INTRODUCTION TO ACCOUNTING
ACNT 1303
Lecture Notes

GENERAL INFORMATION FOR COMPLETING THE CLASS

The following is a summary of the twelve chapters that you will be completing this semester. Be sure that you are taking the time to read and STUDY each chapter. It is important to go through each of the examples in the book and to complete the Review Quiz. Spending time reading and understanding before you start the homework assignment will help you to complete in the exercises and case problems with more understanding. Please ask questions to clarify questions that you may have on any assignment or concept. Be sure to check your answers in the notebooks before turning in your assignments. There are PowerPoint slides on the I drive that you may want to review before taking your exams or as reinforcement to your reading.

Chapter 1
The Nature of Accounting

Accounting is the process of recording, summarizing, analyzing, and interpreting financial (money-related) activities to permit individuals and organizations to make informed judgments and decisions.

By law all businesses must keep accounting records. Decisions are based on accounting information for profit and non-profit companies alike.

There are different forms of business organizations:

- **Private business**—object is to earn a profit
- **Sole Proprietorship**—owned by one person
- **Partnership**—co-owned by two or more persons
- **Corporation**—owned by investors called stockholders (The business—not the owners—are responsible for the company's obligations.)

There are different types of business organizations:

- **Service business**—doctors, lawyers, barber shop, etc.
- **Merchandising business**—purchases goods for resale
- **Manufacturing business**—produces a product to sell

THE ELEMENTS OF ACCOUNTING

ASSETS

Assets are items with money value that are owned by a business. Some examples are: cash, accounts receivable (selling goods or services on credit), equipment (office, store, delivery, etc.), and supplies (office, store, delivery, etc.).

LIABILITIES

Liabilities are debts owed by the business. Paying cash is often not possible or convenient, so businesses purchase goods and services on credit. The name of the account used is Accounts Payable.

Another type of liability is Notes Payable. This is a formal written promise to pay a specific amount of money at a definite future date.

OWNER'S EQUITY

The difference between Assets and Liabilities is Owner's Equity. The can also be called capital, proprietorship, or net worth.

THE ACCOUNTING EQUATION (Study the examples in the book, p. 5)

Assets = Liabilities + Owner's Equity

This equation must always balance!

BUSINESS TRANSACTIONS AND THE ACCOUNTING EQUATION

A transaction is any activity that changes the value of a firm's assets, liabilities, or owner's equity.

Each transaction has a dual effect on the basic accounting elements. A transaction may affect more than two accounts in a transaction. This is called a combined entry.

Withdrawal (Drawing) is the removal of business assets for personal use by the owner. This transaction decreases the asset taken and the value of the business.

Each transaction increases or decreases (or both) the basic elements in the accounting equation.

The effect of recording a business transaction must always leave the two sides of the accounting equation in balance.

To understand how a transaction affects the accounting equation, go through each of the examples in the textbook. Be sure to pay attention to the "Notes" and "Cautions" that are given.

FINANCIAL STATEMENTS

Summaries of financial activities are called financial statements which are prepared on a regular basis at the end of an accounting period. The accounting period typically is one year; however, it can be any length of time for which records are maintained. Usually the minimum is one month and the maximum length of time is one year for financial statements.

There are several financial statements. You are going to prepare the **Income Statement, Statement of Owner's Equity,** and **Balance Sheet.** These must be completed in that order. Notice the page in your book that shows the three statements and how the information goes from one source to another. It is very important to always check your numbers since an incorrect number will affect more than one statement.

Income Statement. This is a summary of a business's revenue and expenses for a specific period of time. It **ONLY** shows revenue and expenses. These should be listed in order from largest to smallest. (This should be done in this chapter because accounts are not given account numbers.)

> **Net Income** is realized when revenue exceeds expenses.
> **Net loss** is realized when expenses exceed revenue.

Statement of Owner's Equity. This is a summary of the changes that have occurred in the owner's equity during a specific period of time.

This statement will show either an <u>increase</u> or <u>decrease</u> in the capital account.

Balance Sheet. This statement is a listing of the firm's assets, liabilities, and owner's equity at a specific point in time. Total Assets must equal the addition of Liabilities and Owner's Equity.

NOTE: Be sure that you are looking carefully at the examples given in the book when completing your assignments. You must write legibly and use a ruler to draw the lines. Notice that there are double rules to show that items have balanced. Be sure to read and study the Summary and Key Terms at the end of each chapter.

Chapter 2
Recording Business Transactions

NOTE: It is important that you read the chapter and work through the problems and examples as given in the text. Reading, doing, and checking your answers will allow you to understand. Read each transaction given and see which accounts are affected. There will always be at least two. I am going to summarize the chapter, but you need to spend quality time going through the exercises in order to apply the information to your assignment homework.

ACCOUNT. An account is an individual record or form to record and summarize information for each asset, liability, or owner's equity transaction.

Each account will have a title and number.

> **Debit** means **left** side.
>
> **Credit** means **right** side.

A "**T" ACCOUNT** is so named because it looks like a capital T. Use this form of an account to help you determine whether the amount is placed on the left (debit) or right (credit) side of the account.

It is important that you think of debits and credits as only meaning **left** and **right!**
Double-entry accounting means that there will be at least two (2) accounts affected by each transaction.

Debits and Credits can either be increases or decreases depending on the type of account. See chart on page 40.

DEBITS MUST ALWAYS EQUAL CREDITS!

Look at the example on page 42 to help you understand the **Temporary Owner's Equity** accounts. All transactions that affect owner's equity could be recorded in one account, but it would be hard to determine profit and loss and would not be very practical. By putting expenses and drawing in separate, temporary debit accounts and revenue and owner investments in separate, temporary credit accounts, it is easier to make decisions. These decisions can be easily obtained from these temporary accounts. At the end of the accounting period these temporary accounts are "closed" into the capital account. They are only temporary—used during the current accounting period. Each accounting period would have these accounts starting with a zero balance.

Increases in Owner's Equity are investments and revenue.

Decreases in Owner's Equity are withdrawals and expenses.

Rules for Owner's Equity Accounts. See page 43 and following based on the relationship to Owner's equity.

Drawing. This account increases on the Debit side (decreases capital). Usually an asset is removed—cash, supplies, equipment, etc.

Expenses. These accounts decrease owner's equity on the Debit side. Expenses are a debt and decrease capital.

TRIAL BALANCE

This statement is a listing on a certain date that shows all accounts and their balances. This usually occurs at the end of the month, but it could be any time.

This is **not** a formal financial statement. See the sample on page 49. Because it is not a formal statement, no dollar signs are needed.

***** Even though the debits and credits equal, there could still be errors. Check carefully to see that you have used the correct amounts.

For each account you must find a balance. This is called **Footing**. For each account, add the debits together, and then add the credits. Subtract the two amounts and list the difference on the same line and side as the balance. Use a pencil (pencil footings). Be sure to look carefully at the examples in your book.

The Normal Balance of Accounts

An account normally has more increases than decreases, so usually the balance is on the normal balance side of the account.

ASSET = DEBIT
LIABILITY = CREDIT
OWNER'S EQUITY = CREDIT

> **Drawing – Debit**
> **Expenses – Debit**
> **Revenue – Credit**

Chapter 3
Starting the Accounting Cycle for a Service Business

NOTE: Be sure to read the chapter carefully and work through the exercises and examples given in the textbook. Study the examples to show the order of recording your transactions. This needs to become a habit so that parts of the entries are not left out. The date of the transaction will be needed on the first line. The very first entry on a page to an account will show the year, month, and day. Remember to show indenting of the credit account name when recording in the Journal on the line below the debit entry. You should also write a very short, but descriptive explanation of the transaction on the third line of the transaction in the General Journal. Be aware, too, of the column that you are entering the amount—either left or right. Do not show dollar signs in the Journal. Skip a line between each entry. **Notice that you are not completing all exercises and case problems. Be sure to follow your assignment sheet. Be sure that you are reading the <u>entire</u> exercise or case problem. Some of the directions are at the end!**

<u>THE ACCOUNTING CYCLE</u>

1. Analyze transactions
2. Record in a journal
3. Post from the journal to the ledger
4. Prepare a trial balance of the ledger

<u>ANALYZE</u>

Decide debits and credits and in which accounts they will be entered

<u>RECORD in journal</u> (diary of information of day-to-day transactions)

Double entry—in chronological order by date
Book of original entry—(first formally recorded place)

SEE PAGE 69

1. Journal pages numbered
2. Date
3. Account Title
4. Posting reference column
5. Debit and Credit columns

JOURNALIZING <u>is the recording of transactions in a journal</u>

SEE PAGE 70 for format

- Debits are ALWAYS written before credits
- NO dollar signs
- <u>MUST INDENT</u> credits to differentiate from debits
- Must enter either zeroes (00) or a dash in the cents column

A **COMPOUND ENTRY** – 3 or more accounts are affected by the transaction (be sure to line up correctly)

Date/Title/Explanation
Skip a line between entries

Debits MUST equal Credits

ADVANTAGES OF USING A JOURNAL

- Provides a chronological record of transactions
- A place is provided for an explanation
- Lessens the chance of error—debits and credits are recorded together
- Easier to locate errors

POST FROM THE JOURNAL TO THE LEDGER with care

- Must transfer to individual accounts to be able to summarize activity and obtain balance
- Can post at the end of the day, week, month, or whenever

CHART OF ACCOUNTS – directory

(The order for the names is taken from the financial statements—Balance Sheet, then the Income Statement.)

ASSETS, LIABILITIES, OWNER'S EQUITY, REVENUE, EXPENSES

The number identifies the account and its location in the ledger.
4-column account form or balance form of account

DEBIT/CREDIT/DEBIT BALANCE/CREDIT BALANCE

Advantages on Page 77

POSTING – PAGE 77

1. DATE
2. RECORD AMOUNT
3. RECORD CODE (GJ1) FOR GENERAL JOURNAL AND PAGE NO.
4. POST ACCOUNT NUMBER BACK IN JOURNAL
5. CALCULATE NEW BALANCE

Record the same way for all account transactions

Ledger is referred to as book of final entry.

LOCATING AND CORRECTING ERRORS – page 82-85

- add twice going in different directions
- find difference in debits and credits—divide by 9/ divide by 2/ double the amount

COMPUTER ASSIGNMENT

Ask your instructor for a copy of the directions for the accounting program, if you did not buy a personal copy. If you have a copy of the software, install it on your computer at home and you may do the work there. Be sure that you are always clicking on "NEXT TRANSACTION" button before going onto the next item. It will become more important as you continue this class work.

The transactions are saved automatically as you work through the assignment. Be sure to print out the necessary forms and turn them in to your instructor.

There are many other assignments on the computer that you may complete for review or extra practice.

Chapter 4
The Accounting Cycle Continued
Work Sheet, Financial Statements, and Adjusting Entries

NOTE: Remember that these notes are just a summary of the chapter. Take time to read the chapter carefully and work through the exercises and quizzes. For this assignment, it would be helpful to use scotch tape to put together the two sheets for the worksheet carefully aligning the rows. Be sure to finish each set of columns completely before going on the next.

STEPS IN THE ACCOUNTING CYCLE:

1. Determine the adjustments needed
2. Prepare a worksheet
3. Prepare financial statements
4. Journalize and post adjusting entries

ADJUSTING ENTRIES

Adjustments are a planned part of the accounting cycle. For some accounts like office supplies, it would be impractical to make entries on a daily or frequent basis. An entry is made at the end of the accounting period to show usage.

Changes in accounts happen because of passage of time, use of items, etc.

Adjustments are internal, never involve cash.

Adjusting entries affect both the balance sheet and the income statement.

EXAMPLES:

OFFICE SUPPLIES USED: Take the original balance; take an inventory to find out what is on hand; subtract to find the balance on hand.

The adjusting entry transaction: DEBIT Office Supplies Expense
CREDIT Office Supplies

When this transaction is posted, you will have the current amount of office supplies showing in the asset account, and the correct amount of expense for the supplies used during the past year.

INSURANCE EXPIRED: Insurance is paid in advance and debited to an asset account named Prepaid Insurance. When Prepaid Insurance has expired, it then becomes an expense. To figure the adjusting entry, calculate the monthly premium and multiply as needed for the months used.

The adjusting entry transaction: DEBIT Insurance Expense
CREDIT Prepaid Insurance

UNPAID SALARIES: This adjusting entry must be made if the end of the pay period and the end of the accounting period are not exactly the same. Calculate the amount of pay for one day and multiply by the number of days needing to be paid.

The adjusting entry transaction: DEBIT Salaries Expense
CREDIT Salaries Payable

Some other accounts that could need to be adjusted are: utilities and taxes.

DEPRECIATION

This is a term used to describe the expense that results from the loss of usefulness of an asset due to age, wear and tear, and obsolescence. This adjustment spreads the cost of an asset over its useful life. Calculate the yearly amount, then the monthly.

Depreciation is **ALWAYS** recorded by debiting an expense account named Depreciation Expense and crediting an account called a "Contra Account" (means opposite or offsetting). The balance of this contra-asset account is a credit—the opposite of an asset account. The amount is not shown as a credit to the asset account, but in this separate contra-asset account. There will be an individual account for each of the above for each item that is being depreciated. Some examples would be: office equipment, store equipment, automobile, delivery truck, etc. Land is never depreciated.

There are several ways to determine depreciation, but this class will only use one—the **Straight-Line Method.**

To determine the depreciation in the straight-line method, take the cost of the asset, less the trade-in value, and divide by the estimated years of usefulness. The "book value" is the difference between an asset's cost and accumulated depreciation.

MATCHING PRINCIPLE

This principle requires that revenue and expenses be recorded in the accounting period in which they occur. This determines net income or loss.

PREPARE A WORKSHEET

Look carefully at the worksheet in the text. Place the transparencies over the blank worksheet and see the entries made. Be sure to complete the worksheet working left to right and balancing the first two columns before going to the next columns. **Remember** that Accumulated Depreciation is a contra-asset account.

Preparing a Worksheet

List all needed accounts under "Account Title" even if they do not have a balance. Enter the ending balances in the Trial Balance columns. Make sure that these columns balance before going on. Record the adjustments. Make sure that these two columns balance before going on. Carry the amounts across to the "Adjusted Trial Balance" columns. If the amounts are both debits, add them and enter the amount in the debit column of the Adjusted Trial Balance. If the amounts are both credits, add them and enter the amount in the credit column of the Adjusted Trial Balance. If there is one amount that is a debit and one a credit, do the calculations and enter the amount in the appropriate column. Make sure that these columns balance before continuing.

The Income Statement columns of the worksheet will contain the amounts from the Adjusted Trial Balance columns that are revenues and expenses. These columns will not balance. Place the difference in the appropriate column—debit if expenses are larger than revenue; credit if revenue is larger than expenses.

The Balance Sheet columns of the worksheet will contain the amounts from the Adjusted Trial Balance columns that are assets, liabilities, capital, and drawing. These columns will not balance. Place the difference in the appropriate column—debit if liabilities and capital are larger than the assets; credit if assets are larger than capital and liabilities. (Be sure to look at sample in the book.)

The difference between the amounts of the columns in the Income Statement and Balance Sheet must be the same amount. The words "Net Loss" or "Net Gain" will be entered in the left column showing the position of the company at the end of the accounting period.

ADJUSTING ENTRIES IN THE GENERAL JOURNAL

Be sure to write the words "Adjusting Entries" at the beginning of the journal after the last entry of the month. By placing these words at the beginning of these entries, it is not necessary to have an explanation at the end of each set of adjusting entry transactions. The entries should be listed with a date, debit, then credit. The credit should be indented in the journal. Be sure to enter "Adjusting Entries" on the computer assignments also by using the "Remark Options" entry.

FINANCIAL STATEMENTS

The financial statements are created from the worksheet. The Income Statement, the Statement of Owner's Equity, and the Balance Sheet.

Chapter 5
Completing the Accounting Cycle for a Service Business
Closing Entries and the Post-Closing Trial Balance

NOTE: Remember that these notes are just a summary of the chapter. Be sure to read the chapter carefully and work through the sample exercises and quizzes. Remember that your Post-Closing Trial Balance should not have any accounts open except for assets and contra-assets, liabilities, and the capital account. This chapter shows you how to "close' or "make zero" the temporary accounts.

Revenue and expense accounts are temporary accounts used to show changes in owner's equity during a single accounting period. The balances are summarized and transferred to the capital account. The account used to summarize the balances of the temporary accounts is called Income Summary.

INCOME SUMMARY ACCOUNT

This is a temporary account used to summarize the balances of the temporary revenue and expense accounts. This is also called a clearing account. There is no "normal" balance for this account. This account never appears on financial statements.

CLOSING ENTRIES

There is a certain order that must be used to close accounts: **REID**

1. The balance of the total **R**evenue to Income Summary
2. The balance of the total **E**xpenses to Income Summary
3. The balance of the **I**ncome Summary account to the Capital account. This will be the Net Income or Net Loss amount.
4. The balance of the owner's **D**rawing account is closed directly to the Capital account. This is not used in the determination of net loss or gain.

You can check the accuracy of the closing entries by comparing the balance of the Owner's Equity capital account, after posting, with the ending balance of capital as reported on the Statement of Owner's Equity—amounts MUST be the same.
Check the diagram on page 151 to see how closing entries are handled.

POSTING CLOSING ENTRIES

When the closing entries are entered in the General Journal, they should appear on the next line after the Adjusting Entries. The words "Closing Entries" should be at the beginning of these entries so that an explanation is not needed for each closing entry. This is entered by using the "Remark Options" entry on the computer assignments.

After the entries have been posted, the permanent accounts will show the correct amount. The temporary accounts will have a zero balance.

The word "closing" should be written on the item line of each ledger entry, like "adjusting" in Chapter 4.

POST CLOSING TRIAL BALANCE

This statement will only show permanent accounts with a balance; all temporary accounts should have a zero balance. Debits and Credits must balance.

Fiscal Period is any period of time covering the complete accounting cycle. Twelve consecutive months is a fiscal year regardless of starting dates. Government is July 1 through June 30; Retail is September 1 through August 31.

Read about the accrued, cash, and modified-cash basis of accounting at the end of the chapter.

TEST 1 REVIEW
CH 1-5

Account normal balance, increases and decreases—debits or credits.

Trial Balance, Income Statement, Statement of Owner's Equity, and Balance Sheet. Know what accounts go on each statement and where on the statement the amount is placed. (debit or credit column)

Journalizing daily entries, Adjusting Entries, and Closing Entries.

Terms as listed in the back of each chapter.

Multiple Choice, fill in the blank, journalizing transactions – 100 points total.

Sample tests at beginning of each chapter in the workbook are good reviews.

Take your test in the classroom/lab when you have completed the chapter work. (You may also take your test in the Testing Center, if you would like. You need to let your instructor know that you need the test placed in the Testing Center at least two (2) days before you intend to take the test. You MUST have your student ID. You may take your calculator and don't take any books.) The Testing Center is located in J232 at the Spring Creek Campus.

The hours are posted on the door.

Chapter 6
Cash and the Combined Journal

NOTE: Remember that these notes are just a summary of the chapter. Be sure to read the chapter carefully and work through the sample exercises and quizzes.

Cash refers to the amount of currency and coin owned by a business or individual. This also includes checks made payable to the business, money orders, traveler's checks, and bank drafts. These are all important to the business.

Without adequate cash, a business cannot survive. Not only is cash needed to pay employees, creditors, expenses, and taxes, cash is also needed for the business to grow and expand.

CONTROL OF CASH

Internal control refers to methods and procedures a business uses to protect its assets. Read the information on pages 180 and 181. Checks are written for all transactions except for petty cash. There should only be a small amount of actual cash available—petty cash.

THE COMBINED JOURNAL

This is a multicolumn journal with special columns for Cash transactions (Debit and Credit) and others that are frequently used. (See p. 182) This can be customized for each business. The use of this journal saves journalizing time because it is not necessary to write the titles of the account when entries are made in the special columns.

If both the debit and credit columns use special columns, you only put a check mark (√) in the Description column.

Post the totals only of the special columns.

Post individually to General Debit and General Credit columns shown in the Description column. (See pages 188-189 for posting.)

ALL DEBITS AND CREDITS MUST EQUAL! This is called "proving the journal." Add up all the debits and they <u>must</u> equal all the credits.

Petty Cash. This is a small amount of money kept in the office for making small expenditures. ($10, $25, $50, etc.) The business will determine how much cash needs to be on hand.

- This needs to be secure and only one person in charge.
- Vouchers must be kept to show usage.
- An Auxiliary Record will be kept to summarize and record the expenditures.

Establishing the Petty Cash Fund. Petty Cash (asset) is debited and Cash is credited.

Replenishing the Petty Cash Fund. Debit each expense account, supplies, or drawing as needed. Credit to Cash.

Petty Cash is only debited when the fund is established or increased.

THE CHANGE FUND. Business that have many cash transactions usually establish this fund, which is an amount of money that is placed in the cash register drawer and is used to make change for customers who pay in cash.

Establishing the Change Fund. Change Fund (asset) is debited and Cash is credited. The only time this fund will be used is if the fund is established or increased, just like the Petty Cash fund.

CASH SHORT AND OVER

This account is used to record both a shortage and overage of cash in the cash drawer. When change is made during a business day, mistakes can be made and the sales will not equal the amount of cash in the drawer. This is determined by counting the drawer money, removing the change fund, and comparing the amount left with the total of the Sales.

This account does not have a normal balance because it only summarizes the cash usage. At the end of the month, if the balance is a debit, it is considered an expense; if its balance is a credit, it is considered miscellaneous income.

Cash Short and Over is closed to the Income Summary account at the end of the accounting period. Miscellaneous Income if overage; Miscellaneous Expense if shortage.

BANK CHECKING ACCOUNTS

Be sure to read about checking accounts, writing checks, and endorsements in the chapter.

THE BANK STATEMENT

The bank will send out bank statements each month. It is important that this statement and the checking account balance balances. There are certain items that the bank is not aware of: outstanding checks, deposits in transit, and others. The business may not be aware of some items from the bank: service charges, bank fees, bank collections, and others.

These items will either be added or subtracted from the bank statement or the checkbook. See the form on page 201. The two balances must balance.

Any adjustment to the checkbook balance needs to have a journal entry. (See page 203.) This amount then will be posted to the correct account.

CHAPTER 7
ACCOUNTING FOR A MERCHANDISING BUSINESS

PURCHASES AND CASH PAYMENTS

MERCHANDISING ACTIVITY

Retail businesses— sell directly to consumers.

Wholesalers—purchase goods in bulk from manufacturers and sell them to retailers, other wholesalers, schools and other nonprofit institutions, and sometimes directly to consumers.

Purchasing Procedures—a large company would use a "purchasing agent" who heads the purchasing department. Small companies would use the owner/manager, etc.

- **Purchase requisition (written request for goods to be ordered)** is sent to purchasing department

- Purchasing department chooses a vendor and prepares a **purchase order**_ (p. 223)
- Seller receives the order and sends an **invoice** (document that shows the name of the buyer and seller, date, terms of sale, description, price, delivery, and total owed) **sales and purchase invoice** and the merchandise

- When merchandise is received, it is checked against the purchase order.

DISCOUNTS—list price is usually printed, given, etc.

Trade discounts—percentage reduction from the list price of the merchandise. These are **not recorded** in the accounting records of the buyer or the seller. The buyer always records goods at their actual cost. The seller records items sold at their actual selling price.

Cash discounts—offered to encourage prompt and early payment by a buyer. Cash discounts **are recorded** in the accounting records of both the seller and the buyer. **Sales or purchases discounts.** A common discount is 2/10,n/30. (2 percent discount if paid in 10 days; total due in 30 days)

To figure the discount using the calculator:

1. Be sure that the decimal selector is on 2 decimal places
2. Key in the amount of the sale
3. Multiply by the percent (use the percent key)
4. The amount that shows in the window is the "discount" amount
5. Press the "minus" sign and you will have the actual amount of the check to be written (original price, minus the discount)

You can also use the "complement" method to figure the sale price.

1. Key the amount of the sale
2. Multiply by the complement (100 percent minus the discount percent)
3. The amount that shows in the window is the actual sale amount
4. Press the "minus" sign and you will the "discount" amount

RECORDING PURCHASES

The source document for recording a purchase of merchandise is the purchase invoice.

- An <u>example of a transaction</u> of purchasing merchandise on account:

Debit to **PURCHASES**

Credit to **ACCOUNTS PAYABLE** and the **NAMED COMPANY**
Purchased merchandise on account

- An <u>example of a transaction</u> of purchasing merchandise for cash:

Debit to **PURCHASES**

Credit to **CASH**

Purchased merchandise for cash

THE PURCHASES ACCOUNT – keeps a record of the cost of <u>merchandise purchased for resale</u> during an accounting period. <u>Assets</u> are recorded as assets—not purchases.

PURCHASES JOURNAL (SPECIAL JOURNAL) Used to record only credit purchases of merchandise—may be only one column that is posted to two accounts. The two accounts would be PURCHASES debit and ACCOUNTS PAYABLE credit. An invoice column is listed also.

ACCOUNTS PAYABLE SUBSIDIARY LEDGER

Accounts are designed to show the balance owed to each creditor. Liability accounts normally have credit balances. The accounts are not assigned numbers, but are arranged in alphabetical order to make it easy to add new accounts and remove inactive accounts.

When all posting is complete, the balance of the Accounts Payable account will equal the sum of the balances of the creditors' accounts. This is called the "controlling" account.

When posting, be careful that BOTH the subsidiary ledger and the general ledger are posted. Daily posting is done to individual ledger accounts. The totals are posted at the end of the accounting period, usually a month.

MERCHANDISE RETURNS AND ALLOWANCES

Return is when a customer returns to the seller pat or all of the items purchased. An **Allowance** occurs when the seller grants a customer a price reduction on items due to some damage or defective goods.

Purchases Returns and Allowances is the name of the account that provides better control of returns and allowances of merchandise. These transactions are recorded in a "contra" account and they have a normal balance of credit.

A **debit memorandum** is the buyer's written request to the seller for credit. The individual account is debited to reduce the amount that they need to pay. The Accounts Payable account will also be reduced since it is the controlling account.

RECORDING CASH PAYMENTS

CASH PAYMENTS JOURNAL—A special journal used to record any payment of cash. There will be a check number given to be recorded in the journal as well. The source document is the check stub. Individual accounts will be posted daily. The totals will be posted at the end of the month.

Purchases Discounts account is used to record discounts given for prompt payment. See above for more information about cash discounts. credit balance (contra account)

To prove the **ACCOUNTS PAYABLE LEDGER**, you will look at the balance of the Accounts Payable account and the balance of the Schedule of Accounts Payable. This schedule lists the balances of the individual accounts that have amounts due. These two figures must balance.

Schedule of Accounts Payable – Lists the balances of the accounts payable ledger, and the Accounts Payable controlling account shows the total amount owed to ALL creditors. These amounts must agree.

FREIGHT CHARGES ON INCOMING MERCHANDISE

FOB—free on board shipping point

FOB destination—pay at the destination point

The account where this is recorded is named **Freight In** or **Transportation In.** The account is ONLY used to record freight on incoming "merchandise." Chapter 7

CHAPTER 8
SALES AND CASH RECEIPTS

SALES ACTIVITY

Just as merchandizing businesses follow certain procedures to process and record purchases, they follow certain procedures to process and record sales.

Terms of Payment

<u>Revolving charge plans</u> are set up so that you can pay a percentage plus a finance charge on a monthly basis.

<u>Credit terms</u> – allow the purchaser a certain amount of time to pay

N/EOM – PAYMENT must be made by the end of the month

SALES ORDER

A <u>Sales Invoice</u> is prepared when the sale is made.

CASH SALES—sales slip or cash register tape will be record of sale

RECORDING SALES OF MERCHANDISE

SALES ACCOUNT is a temporary account with a normal credit balance. It is ONLY used to record the sale of merchandise on account.

In a General Journal <u>Sales</u> is credited; <u>Cash</u> is debited.

CREDIT SALES—Accounts Receivable, the controlling account, and the individual account is <u>debited.</u>

SALES JOURNAL

<u>Used only to record credit sales of merchandise.</u>

ACOUNTS RECEIVABLE LEDGER

Businesses have many customers and the individual businesses are not assigned an account number they are just in alphabetical order

<u>Accounts Receivable</u> is the controlling account

Debit is normal balance

Posting – Accounts Receivable ledger – totals and individual accounts

SALES JOURNAL only records the sale of merchandise on account.

Post totals monthly and individual accounts on a daily basis

SALES RETURNS AND ALLOWANCES

Allowance results when a buyer decides to keep damaged or defective goods, but at a reduction from the original price.

Return results when a buyer returns part, or all of the order

Recording Sales Returns and Allowances

A **Credit Memorandum** is the original document

SALES DISCOUNTS

Sales discount is recorded as a reduction in sales revenue.

Recorded as a <u>debit</u>. “Contra Revenue Account”

CASH RECEIPTS JOURNAL

Source documents: cash register tapes, sales tickets, checks received.

POSTING THE CASH RECEIPTS JOURNAL

Individually to each account and totals to controlling accounts monthly

SCHEDULE OF ACCOUNTS RECEIVABLE – Accounts Receivable and individual accounts must match. The only accounts that will be listed are those accounts with a balance.

SALES TAXES

The sales taxes are collected from customers by the seller and later paid to the appropriate tax office in the government.

REPORTING SALES TAXES COLLECTED

SALES TAX PAYABLE – CREDIT BALANCE

SALES RETURNS INVOLVING A SALES TAX

Tax must also be returned to the customer.

CREDIT CARD SALES

Bank Credit Card Sales – Most retail businesses accept bank credit cards. Treated as a CASH sale.

Recording Bank Credit Card Sales – recorded as a cash sale since the receipts can be deposited in a bank immediately. The bank deducts a discount fee that ranges from 3% to 7%.

Cash
Credit Card Expense
  Sales
  Sales Tax Payable

Recording Private Company Credit Card Sales

Goes to the individual company—not a bank. Treated as a sale on account. The credit card company is responsible for the collection of the fee.

Accounts Receivable—Credit Cards
Credit Card Expense
  Sales
  Sales Tax Payable

SPECIAL JOURNALS

Purchases – All credit purchases of merchandise
Cash Payments – All payment of cash
Sales – All credit sales of merchandise
Cash Receipts – All receipts of cash
General – All transactions not in a special journal

See page 289 for a partial list

Chapter 9
Worksheet and Adjustments for a Merchandising Business

The end-of-period activities for a merchandising business are similar to the end-of-period activities you studied for a service business.

PREPARE A TRIAL BALANCE. All account names will be listed in the left-hand column. Place the account balance in the appropriate debit or credit column for those accounts that have balances. Remember that debits and credits MUST balance.

DETERMINING NEEDED ADJUSTMENTS

Adjustments are needed because certain changes occur during the accounting period. As time passes, however, the value of the asset is consumed in a business, and therefore its cost gradually becomes an expense. Depreciation of long-term assets and unpaid salaries.

The procedure is the same as Chapter 4. Refer to notes for that chapter, if needed. The new adjustment for a merchandising business is Merchandise Inventory.

MERCHANDISE INVENTORY

The cost of merchandise purchased during an accounting period is debited to the Purchases account. To determine the VALUE of the goods on hand, it is necessary to take an **inventory**—a physical count. The value of the goods on hand is then recorded in an ASSET account entitled **MERCHANDISE INVENTORY.**

Merchandise Inventory is decreased by the value of the BEGINNING MERCHANDISE INVENTORY, and it is increased by the value of the ENDING MERCHANDISE INVENTORY.

1) TRANSFER THE BEGINNING INVENTORY FIGURE

Debit INCOME SUMMARY for the beginning inventory amount.
Credit MERCHANDISE INVENTORY for the beginning inventory amount.

2**) RECORD THE ENDING INVENTORY**

Debit MERCHANDISE INVENTORY for the ending inventory amount.
Credit INCOME SUMMARY for the ending inventory amount.
This is preferred so that both inventory amounts show on the Income Statement. (except on the computer assignments)

3) **ADJUSTMENT FOR STORE SUPPLIES USED**

Debit STORE SUPPLIES EXPENSE for the amount USED.
Credit STORE SUPPLIES

4) **ADJUSTMENT FOR OFFICE SUPPLIES USED**

Debit OFFICE SUPPLIES EXPENSE for the amount USED.
Credit OFFICE SUPPLIES.

5)**ADJUSTMENT FOR INSURANCE EXPIRED**

Debit INSURANCE EXPENSE for the amount of insurance that has expired.
Credit PREPAID INSURANCE (asset)

6) **ADJUSTMENT FOR DEPRECIATION EXPENSE**

Debit DEPRECIATION EXPENSE—TRUCK, CAR, EQUIPMENT, ETC.
Credit ACCUMULATED DEPRECIATION—TRUCK, CAR, EQUIPMENT, ETC.

7) **ADJUSTMENT FOR SALARIES OWED BUT UNPAID**

Debit SALARIES EXPENSE (could be SALES, OFFICE, etc.)
Credit SALARIES PAYABLE

THE END-OF-PERIOD WORKSHEET

Show the Trial Balance—debits MUST EQUAL credits
Show the Adjustments—debits MUST EQUAL credits
Carry adjustments forward to the Adjusted Trial Balance columns

(NOTE: Do not combine the Income Summary amounts—show both.)

Carry the amounts from the Adjusted Trial Balance to the Income Statement and the Balance Sheet (only Assets, Liabilities, and Owner's Equity.)
The difference will be either a NET LOSS or NET INCOME.

Chapter 10
Financial statements and Closing Entries for a Merchandising Business

PREPARING FINANCIAL STATEMENTS FOR A MERCHANDISING BUSINESS

(The statements are completed in this order.)

1. Income Statement (contains only revenue and expenses and shows net gain or loss)
2. Statement of Owner's Equity (summarizes the changes during the accounting period)
3. Balance Sheet (lists a firm's assets, liabilities, and owner's equity)

CLASSIFIED INCOME STATEMENT

It is more involved for a merchandising business to determine net income or net loss. Income statement is divided into sections:

1. Revenue
2. Cost of Goods Sold
3. Operating Expenses
4. Income from Operations
5. Other Income and Expenses

See formula on page 352.

Net Sales for the Period
- Cost of Goods Sold
  Gross Profit
- Operating Expenses
+ Other Income
  - Other Expenses
  Net Income

THE REVENUE SECTION

The revenue section provides a figure for net sales, which is the balance of the Sales account, less the balances of the contra sales accounts. (Sales - Returns and Allowances and Discounts = Net Sales)

THE COST OF GOODS SOLD SECTION

The cost of merchandise sold to customers during a period is **subtracted** from the net sales figure for the same period to get the amount of gross profit. (Net Sales – cost of good sold = Gross profit)

Beginning Merchandise Inventory

+ Net Purchases of Merchandise

= Cost of goods Available for Sale

- Ending Merchandise Inventory

Cost of Goods Sold

You need both the beginning and ending merchandise inventory figures and the net purchases for the period. (Purchases Discounts and Purchases Returns and Allowances decrease the cost of Purchases.)

THE OPERATING EXPENSES SECTION

Operating Expenses – directly related to the sale of merchandise

General expenses (administrative expenses) related to the business's office, overall administration of the business.

THE INCOME FROM OPERATIONS SECTION

Income from operations (also called operating income) is a measure of a firm's ongoing operations.

OTHER INCOME AND EXPENSE SECTION

THE COMPLETED INCOME STATEMENT

THE STATEMENT OF OWNER'S EQUITY

The link between the income statement and the balance sheet

THE CLASSIFIED BALANCE SHEET

ASSETS

Current Assets are cash and any other assets that are expected to be realized in cash, sold, used up, or expire within one year. These are listed on the balance sheet according to their liquidity.

LIABILITIES

Current Liability is a debt that is due for payment within one year. **Long-term liability** is one NOT paid in a year.

OWNER'S EQUITY

Also requires an up-to-date amount for the owner's capital.

WORKING CAPITAL AND THE CURRENT RATIO

Working Capital is the amount of current assets minus the amount of current liabilities. This should be computed at the end of each period.
The larger the working capital, the better able the business is to pay its debts.

Working capital = current assets – current liabilities

Current Ratio current assets to current liabilities. A current ratio of 2:1 is generally considered acceptable.

Current ratio = current assets/current liabilities

JOURNALIZING ADJUSTING ENTRIES

Formal journal entries must be made.

CLOSING ENTRIES FOR A MERCHANDISING BUSINESS

ALL temporary accounts are income statement accounts.
Income Summary shows beginning and ending inventory figures. These figures are not considered when closing, but are part of the adjustment process.

CLOSING ENTRIES

1) Close the Sales account and other income statement accounts with credit balances to Income Summary.
2) Close each expense account and other income statement accounts with debit balances to the Income Summary account.
3) Close the Income summary account to the owner's capital account.
4) Close the Drawing account to the capital account.

POST CLOSING TRIAL BALANCE – Debits must equal Credits

REVERSING ENTRIES – Made the first day of the new accounting period. They are the exact opposite of the adjusting entries made to record the accrued expenses. (Salary is the only one that you will be doing.)

INTERIM STATEMENTS are prepared during the fiscal year for periods of less than 12 months—monthly, quarterly, or semiannually. These are used to create statements, but are not journalized until the end of the year.

TEST 2 REVIEW
CH 6-10

True/False, Multiple Choice, and journalizing entries, adjusting, and closing entries.

Account normal balance, increases and decreases—debits or credits.

Trial Balance, Income Statement, Statement of Owner's Equity, and Balance Sheet. Know what accounts go on each statement and where on the statement the amount is placed. (debit or credit column)

Journalizing of daily entries including petty cash, discounts, adjusting entries, and closing entries.

Terms as listed in the back of each chapter.

Sample tests at beginning of each chapter in the workbook are good reviews.

Take the test in the classroom/lab when the chapter work is completed. You may take your test in the Testing Center as long as you have made arrangements with the instructor. You need your student ID and don't take any books.) The Testing Center is located in J232 at the Spring Creek Campus.

The hours are posted on the Testing Center door.

Chapter 11
Accounting for Payroll

Employee Earnings and Deductions

Note: Be sure to place the decimal selector on "3" so that you have answers that contain cents in the answer.

PAYROLL. Important for all employees. Employees are under the direct control of the employer on a continuing basis. An independent contractor agrees to perform and complete a specific job or task. Payroll accounting applies only to the employees of a firm, either salaried and/or hourly workers.

FAIR LABOR STANDARD ACT (Wages and Hours Law) establishes standards for minimum wages, overtime pay, child labor, required payroll record keeping, and equal pay for equal work regardless of sex. This applies only to firms engaged in interstate commerce.

Overtime Pay. This means a minimum of one and one-half times the regular rate of pay for all hours worked over 40 during the week. (time and a half) Some companies will pay more on a holiday, etc.

Piece-rate Plans. Employees receive a certain rate of pay for each unit completed.

CALCULATING GROSS EARNINGS. These are the employee's earnings before any amount is deducted by the employer. Earnings are calculated either by a standard monthly rate, or hours worked times rate of pay.

Payroll Deductions. There are many deductions taken from an employee's earnings. These are deducted by the employer before the employee receives a check. Deductions can be mandated by law, or decided upon voluntarily by the employee.

FICA Tax (Social Security). Both the employee and the employer contribute equally.

> **OASDI – Federal Old-Age, Survivors, and Disability Insurance**
> **HIP – Hospital Insurance Plan, or Medicare**

OASDI has a Taxable Wage Base that is the maximum amount of earnings during a calendar year that is subject to OASDI taxes. ($87,000) The tax rate is 6.2% for the first $87,000 earned. These are figures from when the book was published—not necessarily current. Use these figures to complete your assignment.

HIP has no maximum amount, and therefore all earnings are subject to HIP. The tax rate is 1.45% of all earnings.

FEDERAL INCOME TAX

Unless specifically exempted, all income (legal and illegal) is subject to the personal income tax. Withholding depends on 1) the employee's gross earnings, 2) the employee's marital status, and 3) the number of withholding allowances claimed. (exemptions) The employee fills out a W-4 to claim the number of exemptions. The employer uses a tax table to determine the correct amount to be withheld. See the tax table on page 404 and 405 of the text to determine this amount.

STATE AND LOCAL INCOME TAXES

Some states also withhold state income taxes. Texas does not. If the state withholds taxes, there will be form similar to the federal one to determine the amount withheld from the employee's pay.

OTHER DEDUCTIONS Bonds, insurance, pension plans, union dues, and many other items may be deducted from the employee's pay. This is determined by each employee and employer.

CALCULATING NET EARNINGS (TAKE-HOME PAY)

Gross earnings minus deductions equals net earnings.

PAYROLL RECORD KEEPING

The employer must maintain payroll records that will supply the name, address, social security number, gross earnings for each payroll, period of employment, taxes and deductions, and the date of each payroll.

THE PAYROLL REGISTER

This is a summary of the gross earnings, deductions, and net pay for all employees for a specific payroll period. The register shows all amounts and then is "proved" by cross-footing the column totals. The totals MUST equal.

PAYROLL SYSTEMS include both manual and computerized payroll systems.

The Accounting Entry for Employee Earnings and Deductions

The employer is the "agent" who is responsible for withholding the amounts of the deductions and then passing them on to the proper agency. The employer is liable for each amount withheld until it is passed on to the appropriate agency. Each deduction is recorded in a liability account.

Salaries Expense—debit (This can be Office Salaries Expense and Sales Salaries Expense if more than one account is needed to keep track of the salary expense.) This is an account used **to record the gross amount** of the payroll.

Credits:

FICA Tax Payable—OASDI
FICA Tax Payable—HIP
Federal Income Tax Payable
Other accounts withheld

PAYMENT. One check for the net amount of the payroll is written on the company's regular checking account. This check is then deposited in this separate payroll account. The individual checks for employees are then written on the special account. When all the checks have been cashed by employees, the payroll account should have a zero balance.

Chapter 12
Accounting for payroll
Employer Taxes and Reports

Everyone who works must have a social security number. All employers in this country who have at least one employee must have an **employer identification number.** This number must be listed on all reports to the government and on all deposit forms that accompany payments of employees' federal income and FICA taxes.

Payroll taxes are a necessary part of operating a business—**Payroll Tax Expense.**

Debit—used to record the employer's FICA taxes, state unemployment taxes, and federal unemployment taxes incurred during an accounting period.

Credit—closed to Income Summary at the end of the accounting period (along with all other expenses).

FICA TAX – This is a matching tax paid equally by the employee and the employer. Two parts—OASDI and HIP. Current rate for OASDI is 6.2% on the first $87,000 earned in a year, and the HIP rate is 1.45% of all earnings.

FEDERAL UNEMPLOYMENT TAX (FUTA) requires the payment of taxes to provide benefits for workers during periods of temporary unemployment. This is paid ONLY by the employer. It cannot be withheld from the pay of employees. Set by federal legislation. The current rate is 6.2% for the first $7,000 of wages paid to each employee during the calendar year. The employer may take a credit of up to 5.4% for timely contributions to state unemployment funds. This leaves an effective FUTA rate of only 0.8%.

STATE UNEMPLOYMENT TAX. This is referred to as SUTA (State Unemployment Tax Act). The taxes are paid to the state in which the employer conducts business. This rate varies from state to state. (up to $7,000 of wages)

RECORDING EMPLOYER'S PAYROLL TAXES

Debited to an expense account—Payroll Tax Expense.

Credited to the individual Tax Payable accounts (p. 431)

These amounts are then sent to the appropriate agency.

FICA TAX PAYABLE—OASDI. The same account is used to record both the employees' and the employer's share. Credited to record taxes imposed, and debited when the taxes are sent in.

FICA TAX PAYABLE—HIP. The same account is used for employee and employer.

FUTA TAX PAYABLE. **Used to record employer's obligation for federal unemployment taxes.**

SUTA TAX PAYABLE. Current liability account to record the employer's obligation for state unemployment taxes.

FICA AND FEDERAL INCOME TAXES. Employers must file Form 941 with the IRS at the end of each calendar quarter. There are many rules about when to turn in taxes—pages 433, 434.

PAYING OTHER AMOUNTS WITHHELD. The employer makes a deduction, and credits an appropriate liability account. (U.S. Savings Bonds Payable, for example)
WORKER'S COMPENSATION INSURANCE provides protection for employees who suffer a job-related illness or injury. The entire cost is usually paid by the employer. The cost depends on how many employees a company has, the accident history, the risk factors associated with the job, etc.

The employer makes a payment at the beginning of the year using an estimated payroll figure for the year.

Debit – Workers' Comp. Insurance Expense
        Credit – Cash

When the end of the year comes, the actual amount is figured and more is sent in, or a refund is given to the employer. (p. 442)

REVIEW FOR TEST 3

CHAPTERS 11 AND 12

True/False

Calculation of the FICA taxes for employees.

Journalizing entries to record the payroll and the payment of the payroll.

You need to take this exam in the classroom/lab.

January 2006