receipts should be deposited daily.
- All payments should be made by cheque.
- All expenditures should be verified before the cheque is issued. These jobs should be separate.
- Bank statements should be reconciled.

**Cash Receipts**

**A/R received through mail.**

- cheques should be stamped "For deposit only."
- they should be recorded on a control listing.

**Cash received over the counter.**

- all cash received is recorded on the cash register. Tape keeps track of all transactions. Someone from accounting will remove the tape.
- the cash register could be a point-of-sale terminal connected to accounting records.

**Cash Over and Short**

- in handling cash, mistakes are made when giving change.
- the difference between recorded cash receipts and the money in the cash register are recorded in an account called "Cash Over and Short."
- debit for a shortage/ credit for an overage.

**Cash Disbursements**

- all disbursements should be made by prenumbered cheques. Signing cheques, approving payment and making accounting entries should be different jobs.

**The Voucher System**

- every transaction that results in a cash payment must be verified, approved in writing, and recorded before a cheque is issued.
- a written authorization called a voucher is prepared for every transaction that will require a cash payment.

**Preparation**

1. The appropriate blanks are filled in with information from the invoice (name, number, date, amount).
2. The Voucher is sent to an employee who verifies information
3. The voucher is then sent to employee in accounting who indicates the credit and debit
4. All verification is checked
5. The voucher is then entered in the Voucher Register

# Petty Cash

- it is important to made large cash payments by cheque
- sometimes a business needs to have a small amount of cash to pay small expenditures when cheques are not practicable ( birthday cakes, office supplies,etc)

**Creating the petty cash funds**

- a cheques is written payable to petty cash/ it is cashed/ the money is kept on hand in a locked box.

| | |
|---|---|
| Petty Cash | 100 |
| Cash | 100 |

- As petty cash is used, petty cash vouchers are prepared.
- petty cash voucher: date, amount paid, purpose, signiture
- the box should always contain cash and vouchers totalling the amount of the fund.

**<u>Replenishing</u>**

- when the cash is low, a new cheque is drawn and the expenses are recorded.

| | |
|---|---|
| Office Supplies Expense | 25 |
| Entertainment Expense | 60 |
| Cash | 85 |

- -Petty cash is only debited when first established; there are usually no further entries to the account.

# Accounts Receivable

- selling goods or services on credit is important to business.
- however, businesses realize that when sales are made on account, some of these accounts receivable will be **uncollectible.**
- once an A/R is determined to be uncollectible, it is no longer an asset.
- the loss of an asset is an expense (uncollectible accounts expense).
- accounting principles require that in measuring income, revenue should be matched with the expenses incurred in raising the revenue.
- because the A/R may not become uncollectible until sometime later, the uncollectibles must be **estimated** and then matched.

| | | |
|---|---|---|
| **Uncollectible Accounts Expense** | **5000.00** | |
| **Allowance for Doubtful accounts** | | **5000.00** |

- **Allowance for Doubtful Accounts** will appear on the balance sheet as a deduction from A/R.

**Balance Sheet**

| | | |
|---|---|---|
| Accounts Receivable | 75,0000 | |
| Allowance for doubtful accounts | 5,000 | |
| Final A/R Amount | | **70,000** |

**<u>Allowance for Doubtful Accounts Assets</u>**

- there is no way of telling which A/R will turn out to be uncollectible.
- crediting the controlling account for A/R would throw the individual accounts out of balance with the controlling account.
- therefore, Allowance for Doubtful Accounts is credited.
- it is a contra asset account.
- it must be estimated in a conservative manner.
- the account must be adjusted monthly.

**<u>Writing Off an Uncollectible A/R</u>**

- when an A/R from a specific customer is determined to be uncollectible it is no longer an asset and should be written off.

| | | |
|---|---|---|
| **Allowance for Doubtful Accounts** | **700.00** | |
| **Accounts Receivable (JJ Jackson)** | | **700.00** |

- this is not a debit to an expense because the expense has already been estimated.
- write-offs will seldom agree with estimates.
- if an A/R previously written off is recovered, then the opposite entry is made.

Accounts Receivable (JJ Jackson)
Allowance for Doubtful Accounts

**Monthly Estimates of Credit Loss**

- At the end of each month, uncollectible accounts should be estimated and an adjustment should be made to **Allowance for Doubtful Accounts.**
- If some accounts have been written off and the balance is the allowance account hsould be higher, then an entry to increase the balance must be made
- Estimate for Credit Loss are base on:

1. The **balance sheet** approach based on aging schedule.
2. The **income statement** approach based on a percentage of net credit sales

3. Direct Write-off method
   Monthly Estimates - Credit Losses

- At the end of each month, credit losses should be estimated and Allowance for Doubtful accounts adjusted.

Balance Sheet for Aging Method

- Most widely used
- Each A/R is classified according to its age

**Aging Schedule**

| | Total | Not yet Due | 1-30 Days past due | 31-60 days past due | 61-90 days past due | Over 90 days past due |
|---|---|---|---|---|---|---|
| Jackson Machine Co. | 9000 | 9000 | | | | |
| XYX Co. | 24000 | | | 24000 | | |
| ABC Co | 4000 | 3000 | 1000 | | 600 | 1000 |
| Spade Wholesale | 1600 | | | | | |
| Richmond Supply | 13000 | 7000 | 6000 | | | |
| Buggy stores | 70000 | 32000 | 22000 | 9600 | 2400 | 4000 |
| Totals | 100000 | 51000 | 29000 | 12000 | 3000 | 5000 |

The schedule is used to review that status of individual accounts and as the basis of estimates of uncollectible accounts
The longer an account is past due, the greater the chances it won't be collected.

Based on experience, the credit manager will estimate the percentage of credit losses likely to occur in each age group.

| **Age Group Total** | **Percentage** | **Estimated** Considered Uncollectible | Uncollectible Accounts |
|---|---|---|---|
| Not Yet Due | 51000 | 1 % | 510 |
| 1-30 days past | 29000 | 3% | 870 |
| 31-60 days past | 12000 | 10% | 1200 |
| 61-90 days past | 3000 | 20% | 600 |
| Over 90 days past | 5000 | 50% | 2500 |
| Totals | 100000 | | 5680 |

**Income Statement Method**

- focuses on estimating the uncollectible accounts expense for the period.
- an estimate is based on percentage of net credit sales.
- fast and simple: used by smaller businesses.

# Notes Receivable

- **promissory note:** promise to pay on demand on or before a future date, a definite sum of money.
- Maker: person who promises to pay - borrower of the money (L)
- Payee: person to whom payment is to be made - lender of the money s (A)
- Interest
- Charge made for the use of money
- Interest = Principle * Rate * Time
- Rate (interest rate annual)
- rate is on an annual basis
- time is in days, months or annual
- 3 days grace from when due (use this to calculate exact days)

**When initially lending money: Note to pay A/R:**

Dec I
Notes Receivable 30000.00
A/R 30000.00 90 days 12%

Adjust for interest earned at end of year: Dec 31
Interest Receivable 295.89
Interest Revenue 295.89 30,000 * 12% * 30/365

When paid:
March 4
Cash 30917.26
Notes Receivable 30,000
Interest Receivable 295.89
Interest Revenue 621.37
30,000 * 12% * 93/365

**Accounts Receivable TurnOver Rate**

- indicates how quickly a company converts its accounts receivable into cash.
- The Accounts Receivable turnover rate is determined by dividing **net sales** by the **average of accounts receivable.**
- The number of days required to collect accounts receivable then may be determined by dividing the number of days in a year **(365)** by the **turnover rate.**

Net Sales / Avg of Accounts Receivable
50,000 / 11000 = 4.455
Average of accounts receivable: Start (10,000) + End (12,000) = 22,000 / 2 = 11,000 For instance: 365 / 4.455 = about 81

- the interpretation of the average age of receivables depends upon the company's credit terms and the seasonal activity immediately before year-end.

**Basic Formula**

| | | |
|---|---|---|
| Net Credit Sales | = | **Turnover Rate** |
| Monthly Average Receivables | | |
| 365 | = | **Days required to collect** |

**Turn over rate**

**Average Receivable = (Beginning + Ending ) / 2**

# Accounting for Merchandising Activities

- Merchandising companies earn revenue by selling goods.
- The goods being sold are called **Inventory.**
- Inventory is a very liquid asset that usually appears near the top of the balance sheet.

**Operating Cycle - Merchandising Company**

**purchase merchandise** **sale of merchandise**

**I Operating Cycle I**

**Collection of Accounts Receivable**

Income Statement of a Merchandising Company

- a major cost to merchandising businesses is the cost of the goods it buys to resell (cost of goods sold).
- this is an expense that is shown separately on the income statement.

**Sales**
**- Cost of goods sold**
**= Gross Profit on Sales**

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**Gross Profits on Sales E**
**- Expenses**
**= Net Income**

**A merchandising company needs more information.**

Accounts receivable in accounting statements is the total accounts receivable. The company needs to know the accounts receivable for each customer. The detailed information is found in a **subsidiary ledger.**

**Subsidiary Ledger:** shows the individual items that comprise the balance of a general ledger account.

**example:** Accounts Receivable Leger contains a separate account for each customer.

- the general ledger account that summarizes the content of the subsidiary ledger is called a **controlling account.**

**Merchandising Transactions require:**

- Accounts Receivable Ledger
- Accounts Payable Ledger
- Inventory Ledger

**Posting**

- any entry that affects a subsidiary ledger also effects the controlling account and must be posted twice.
- post first to the sub ledger and then to the controlling account.
- a check mark shows it is posted to sub journal.

# Classified Financial Statements

**Classified Balance Sheet**

Assets are presented in three groups:
1. **Current Assets**
   - "liquid"
   - capable of being turned into cash within a short period of time (one year) examples are: cash, inventory, accounts receivable.

2. **Plant and Equipment**
   - fixed assets
   - examples: land, building

3. **Other assets**

Liabilities are grouped into two categories:
1. **Current liabilities**
   - existing debts that must be paid within the same time period as current assets.
   - examples: notes payable, accounts payable.

2. **Long term liabilities**
   - example: mortgage.

**The current ratio**

- a widely used measure of short-term debt-paying ability.
- total current assets divided by total current liabilities.

Example:
total current assets $400,000.00 total
current liabilities $280,000.00
Current ratio: = $400,000.00 / $280,000.00 = 1.43
The current ratio is 1.43 to 1.

- this means the current assets are 1.43 times greather than current liabilities. The higher the current ratio, the more solvent the company appears to be.
- 2 to 1 is considered good for credit ratings.

**Working Capital**

The excess of current assets over current liabilities (how much more current assets you have than current liabilities).
$400,000.00 - $280,000.00 = $120,000.00
The amount of working capital needed to remain solvent depends on the size and nature of the organization

# Financial Ratios

- to interpret financial ratios properly, you must understand the company and the industry.
- wholesalers and retailers have low CRs (current ratios)
- manufacturers have higher CRs (current ratios)
- service businesses have lower CRs (current ratios)

**Standards of Comparison**

- A trend in the ratio over a period of years.
- Ratios are compared with similar companies and with the industry average.

**Owner's Responsibility for Debts of a Business**

- owners of unincorporated businesses are personally liable for all debts of the business. (Sole Proprietorships and Partnerships).
- creditors base lending decisions on the solvency of the **owners. -** in a **corporation,** the owners are not personally responsible for the debts and therefore all lending decisions are based only on the solvency of the **business.**

# Income Statement Classifications

- income statements are set up as **single step** or **multiple step.**

**Multiple-Step Income Statement**

- uses a series of steps to deduct costs and expenses from revenue.

1. **Cost of goods sold** is deducted from **revenue** to determine **gross profit (income).**

**Revenue**
**- Cost of goods sold**
= **Gross Income**

2. Operating expenses are deducted to obtain operating income.
3. Other expenses are subtracted to arrive at net income e.g income tax.

**Revenue Section**

usually has one line- Net sales

- the trend in net sales from one period to another is a key indicator of future prospects.
- prices increase over time due to the rate of inflation. Therefore, an increase in dollar value of sales does not necessarily mean an increase in quantity.

**Cost of goods sold**

- the matching principle requires revenue be offset by the costs and expenses incurred in generating that revenue.
- In a merchandising business you must offset the sales with the cost of goods sold.

**Gross Profit**

- the difference between sales revenue and the cost of goods sold.
- analysts look at gross profit as a percentage of net sales called **gross profit rate.** (gross profit divided by net sales).
- gross profit rate is observed over successive accounting periods. A rising GPR shows strong demand for products.
- GPRs lie between 30% and 50%.
- low on fast moving merchandise (groceries).
- high on low-volume goods.

**Operating Expense**

- sometimes subdivided into functional classifications: selling expenses, administrative expenses.
- this is useful for management.

**Operating Income (Net Income)**

- shows the relationship between revenue earned from customers and the expenses incurred in producing that revenue.
- it shows the profitability of basic business operations.

**Non-operating items**

- revenue and expenses not directly related to the company's primary business activities are listed in the final section of the income statement.
- Interest expense, corporate income taxes expenses.

**Single-Step Income Statements**

- all costs and expenses are deducted from total revenue in a single step format.

**Evaluating the adequacy of Net Income**

**Sole Proprietorship**

- there is no salary expense for the value of the personal services performed by the owner. Anything paid to the owner is a withdrawal.
- Net income represents compensation for time and effort of the owner. It must also represent a return on capital investment. Net income must be adequate to compensate the owner for taking risks.

# Perpetual Inventory System

- merchandising transactions are recorded as they occur.
- records for merchandise are kept up to date.
- an inventory subsidiary ledger is included.

**<u>Purchase of Merchandise</u>**
(buying things to sell in your store)
**Example**
Below is an entry to record a purchase. (10 units @ $20 each)

Inventory $200.00
Accounts Payable $200.00

**Sales of Merchandise**
(When you sell things from your store)
**Example**

- Below is an entry to record a sale (1 unit @ $25)

Accounts Receivable (S.Spade) $25.00
Sales $25.00

- and the related cost of goods sold is:

Cost of Goods Sold $20.00
Inventory $20.00

**Payment of Accounts Payable to Supplier** Accounts Payable
$200.00
Cash $200.00

**Collection of Accounts Receivable from Customer** Cash $25.00
Accounts Receivable (S.Spade) $25.00

**<u>Physical Inventory</u>**

- due to the possibility of inventory shrinkage (theft, breakage), the inventory should be counted and updated once a year.
- a physical count is taken.
- then you must **adjust** for inventory breakage.

Cost of Goods Sold $45.00

**Inventory $45.00**

**Periodic Inventory System**

- no effort is made to either update the inventory account or to record the cost of goods sold as transactions occur.
- the accounts are updated at year end.
- a complete physical inventory is taken at year end.
- when merchandise is purchased the cost is debited to Purchases.
- no entry is made to record the cost of goods sold.
- When merchandise is sold, its cost is credited to sales.

| | |
|---|---|
| Inventory, beginning of the year .................................... | 1000.00 |
| Add: Purchase | 200.00 |
| Cost of goods available for sale | 1200.00 |
| Less: Inventory, end of year | 1100.00 |
| Cost of goods sold 100.00 | |

(Buying Price)

| | |
|---|---|
| East of goods sold: | Debit (expense) |
| Sales | Credit (revenue) |
| Inventory | Asset (Balance sheet) |

Periodic Inventory System
Net sales - Cost of goods sold = Gross profit
Gross profit - expenses = net income
(Beginning inventory + net purchase) - ending inventory = cost of goods sold

# Merchandising Transactions: Sales

- sales revenue earned is affected by credit terms and merchandise returns. **Net sales = Sales - (Sales returns and allowances + Sales discounts)**

**Sales Returns and Allowances**

- a refund is often given to customers if merchandise is unsatisfactory.
- if the customer agrees to keep this merchandise, they may be given an allowance or reduction in the price.

**the effect on revenue of a refund or allowance is an entry to reduce sales revenue.**

**Sales Returns and Allowances $500 (expense)**
**Accounts Receivable (or Cash) $500**
returned merchandise purchased on account/full credit on return.

- Sales Returns and Allowances is a contra-revenue account (it is deducted from gross sales).

**an entry to remove the cost of merchandise from Cost of goods sold and return it to inventory.**

Inventory $490
Cost of goods sold $490
merchandise returned by customer (at cost).

**More Merchandising Transactions Purchases**

**Credit terms and Cash Discounts**

- merchandise is often bought on account or with credit.
- the credit **terms** are on the invoice.

example: n/30 or net 30 means the full amount is due in 30 days.
n/60 or net 60 means the full amount it due in 60 days.
2/10,n/90 means you get 2% discount for the first 10 days and the payment is due in 90 days.
2/10,n/30 means 2% discount if paid in 10 days, full amount due in 30 days.
called purchase discounts by the buyers and sales discounts by the sellers.

**a) Purchase recorded at net cost (cost - discount) (2/10,n/30)**

Inventory $9,800.00

When Company purchases goods on discount, it records the transaction when the discount. Conversely, when a company sells goods on discounts, it records it without discount and thus the full sales prices until the buyer pays with in time limit sales.

Accounts Payable $98,000.00
purchase of 20 Tvs at net cost ($500 * 98%x2Ounits)

**b) Recording loss of cash discount**

**Accounts Payable $9,800.00**
Purchase Discounts Lost $200.00
Cash $10,000.00

**a) Returns of Merchandise**

- occasionally merchandise must be returned by the purchaser because it is unsatisfactory.

**Return is based on recorded cost to buy.**

Accounts Payable $490.00
Inventory $490.00
returned a defective TV to supplier ($500 * 98%xl unit)

**Sales Discount**

- the seller records discounts if taken by the customer.

***Sales are recorded at the full sales price.***

Accounts Receivable $500
Sales
$ 5 0
0 sold merchandise on account. Terms 2/10,n/30

***if the bill is paid within the discount period.***

Cash $490
Sales Discount $10
Accounts Receivable $500
collected $500 with A/R with 2% discount.

- Sales discounts is a contra-revenue account.

**Sales Tax**

Sales tax recorded at time of sale.
Cash (or Accounts Receivable) $114
Sales Tax Payable $14
Sales $100 records sales with 7% GST and 7% provincial tax.

# Accounting Information Systems

- personnel, procedures, devices, forms and records used by an entity to develop accounting information and to communicate this information to decision makers.
- systems vary greatly from simple to sophisticated.
- the purpose of the system must be to meet the needs of the organization.
- determine the accounting needs (i.e Corporations, accounts receivable).
- the information managed must depend on usefulness and cost (Le department sales).
- value of information must not exceed cost.

**Basic functions of an Accounting System**

1. Record effects of business transactions.
2. Classify the effects so various totals can be reported.
3. Summarize and communicate data.

- the differences between systems vary according to the manner, speed and detail that these functions are performed.

Example: textbook manual vs large business computerized.

**Design**

- large business has a staff of accountants who work full time designing and improving.
- medium businesses hire an accounting firm.
- small businesses buy packaged systems.

**Special journals**

**Cheque Register* (not commonly used)**

- most common special journal.
- used to record all the transactions of a chequing account.

**Sales Journal**

- used for only one type of transaction that is: **sales of merchandise on account.**
- post individual amounts to sub Ledger and total to A/R and Sales in General Ledger.

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**Purchases Journal**

- records all purchases of merchandise on account.
- post individual amounts to sub Ledger and total to A/P and Purchases in General Ledger.

**Cash Receipts Journal**

- every transaction that involves a receipt of cash.
  - columns for common individual amounts are provided for speedy entry.
- the "other' 'column is used for any other amount and the name of account must be entered.
- post to sub ledger as transaction occurs.
- also amounts from other columns should be posted regularly.
- total posted at end of the month.

**Cash Payments Journal**

- all payments of cash.
- post like Cash Receipts.

**The General Journal**

- only a few transactions are left to be recorded here e.g refund.

# Internal Control

- policies and procedures taken by an organization for the purpose of:
    - b) protecting its resources against waste, fraud or inefficient use.
    - c) ensuring reliable accounting data.
    - d) making sure management's policies are being followed.
    - e) evaluating performance.
- the accounting system depends on internal control to ensure the reliability of accounting data.
- internal control depends on accounting for monitoring assets and performance of departments.

**Accounting Controls:** Policies and procedures that relate directly to the protection of assets or the reliability of accounting data.

**Administrative Controls:** policies and procedures designed to increase operational efficiency.

**Policies and Procedures for achieving strong Internal Control**

- establish clear lines of authority and responsibilty (organizational chart).
- establish routine procedures for processing each type of transaction (authorized, approved, executed, and recorded)
- separation of duties: no one person or department handles a transaction completely from beginning to end.
- the accounting function must be separate from custody of assets. One person in charge of the asset, another maintains a record of the asset.
- additional internal control methods include:
    - a) internal auditing (separate group within the organization checking the financial records)
    - b) competent personnel
    - c) serially numbered documents
    - d) financial forecasts
    - e) rotation of employees

**Audits**

- an examination of a company's financial statements performed by a firm of public accountants.
- it provides an opinion on the fairness of the financial statements (complete, unbiased and reliable).
- audits bridge the credibility gap between management and the users of the statements.
- the auditors must be independent and provide a sound basis for their opinions. - auditors will test the internal control of a company to get a feel for the accuracy and reliability of the information. Information is gathered to check every material (significant) item on the financial statements.

**Auditor's Report**

- the expert opinion expressed by auditors as to the fairness of financial statements. It accompanies financial statements when they are presented outside of the business.

**Audit Facts**

**1.** Audits are not used to detect **fraud.**
**2.** Audits will detect errors or irregularities that are **material (significant).**
3. Auditors are not **liable** for errors or irregularities that go undetected.
4. A **review** of financial statements is done when an audit may be too expensive.

# Business Net Income

- **Net Income:** an increase in owner's equity resulting from the profitable operation of the business. A decrease is called a **net loss.**
- there is no direct connection with assets and liabilities.

**1) Revenue:** the price of goods sold and services rendered (done) during a given accounting period.

- revenue causes owner's equity to increase.
- examples: sales, fees earned, interest earned.
- the **realization (recognition) principle (GAAP)** states that revenue must be recorded when it is earned.

**2) Expenses:** the cost of the goods and services used up in the process of earning revenue.

- expenses cause the owner's equity to decrease.
- examples: rent, wages, depreciation.
- the **matching principle (GAAP)** states that expenses should be recorded in the period to offset revenue earned in that period.

<u>**The Simple Income Statement**</u>

- prepared at regular intervals to monitor the progress of the business.
- total expenses are deducted from the total revenue to calculate net income.

**Big Green Golf Course**
**Income Statement**
**For the Year ended October 31,1998**

| | | |
|---|---|---|
| **Revenue** | | |
| Green Fees | 29,000.00 | |
| Snack Bar Sales | 14,000.00 | |
| Total Revenue | | 43,000.00 |
| | | |
| **Expenses** | | |
| Wages Expense | 28,000.00 | |
| Insurance Expense | 2,000.00 | |
| Utilities Expense | 4,000.00 | |
| Telephone Expense | 1,000.00 | |
| Maintenance Expense | 3,000.00 | |
| Total Expenses | 38,000.00 | |
| | | |
| Net Income | 5,000.00 | |

If Net income is negative, put it in brackets e.g. (5,000)
Double underline the net income
If expenses are great than revenue, net income changes to net loss.
Revenue is not asst
Expenses are not liabilities

Debit expenses:  Increase expenses (pg106)
Credit Revenue: Revenue increases

| Revenue | | Expense | |
|---|---|---|---|
| D | C | D | C |
| | + | + | |
| | | | |

N.I = R-E
E = R-NI
NI = R-E
R = NI+E

Revenue is recorded by credit (Increase)
Expense is recorded by debit (Increase)

# Adjusting Entries

- some assets are used up during their lifetime and become expense.
- the cost is allocated to expense over the span of several accounting periods with adjusting entries.
- adjusting entries are made at the end of the accounting periods to make the financial statements accurate.
- one of the most common adjustments is **depreciation** expense.

**Depreciation Expense**

- an expense is the cost of goods and services used up in the process of earning revenue.
- some assets are purchased and then used up gradually over several accounting periods.
- the portion used up is called depreciation expense.
- **Depreciation** is the systematic allocation of the cost of an asset to expense.

**Example:**

Building: purchased for $120,000

estimated useful life 30 years.

a portion is used up each year.

**straight line depreciation:** each year will bear an equal share of the cost.

annual depreciation expense, 1/30 of $120,000 is $4,000. monthly ($120,000 cost/360) = $333.33

**Journal Entry to record Depreciation**

| | | |
|---|---|---|
| Nov 30 | Depreciation Expense: Building $333.33 | |
| | Accumulated Depreciation: Building | 333.33 |
| | To record depreciation for November. | |

- Depreciation expense is recorded with expenses on the November Income Statement.
- Accumulated depreciation is recorded on the balance sheet as a deduction from the asset account.

| | | |
|---|---|---|
| Building: | $120,000.00 | |
| Less: Accumulated Depreciation | 333.33 | 119,666.67 |

- Accumulated depreciation is called a **contra-asset account** because it has a credit balance that offsets the corresponding asset account.

**Adjusting Trial Balance**

- after all adjusting entries have been journalized and posted an adjusted trial balance is prepared to prove the ledger.

- it includes amounts for depreciation expense and accumulated depreciation. Example: pg 117.

**Closing Temporary Accounts**

- revenue, expense and drawing accounts are called temporary accounts or nominal accounts.
- they accumulate the transactions of only one accounting period.
- at the end of the accounting period, the balances in these accounts are transferred to the capital account through a temporary clearing account called Income Summary.
- this process updates the balance in the capital account for changes that have occured during the period and it returns the balances of the temporary accounts to zero.
- the owner's equity account and the other balance sheet accounts are called real accounts.
- the process of transferring balances of the temporary accounts to capital is called closing the accounts.

**Closing Entries for Revenue Accounts**

- Revenue accounts all have credit balances.
- To close a revenue account, you transfer a credit balance to Income Summary.
- debit revenue amount equal to credit balance/ credit income summary.

**Closing entries for Expense Accounts**

- expense accounts have debit balances.
- to close, a debit balance must be transferred to income summary.
- credit expense amount equal to debit balance/ debit income summary.

**Closing the Income Summary Account**

- the balance, after the revenue and expense accounts have been closed into income summary is closed into capital.
- debit income summary amount equal to credit balance/ credit capital (net income).

**Closing the Owner's Drawing Account**

- the drawing account is closed directly into capital.
- credit the drawing account amount equal to debit balance/ debit capital.

# Completion of the Accounting Cycle

**Accounting Periods**

- span of time covered by an income statement
- usually one year (but also 1 month or 3 months)
- transactions that effect more than one accounting period require adjusting entries.
- the Matching Principle (GAAP) states: earned fees are rnatclilc,.-f with incurred expenses.

Adiusting entries

- Every adjusting entry affects both an income statement account (revenue or expense) and a balance sheet account (asset or liability).
- Adjusting entries are based on the concepts of accrual accountin[g] • 27
- not on bills or transactions.

Types of **Adiustments**

1. To apportion recorded costs.

- A cost that will benefit more than one accounting period is first recorded as a debit to an asset.
- Then in each period that benefits from the asset, an adjustin(l, entry, is made to allocate a portion of the asset's cost to expense. Examples: Insurance, supplies, depreciation

- Purchase of supplies recorded as an asset Supplies
300.00
Bank 300.00

Adjusting entry. Part of asset used up (becomes expense). Supplies Expense
90.00
Supplies 90.00

**2. To apportion unearned revenue when money is collected in advance.**

- a business may collect in advance for services that will be performed in future accounting periods.
- in the period when service is rendered an adjustment is made to record revenue earned.

Example: season tickets, management fees.

Revenue collected but not earned

| | | |
|---|---|---|
| Bank | 200,000.00 | |
| Unearned fees | | 200,000.00 - this is a liability unearned. |

Adjusting entry to recognize earning of a part of the management fee.

| | | |
|---|---|---|
| Unearned Fees | 2,000.00 | |
| Fees earned | | 2,000.00 |

3. **To record unrecorded expenses.**
   - An expense may have been incurred in the current accounting period even though no bill has been received.
   - An adjustment to record these expenses is made at the end of the accounting period.

| | | |
|---|---|---|
| Salaries expense | 24,000.00 | |
| Salaries payable | | 24,000.00 |

4. **To record unrecorded revenue**
   - Revenue may be earned during the current accounting period hw not yet billed.

| | | |
|---|---|---|
| Management Fees Receivable | 3,000.00 | |
| Management fees earned | | 3,000,00 |

Sept 1st - Business started with owner's cash $180,000

Sept 3rd - Land purchased for $ 141,000 Cash

Sept 5th - A building was purchased for $36,000. Payment of $15,000 and a balance $21,000 due in 90 days (A/P).

Sept 10th - Part of land was sold for $11,000 Credit. Payment will be received later.

Sept 14th - Office Equipment was purchased on credit for $54,000.

Sept 20th - Part of cash owned to you from sale of land is received $1500.

Sept 30th - Paid cash as part payment of amount owed for office equipment $3000.

**Lesson:**

1. Every business transaction affects two or more accounts in the expanded Accounting Equation.
2. After the changes the equation must balance. * (Changes can happen on the same side of the equation).