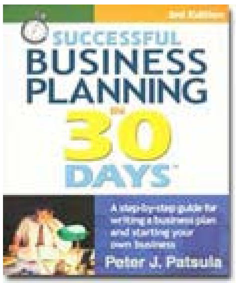
The **ENTREPRENUER'S**
Guidebook Series™

Next Page

THANKS for selecting this guidebook! Many hours of painstaking work have gone into its creation. Send feedback or suggestions to www.patsulamedia.com. And check out our **highly rated planner / guide …** at [bp30.com](bp30.com)



Highly Rated
Amazon.com

It's one of the best of its kind.
- Alan Caruba
Bookview.com

COPYRIGHT INFO

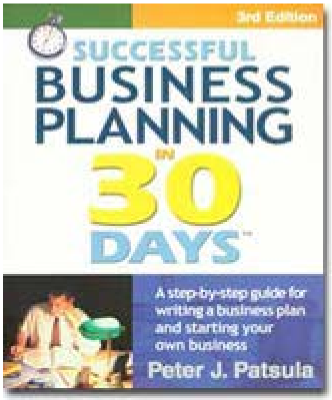
NOTE The author and publisher shall have neither liability nor responsibility to any person or entity with respect to any loss or damage caused, or alleged to be caused, directly or indirectly by any information contained in this guide. Although this publication is designed to provide accurate information in regard to the subject matter covered, it is sold with the understanding that the publisher is not engaged in rendering legal, accounting or other professional services. If **legal** advice or other expert assistance is required, the services of a competent professional should be consulted.

384 pages $21.95

Successful Business Planning in 30 Days™

A Step-by-Step Guide for Writing a Business Plan and Starting Your Own Business, **3rd Edition**

Purchase this book online at bp30.com or by calling toll-free **1-800-247-6553** (orders only, please have credit card ready).



ISBN 0967840236

Immersing you in the language of business to help you think like an entrepreneur!

INCLUDES:

- The **30 Day** Business Plan™
- The **One Day** Business Plan™
- 150 pages of **Time-Saving Worksheets** including 100 + sample passages to get you started fast and thinking in the right direction!
- A **15 page** sample business plan.
- **200** + motivational and fact quotes, 11 success stories, and 33 profit tips!

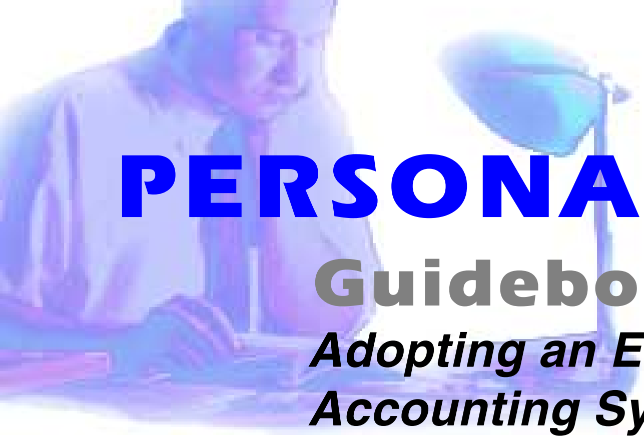
Praise from Readers and Critics

Five Star Reviews

Provides an important key to writing a business plan and starting your own business.
- **Midwest Book Review**, Oregon, WI
Amazon.com review

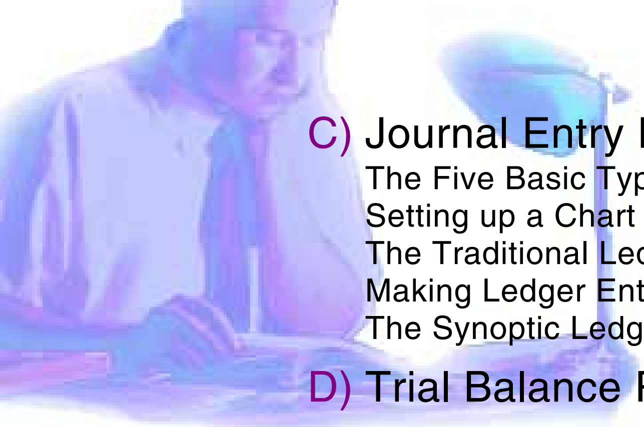
This is a must read for anyone before starting your own business.
- **Mike Milliken**, BN.com Review.

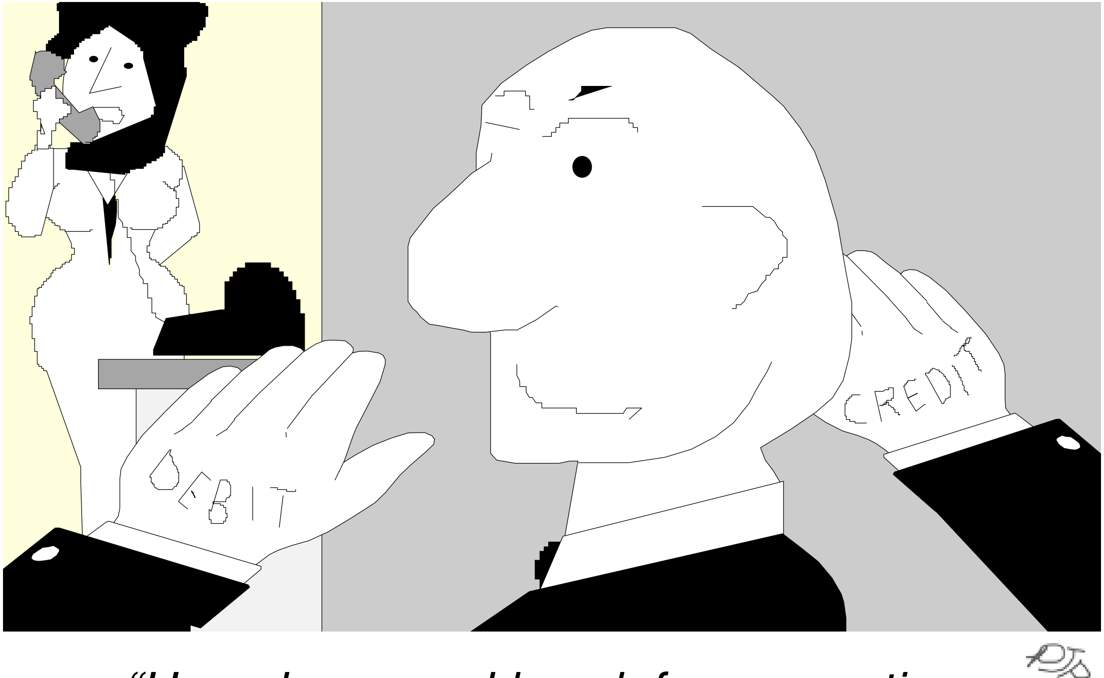
This book has helped me a great deal in thinking about my business
- **Jason Myers**, TX
Amazon.com review



PERSONAL PLANNING

Guidebook #28:





*"Harry has a real knack for accounting.
I don't know how he does it?"*

ADOPTING AN EASY-TO-USE ACCOUNTING SYSTEM

MENTION the word accounting, and otherwise competent business men and women suddenly grit their teeth, furrow their foreheads, and start uncontrollably pulling out chunks of their own hair. Why is this? How can a craft, which is nothing more than a tool to keep track of the inflow and outflow of cash, be thought of with such contempt and fear?

The mystery becomes even more puzzling once you realize that ACCOUNTING is essentially the discipline of counting money. And since most people start a business to make money, it seems rather silly they shouldn't enjoy counting it.

INTRODUCTION TO ACCOUNTING

BEFORE you begin your journey into the world of accounting, to uncover the mysteries of debits & credits, balance sheets and income statements, consider the following 7 questions:

1. What is accounting?
2. What is an account?
3. What is an accounting period?
4. Why learn accounting?
5. Why keep good accounting records?
6. What makes a good accounting system?
7. What kind of records should you keep?

A good bookkeeper does a little each day, not a whole bunch just before taxes are due.
SUPERTIP

What is Accounting?

Accounting is the process of keeping and analyzing financial records.

What is an Account?

An account is simply a record of transactions involving a particular item or person.

What is an Accounting Period?

Every taxpayer (business or individual) must figure taxable income and file a tax return based on an annual accounting period, called your "tax year." Accounting periods can either be based on a

- Calendar tax year
- Fiscal tax year

Calendar Tax Year – If you adopt the calendar year for your annual accounting period you must maintain your books and records and report your income and expenses for the period from January 1 to December 31. You must adopt the calendar year if:

- you do not keep adequate records
- you have no annual accounting period
- your present tax year does not qualify as a fiscal year

Individuals such as sole proprietors, partners, and shareholders in an S-corporation generally use the calendar tax year unless they get permission to change.

Basic knowledge of accounting is, not only essential to the productive management of your business, but also a prerequisite to assuring profitability.
SUPERTIP

NOTE If you file your first return as a wage earner using the calendar year and later begin a business as a sole proprietor, you must keep your business books on a calendar-year basis, unless you obtain permission to change it. To get permission you need to file Form 1128 and pay a fee.

Fiscal Tax Year – A regular fiscal tax year or fiscal period is 12 consecutive months ending on the last day of any month except December. If you adopt a fiscal tax year, you must maintain your books and records and report your income and expenses using the same tax year.

A new corporation can use either a calendar year or a fiscal year as its tax year. It establishes its tax year when it files its first income tax return.

NOTE It is possible that you may end up with a fiscal period which is less than 12 months in certain circumstances, such as when your new business begins or when your business ceases to exist.

Why Learn Accounting?

As a business owner, it helps to have a deep and abiding interest in the products or services you sell or intend to sell. However, this isn't enough to be a success. If you don't quite understand the financial side of your business, you won't be in a good position to assure its profitability, and without profit, unless you have access to an unlimited bankroll, your business will eventually fail.

Keep good accounting records to keep informed about the past and present financial position of your business.

Why Keep Good Accounting Records?

Keeping good records not only helps you keep track of deductible expenses to lower your income tax liability, but it also:

- Better informs you about the past and present financial position of your business.
- Helps prevent problems that may arise if your tax return is audited.
- Helps you budget and control cash flow.
- Helps you monitor the progress of your business.
- Helps you get loans from banks and other lenders – who like to know that you are constantly aware of what is happening within your business.

Of course, businesses must also keep good, accurate and organized records, because tax laws require that both an income statement and a balance sheet (in the case of partnership and corporations) be filed each taxation year. Usually the tax form itself provided by the government meets these requirements.

A good accounting system must be simple to use, easy to learn, accurate and flexible to change.

What Makes a Good Accounting System?

A good accounting system must be simple to use, easy to learn, accurate and flexible to change. It must also:

- be able to give information on a timely basis
- consume as little time as possible and be within budget to implement and maintain
- protect your business from fraud and error
- provide accurate information for every business transaction in a manner that allows no needless overlapping or repetition of procedures
- take into consideration the size, nature and extent of your business as well as your accounting abilities

A good accounting system must also recognize the following two important needs:

1. **The needs of MANAGEMENT.** A good accounting system compiles and organizes information to help improve management's decision making proc-

ess.

2. **The needs of GOVERNMENT.** A good accounting system meets the minimum record keeping requirements of government income tax laws.

What Kind of Accounting Records Should You Keep?

Every person carrying on a business is required by law to keep records and books of account for tax purposes. However, as a general rule, tax departments do not specify the exact type of records you should keep, other than that they should be permanent, contain a systematic account of your income and expenses to determine your tax payable, and be supported by vouchers or other source documents.

Every person carrying on a business is required by law to keep records and books of account for tax purposes.

Therefore, to meet the basic requirements of the government, you need to set up an accounting system that keeps records of all:

- accounts payable & accounts receivable
- assets, equipment & inventory
- business expenses
- capital gains and losses
- cash disbursements & cash receipts
- employment taxes including: income tax withholdings, social security and Medicare taxes, federal unemployment taxes
- employee expenses
- medical and dental expenses

- gross sales (all sources of income you receive from your business)
- travel, transportation, entertainment and gift expenses

To better meet your financial management needs, you should also further supplement and break down these basic accounting records with more specific accounting records, tasks and practices. A summary of the basic daily, weekly and monthly accounting records, tasks and practices, needed to meet the needs of the government and management, as well as the necessary information derived from these, is outlined in on the next four pages.

NOTE When designing your accounting system it is important that the forms you use allow for easy routine processing. This means they should flow automatically to bookkeepers, computer operators, or other individuals who process them and enter them into your accounting books or software, without the likelihood of creating errors, or worse yet, misplacement.

When designing your accounting system it is important that the forms you use allow for easy routine processing.

✷

What Records You Should Keep?

On a **DAILY BASIS** keep track of:

- ❑ *cash sales & receipts*
- ❑ *all monies disbursed by cash or check*
- ❑ *cash on hand & bank balance*
- ❑ *miscellaneous sources of income* – including income from professional fees, property, investments, taxable capital gains, estates, trusts, employment, and pensions
- ❑ *errors* – discovered in the recording of previous transactions

What Records You Should Keep?

On a **WEEKLY BASIS** keep track of:

- *accounts receivable* – so you can take action on slow payers
- *accounts payable* – so you can take advantage of discounts
- *amount of weekly payroll* – including name and address of employee, social security number, number of exemptions, date ending the pay period, hours worked, rate of pay, total wages, total deductions, net pay and check number
- *all withholdings set aside for State and Federal Governments* – including sales tax, employee income tax withholdings, social security payments, pension plan payments and unemployment insurance payments

What Records You Should Keep?

On a **MONTHLY BASIS** keep track of:

- ❑ *amount of business done in cash & credit*
- ❑ *amount of business tied up in receivables*
- ❑ *amount of collections & losses from credit sales*
- ❑ *amount owed to creditors & suppliers*
- ❑ *total expenses*
- ❑ *gross profit*
- ❑ *net profit earned & taxes owed*
- ❑ *which product or service makes a profit*
- ❑ *which product or service loses money*
- ❑ *amount of money invested in inventory*

What Records You Should Keep?

ALSO, at the **END OF THE MONTH**, make sure that:

- all *Journal entries* are classified according to like elements and posted to the General Ledger
- a *Cash Flow Statement* is prepared
- an *Income Statement* & *Balance Sheet* for the month is available within a reasonable time, usually 10 to 15 days following the close of the month – for smaller business semi-annual statements are sufficient
- *Petty Cash* account is in balance
- *Bank Statement* is reconciled i.e., the owner's books are in agreement with the bank's record of the cash balance
- *all Federal Tax Deposits*, Withheld Income and FICA Taxes (form 501) and State Taxes are made
- *accounts receivable* are aged i.e. 30, 60, 90 days past due – note amount of credit given to delinquent accounts
- *Inventory* is inspected to determine which items need to be reordered or discounted due to slow turnover

THE ACCOUNTING CYCLE

THE ACCOUNTING process consists of:

- entering transactions in a book called a **JOURNAL** (and filing away any related documents to prove these transactions)
- posting these entries to an appropriate account in a book called a **LEDGER**
- summing up and analyzing account balances periodically and most importantly at the end of each fiscal year

Accounting: A respectable, conscious or unconscious way of disclosing, hiding or misrepresenting financial information to give a skillfully adapted economic picture of a company or its components.
PAULSSON FRENCKNER

In more detail, this process, known as the **ACCOUNTING CYCLE**, can be broken down into the following eight areas.

A. Transaction Occurs

B. Transaction Entered in Journal

C. Journal Entry Posted to General Ledger

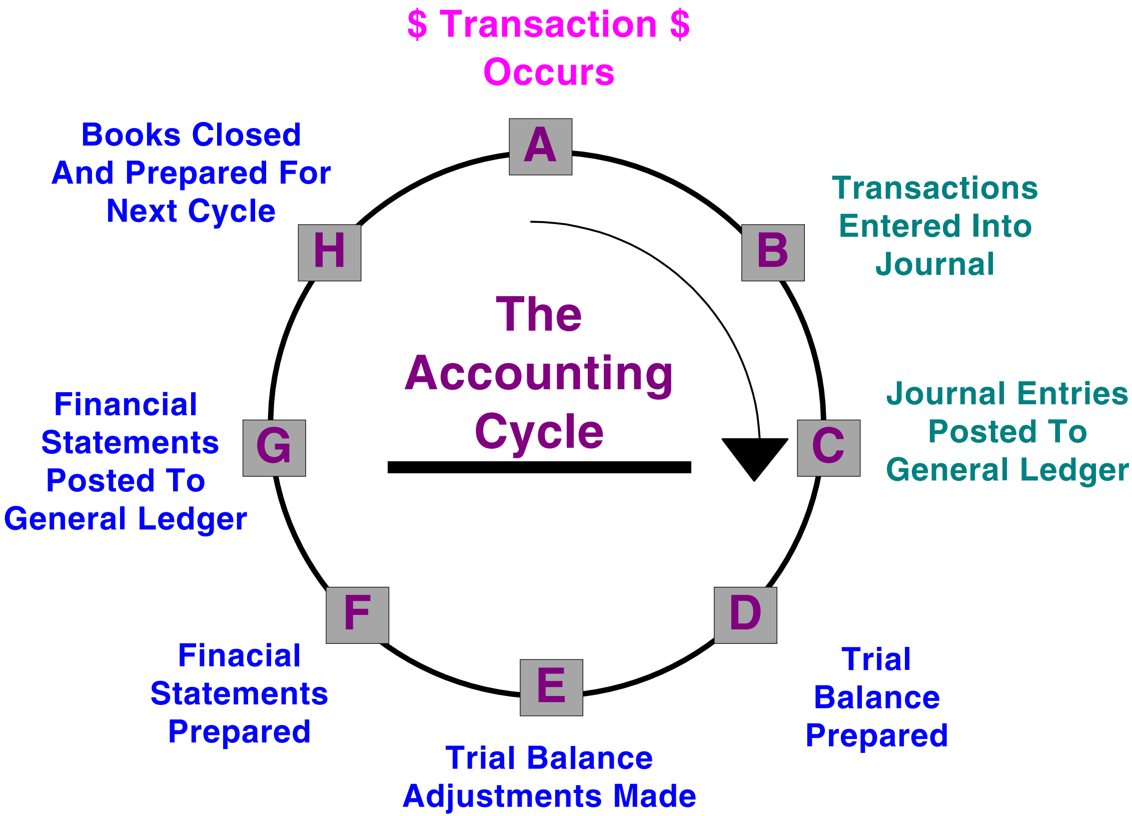
D. Trial Balance Prepared

E. Trial Balance Adjustments Made

F. Financial Statements Prepared

G. Financial Statements Posted to Ledger

H. Books Closed & Prepared for Next Cycle


$ Transaction $
Occurs
A
Transactions
Entered Into
Journal
B
Journal Entries
Posted To
General Ledger
C
Trial
Balance
Prepared
D
Trial Balance
Adjustments Made
E
Finacial
Statements
Prepared
F
Financial
Statements
Posted To
General Ledger
G
Books Closed
And Prepared For
Next Cycle
H
The
Accounting
Cycle

A) TRANSACTION OCCURS

A **TRANSACTION** is any business dealing that involves the exchange of capital. Capital is usually in the form of money, e.g., cash, check, or money order, or it may be in the form of a promise to pay e.g., a charge slip, credit note, or mortgage. Common transactions include sales and purchases of goods and services, loans, lease payments, barter agreements, or any activity in which capital is shifted from one *place* or *account* to another.

A "transaction" is any business dealing that involves the exchange of capital.

Regardless of the method of payment or the type of capital exchanged, all transactions must be recorded on either a computerized or paper form, such as a numbered invoice, purchase order, receipt, canceled check or bill of sale.

In short, every calculation or entry into a Journal, especially those that identify sources of income and expenses, must be followed by a piece of paper known as a *voucher* that proves its existence. In the accounting field this process is known as creating an *audit* or *paper trail.*

Supporting Documents

To prove a transaction and verify income and expenses, you need to keep and file away canceled checks, account statements, and vouchers such as receipts, sales slips, deposit slips, paid bills, and invoices. It is also important to maintain a check register and file away cash registers tapes and slips.

Canceled Checks – All business owners should make disbursements using checks. Canceled checks are the best source documents along with receipts and sales slips to prove a business expense deduction.

Account Statements – If you don't have a canceled check, to prove payment of an amount reported on your return, you can prove the payment with an account statement prepared by your bank (or other financial institution). The statement must show:

1. The check number (if check).
2. The amount of the check, electronic funds transfer, or credit card charge.
3. For a check or electronic funds transfer, the date the check or transfer was posted to your account by the bank.
4. For a credit charge, the date of the charge by you (the transaction date).
5. The name of the payee.

All business owners should make disbursements using checks.

NOTE If you do not have either a canceled check or an account statement showing the required information to prove payment of an item on your return, you can provide other proof. For example, you can prove payment with a combination of an invoice marked "Paid," a check register or copy of the check, AND an account statement that shows the check number, date, and amount.

Vouchers – It is important to understand that for many types of expenses canceled checks or financial account statements may not provide enough evidence to verify your claim to a deduction. Therefore, you should also keep and file away, by year and type of income or expense, support documents such as receipts, sales slips, deposit slips, invoices, purchase orders, paid bills and any other form that verifies the amount and other details of a transaction. These support documents are often referred to as vouchers. Vouchers are documents that serve as evidence of a given transaction.

The IRS and Revenue Canada will not generally accept photocopies of source documents such as invoices, canceled cheques or purchase vouchers as proof of what is entered in your books.

Vouchers should contain:

- addresses and signatures of vendors
- officers of your company
- other parties involved in the transaction that gave authorization for the issuance of funds

Vouchers should also contain:

- exact amounts of money exchanged,
- particulars identifying the goods and services including quantities,
- special conditions or terms of the sale

Furthermore, a voucher should contain:

- a date of purchase
- the address to which the goods were shipped or delivered to

Bear in mind that if you do not keep your receipts or other vouchers to support your expenses – or if you lose them in an inefficient filing system thus having no other evidence to support your claims – tax agencies may reduce the expenses you have claimed.

NOTE The IRS and Revenue Canada will not generally accept photocopies of source documents such as invoices, canceled cheques or purchase vouchers as proof of what is entered in your books. This is because it is relatively easy to alter an original document using photocopying equipment and such alterations are difficult to detect.

Vouchers are documents that serve as evidence of a given transaction.

It should also be noted that: if there is no *description* on a particular voucher, this voucher may still be acceptable if there is sufficient information to support that the expense was made or incurred for the purposes of earning income and the total amount of this payment is reasonable in the circumstances.

Cash Register Tapes & Slips – It is important to file all cash register tapes and slips that you generate from sales or accumulate from paying expenses. If key information is missing from your cash register tape or slip, it is a good idea to write that information on the back of it, especially when describing the nature of an expense.

Check Register/Checkbook – A check register or even a checkbook can be a basic source for keeping a record of your deductible expenses. Using a checkbook –

that allows enough space to identify the source of deposits as business income, personal funds, or loans – is very helpful when it comes times to update your accounting records, prepare your tax returns and determine if the amount is a deductible expense.

To verify **gross sales** you should keep:

- cash register tapes
- bank deposit slips
- receipt books
- invoice
- credit card charge slips

To verify purchases you should keep canceled checks.

To verify *purchases* you should keep:

- canceled checks
- cash register tape receipts
- credit card sales slips
- invoices

To verify **expenses** you should keep:

- canceled checks
  - cash register tapes
  - account statements
  - credit card sales slips
  - invoices
  - petty cash record system

B) TRANSACTION ENTERED IN JOURNAL

WHEN A TRANSACTION occurs, it must be recorded, often as an entry in some kind of business diary. This book of original entry is called the *General Journal* or more simply, the Journal.

This *Journal*, whether it be a book (of which a variety can be purchased at most stationary stores) or a computer file should be protected at all costs. It is the *soul* of your accounting system. If disaster strikes and your accounting records and calculations are completely wiped out, as long as you've kept your Journal in a safe place, you can always go back and rebuild your system.

When entering your sources of income into your journal there are two different methods you can use: the "cash" or the "accrual" entry method.

NOTE Practically any notebook can be used as a Journal.

Cash vs. Accrual Accounting Methods

When entering your sources of income into your journal there are two different methods you can use:

- *cash* entry method
- *accrual* entry method

Under the **CASH** method, you report income in the year you receive it, and deduct expenses in the year you pay them regardless of when you incurred them. Under the **ACCRUAL** method, you report all income in the fiscal period you earned it, regardless of when you received payment, and you deduct all expenses in the fiscal period you incurred them, regardless of when you paid them.

In general, a very small business such as a hot dog stand will use the cash entry method for bookkeeping. A larger, more complicated business no doubt will use the accrual entry method.

NOTE You must use the accrual method if you offer your customers or clients credit (that is the opportunity to receive a product or service and to pay for it later). As well, any business with a physical inventory of products or parts is also required to use the accrual method to keep track of its inventory and cost of goods sold.

Cash Entry Method – *The cash method of accounting is used by most individuals and many small businesses with no inventories.*

Cash Entry Method – The cash method of accounting is used by most individuals and many small businesses with no inventories. However, if inventories are necessary in accounting for your income, you must use an accrual method for your sales and purchases. The cash method however, cannot be used by corporations (other than S-corporations).

In calculating income from a farming or fishing business, you may also choose the cash method. When using this method, if for example you sell an item on December 14 and don't receive payment until January 15, report the sale as income on January 15 when you actually received it. Similarly, deduct your expenses in the year in which you actually paid them.

Accrual Entry Method – Using the accrual entry method, charge sales are credited immediately to your *Sales Account* and then charged to your *Accounts Receivable*. When bills are collected, you credit your *Accounts Receivable*. For example, if you have a December 31 fiscal year-end and you sell and item on credit on December 15, you have to include the sale price in your income for that year even if you don't receive payment until January of the following year. Similarly you can deduct allowable expenses in the fiscal period in which you incur them, whether or not you paid them in that period. However, there are two exceptions to this second point:

The accounts are a snapshot of a business at a moment in time. Take a picture the following day and the scene may look very different. As with many of us, companies like to look their best when they are photographed and sometimes dress for the occasion.
M.A. PITCHER

- *You must, claim the cost of goods purchased or produced for sale in the year you sold the goods.* For example, suppose that you purchased two hundred blenders, which you planned to resell at a profit. During the year, you actually sold 100 units. You may therefore claim only the cost of purchasing 100 units. You must claim the balance of the purchase costs in the year that the balance of the blenders are sold.
- *You must claim prepaid costs as an expense in the year during which you*

received the related benefit. For example, if, in the middle of your fiscal period you prepaid a full years rent of $5,000, you can only claim one half of the rent or $2,500 in the year you paid. You would claim the other $2,500 the following year.

If you own more than one business, you can use a different accounting method for each business if the method you use for each clearly shows your income.

Combination (hybrid) Method – Generally, you may use any combination of cash, accrual, and any special methods of accounting for depreciation, amortization, deductions for bad debts and installment sales, as long as the combination clearly shows income and you use it consistently. However, the following restrictions apply:

1. If inventories are necessary to account for your income, you must use an accrual method for purchases and sales. You can use the cash method for all other items of income and expenses.
2. If you use the cash method for figuring your income, you must use the cash method for reporting your expenses.
3. If you use an accrual method fro reporting your expenses, you must use an accrual method for figuring your income.

NOTE If you own more than one business, you can use a different accounting method for each business if the method you use for each clearly shows your income. However, you will need to keep a complete and separate set of books and records for each business.

Changing Your Method of Accounting –Once you have set up your accounting method, you must get permission from you tax authorities before you can change to another method. A change in accounting method not only includes a change in your overall system of accounting (such as switching from a cash to an accrual method), but also a change in the treatment of any material item. Your tax authorities will consider the need for consistency in the accounting area against your reason for wanting to change your accounting method.

Single & Double-entry Systems of Accounting

There are two basic types of journals and accounting systems:

- *single-entry* system of accounting
- *double-entry* system of accounting

To keep the books balanced and error free, most accounting systems are set up as double-entry systems.

Single-entry System of Accounting – The single-entry system of accounting is not a complete accounting system, but it shows income and expenses well enough for tax-purposes. Using this system, keep a day-today record of your income and expenses. A columnar book with separate pages for income and expenses is most convenient. Keep this record, together with your deposit slips, bank statements and canceled cheques, as well as receipts which support your expenditures (see **page 116, 119, 154** and **155** for examples of single-entry systems).

Double-Entry System of Accounting – To keep the books *balanced* and *error* *free*, most accounting systems are set up as double-entry systems. Double-entry means that for every transaction there are at least two corresponding *debit* and *credit* entries. In simple terms, this means that if you put something into one account, you must take it out of another account, and if you take something out of one account you must put something back into another account.

More specifically, this means that all transactions must eventually be posted to your ledger **TWICE**, as a debit to at least one account and a credit to at least one other account. This double-entry system ensures that if all transactions are recorded correctly, and that the total debits in all asset accounts will equal the total credits in all equity accounts (see page 158 and Journal entries 1 thru 55 starting on page 33 for examples of double-entries).

According to a study conducted at the University of West Florida, other than planning, poor general accounting and bookkeeping practices were found to be the major cause of financial problems for new small businesses. ***FUNFACT***

NOTE The double-entry method provides an essential continual check on accuracy, preventing terrible mistakes from going unnoticed indefinitely.

Understanding Debits & Credits

The concept of what is a *debit* and what is a *credit* has confused more people that any other accounting concept or principle. Perhaps because so few books succeed in explaining them in a straightforward non-threatening matter. Thus, to help start you off on the road of *debit and credit enlightenment*, memorize the following three straight forward non threatening principles:

- To keep your accounting books *balanced* whenever you put something into one account, you must take it out of some other account.
- A debit is always entered in the left-hand column of a Journal or Ledger and a credit is always entered in the right-hand column (memory aid: credit has an “R” in it for right).
- Sit down, close your eyes and seriously ask yourself why you started your business in the first place: to make money, right? Therefore, any money you **PUT IN** to your business, like rent payments, the purchase of a new photocopy machine, purchase of inventory or any other expense item including pencils and paper clips, takes away from you profits and hence can be considered a *debit*. On the other hand, any money you **TAKE OUT** of your business, whether it be in the form of sales revenues, or funds used to pay yourself and debts owed to creditors, can be considered a *credit*.

Accountants traditionally have dealt in debits and credits and in so doing have brought mystery, frustration and acid indigestion into accounting.

NOTE Accountants traditionally have dealt in debits and credits and in so doing have brought mystery, frustration and acid indigestion into accounting. However, despite the greater utility of debit and credit double-entry systems, many small business owners can choose not to concern themselves with such terminology, as long as they stick to single-entry systems and make sure that all transactions are as clearly explained as possible within such systems.

A Few Debit & Credit Theoretical Applications – Now that you have a pretty good idea of what a debit and a credit is and you're saying to yourself: "Hey I thought you said this was tough!" be warned that putting these concepts into actual use can be a bit tricky.

If you make the mistake of adding the date to the right side of an accounting statement, you must add it to the left side as well.
ANON

For example, most people would think that a liability such as a bill you owe to Joe Smoe's Widget business for a "what'cha ma'call it" you bought last week, should be considered a *debit* – something bad – while an asset such as a car you bought for your company should be considered a *credit* – something good? However, if you also think this way, then soon you will be completely and hopelessly bamboozled. Don't equate debits with traditional understandings of what *minus* is and credits with traditional understanding of what *plus* is.

To keep yourself from making more debit and credit errors, remember, all businesses are started to make profit, that is to take money **OUT** of the company and put it into personal bank accounts. Since the car is not your personal asset (the company owns it not you), it is therefore classified as money put **IN** to your business and hence must be entered as a debit. On the other hand, the bill you owe for the "what'cha ma'call it" you bought last week will eventually require you to take money **OUT** of your business to pay Joe Smoe. Money you take **OUT** of your business is always entered as credit whether you paying yourself or some other company.

NOTE It sometimes helps to think of debit and credit *columns* as representing debit and credit *accounts* (asset vs. equity accounts). Therefore when making an entry think of it as being a number you enter into a debit or credit account not an actual debit or credit entry.

It sometimes helps to think of debit and credit columns *as representing debit and credit* accounts *(asset vs. equity accounts).*

Making Journal Entries

Transactions are entered into the journal in chronological order that is the order in which they occur. Each entry requires that you:

FIRST, date the entry on the left edge.

SECOND, write the debit account title(s) as far to the left as you can as well as its corresponding dollar amount in the left-hand money column (to ease posting to the ledger, also write the corresponding account number).

THIRD, write the credit account title(s) – indented a half-inch or so – and its corresponding dollar amount in the right-hand money column (a debit can be, but doesn't have to be, entered in red ink, while a credit is usually entered in black ink – don't reverse).

And **FOURTH**, write a brief note of explanation regarding the transaction (see example below).

In other words, all journal entries require at least three lines on a page:

- at least one line for a debit entry
- at least one line for a credit entry
- a line for an explanation (sometimes, a single transaction can impact more than two different accounts at the same time and thus take up more than three lines)

NOTE The information for each transaction or journal entry is derived from original source documents – copies of sales slips, cash register tapes, check stubs, purchase order etc. In fact, complied copies of such transaction records are often used as the journal, each record being an entry. In other words, it is not necessary to make an individual entry for every single transaction that occurs during the course of your busi-

General Journal

	p.1		*Harry's Pet Supplies*		☜	☞		
	DATE		DESCRIPTIONS	AC#	DEBIT ACCOUNT	CREDIT ACCOUNT	P✓	
1	Jan	12	Merchandise	130	1 2 0 0 0 00		1/12/95	1
2			Accounts Payable	210		1 2 0 0 0 00		2
3			*Purchase of Bulk*					3
4			*Puppy Chow*					4

ness day or even business week. Certain kinds of transactions can be grouped or rather entered in batches as summarized lists. These summaries are then entered into special accounts set up specifically to record the items in question.

Common Journal Entries for a Small Business

Starting with the account balances shown in Example **#1,** listed below are typical Journal entries for Jim's DTP Services, a small computer publishing proprietorship:

NOTE All Journal entries for Jim's DTP Services, as well as other fictional companies used in this Guidebook are for illustration purposes only and should not be considered real-life data. The ledger to which these entries are posted to can be seen on **page 74.**

1) *Ledger Account Balances*

Date	DESCRIPTIONS	AC.	DB	CR
3/1	Cash in Bank	110	10,500	
	Accounts Receivable	120	1,950	
	Supplies	140	700	
	Equipment	170	8,500	
	Allow. For Deprec.	180		1,700
	Accounts Payable	210		1,000
	J. Smith, Capital	310		18,950

Ledger account balances at the beginning. of the month Wed., March 1, 95 for Jim's DTP Services.

2) *Prepaying Rent*

Date	DESCRIPTIONS	AC.	DB	CR
3/1	Prepaid Rent	148	1,500	
	Cash in Bank	110		1,500

To record $1,500 paid by check Mar. 1 on a lease rental contract for the second quarter of the year. The asset acquired in exchange for the payment is the use of the property for three months. The asset account *Prepaid Rent* increases and is debited for $1500; the asset account *Cash in Bank* decreases and is credited for $1,500. You only need this account if you prepay your rent.

NOTE When rent for a single month is prepaid at the beginning of a month, it is customarily debited to the rent expense account at the time of payment, thus avoiding the necessity of transferring the amount from *Prepaid Rent to Rent Expense* at the close of the fiscal period.

3) *Accounts Payable Purchase*

Date	DESCRIPTIONS	AC.	DB	CR
3/4	Equipment	170	1,750	
	Accounts Payable	210		1,750

To record $1,750 for computer equipment purchased on account Mar. 4 from Oliver's Computer Shack. The asset account *Equipment* increases and is therefore debited for $1,750. The liability account *Accounts Payable* increases and is credited for $1,750.

NOTE The use of individual accounts payable to creditors is described later on in this Step.

4) *Accounts Receivable Collection*

Date	DESCRIPTIONS	AC.	DB	CR
3/6	Cash in Bank	110	675	
	Accounts Rec.	120		675

To record $675 received (and deposited in the bank) Mar. 6 from customers in payment of their accounts including a $420 check from Harry Griswald, owner of Harry's Pet Supplies. The asset account *Cash in Bank* increases and is debited for $675. The asset account *Accounts Re-*

ceivable decreases and is credited for $675.

NOTE The use of individual accounts receivable from customers is described later on in this Step (see FIG. 9).

5) *Miscellaneous Expense*

Date	DESCRIPTIONS	AC.	DB	CR
3/7	Miscellaneous Exp.	590	80	
	Cash in Bank	110		80

To record $80 paid by check Mar. 7 for Association Fees. Expense accounts are in a manner of speaking, subdivisions of asset accounts. Expenses are assets of a very short duration. Increases in expenses are decreases in profit; hence an expense account is debited for $80. The asset account *Cash in Bank* was decreased by the transaction; therefore that account is credited for $80.

NOTE Miscellaneous Expense is debited because total expenditures for Association Fees for *Harry's Pet Supplies* during a fiscal period are expected to be relatively minor.

6) *Accounts Payable Payment*

Date	DESCRIPTIONS	AC.	DB	CR
3/9	Accounts Payable	210	500	
	Cash in Bank	110		500

To record $500 paid by check Mar. 9 to Bloomers Software House to partly pay off a $1,000 debt owed to them. This payment decreases the liability account *Accounts Payable*, so that account is debited for $500. It also decrease the asset account *Cash in Bank*, which is credited for $500.

7) *Salary Expense*

Date	DESCRIPTIONS	AC.	DB	CR
3/15	Salaries Expense	510	300	
	Cash in Bank	110		300

To record $300 paid Mar. 15 to a part-time assistant for two weeks salary.

8) *Sales Revenue*

Date	DESCRIPTIONS	AC.	DB	CR
3/18	Cash in Bank	110	2,100	
	Sales Revenues	410		2,100

To record $2,100 received (and deposited in the bank) from sales for the first half of March. *Cash in Bank* increases and is debited. The revenue account *Sales Revenues*, increases and is credited.

9) *Purchase of Supplies*

Date	DESCRIPTIONS	AC.	DB	CR
3/20	Supplies	140	795	
	Cash in Bank	110		795

To record $795 paid by check Mar. 20 for supplies. The asset account *Supplies* increases and is debited, the asset account *Cash in Bank* decreases and is credited.

10) *Purchase of Equipment by Check*

Date	DESCRIPTIONS	AC.	DB	CR
3/21	Equipment	170	8,000	
	Cash in Bank	110		8,000

To record $8,000 paid by check Mar. 21 for a color laser printer. The asset account *Equipment* increases and is debited, the asset account *Cash in Bank* decreases and is credited.

11) *Salaries Paid*

Date	DESCRIPTIONS	AC.	DB	CR
3/29	Salaries Expense	510	300	
	Cash in Bank	110		300

To record $300 paid by check Mar. 29 to a part-time assistant for two weeks salary.

12) *Miscellaneous Expense*

Date	DESCRIPTIONS	AC.	DB	CR
3/29	Miscellaneous Exp.	590	42	
3/29	Miscellaneous Exp.	590	112	
	Cash In Bank	110		154

To record $42 for monthly phone bill and $112 for monthly electric bill paid by check Mar. 29 to the city.

13) *Sales Revenue*

Date	DESCRIPTIONS	AC.	DB	CR
3/31	Cash in Bank	110	2,354	
	Sales Revenues	410		2,354

To record $2,354 received (and deposited in the bank) from sales for the second half of March.

14) *Accounts Receivable Sales*

Date	DESCRIPTIONS	AC.	DB	CR
3/31	Accounts Receivable	120	1,100	
	Sales Revenues	410		1,100

To record sales on account totaling $1,100 for the month of March.

15) *Personal Drawing*

Date	DESCRIPTIONS	AC.	DB	CR
3/31	J. Smith, Drawing	315	1,900	
	Cash in Bank	110		1,900

To record $1,900 Jim withdrew Mar. 31 for his personal use.

NOTE A good business owner would never place an unrealistic management salary burden on a fledgling business.

MORE Journal Entries for Small Businesses

Below is a selection of more common Journal entries for a small business including transactions involving:

- A/Ps
- A/Rs
- Sales Revenues
- Supplies purchased
- Merchandise and Inventory purchased

- Equipment purchased and sold
- Stock issued for a corporation
- Marketable Securities purchased
- Deprecation expenses
- various other expenses incurred

Accounts Payable Transactions

16) *Purchase*

Date	DESCRIPTIONS	AC.	DB	CR
5/1	Merchandise	130	1,000	
	Raw Materials	135	250	
	Supplies	140	350	
	Accounts Payable	210		1,600

To record amounts owed for the purchase of merchandise, raw materials, and supplies from Jay. Co.

17) *Freight & Transportation Charges*

Date	DESCRIPTIONS	AC.	DB	CR
5/1	Merchandise	130	59	
	Accounts Payable	210		59

To record freight and transportation charges as an added cost of the merchandise purchased above.

18) *Discount Received*

Date	DESCRIPTIONS	AC.	DB	CR
5/6	Accounts Payable	210	1,000	
	Cash in Bank	110		980
	Merchandise Dis.	131		20

To record an early $980 payment by check to a supplier (Jay Co.) and the subsequent cash discount received as offered by the supplier.

NOTE Instead of using the contra account *Merchandise Discount* to reflect the reduction in your recorded cost for merchandise, you can make a $20 credit directly to the

Merchandise account.

19) *Returned Merchandise*

Date	DESCRIPTIONS	AC.	DB	CR
5/9	Accounts Payable	210	100	
	Merchandise Returns and Allowances	132		100

To record returns of merchandise for credit and to record reductions in prices (allowances) granted by the suppliers on goods found to be defective or not in accord with specifications.

NOTE Instead of using the contra account *Merchandise Returns and Allowances* to reflect the reduction in your recorded cost for merchandise, you can make a $100 credit directly to the *Merchandise* account.

Accounts Receivable Transactions

20) *Collection*

Date	DESCRIPTIONS	AC.	DB	CR
5/9	Cash	100	1,000	
	Accounts Rec.	120		1,000

To record the collection of cash from a customer or customers who at an earlier time purchased merchandise from you "on account."

21) *Discount*

Date	DESCRIPTIONS	AC.	DB	CR
5/18	Cash	100	8,900	
	Sales Discounts	415	100	
	Accounts Rec.	120		9,000

To record collections from customers of invoices totaling $9,000 face value, less discounts totaling $100.

NOTE When you sell goods or services with the understanding that the customer can take a cash discount if he pays, within lets say 10 days, your initial recording of sales revenue (at gross) must be revised if you collect the smaller amount. You could simply debit *Sales Revenue* for $100 but for the purpose of keeping management informed on the amount of discounts the customers are actually taking, in may be better to make the debit to a contra account, *Sales Discounts*. The account *Sales Discounts* is then treated as a subtraction from *Sales Revenues* in your Income Statement.

22) *Allowance for Bad Debts*

Date	DESCRIPTIONS	AC.	DB	CR
5/23	Allowance for Bad Debts	125	1,000	
	Accounts Rec.	120		1,000

To record a debt that hasn't been paid.

Asset Transactions

23) *Sale of Equipment*

Date	DESCRIPTIONS	AC.	DB	CR
6/5	Cash on Hand	100	3,000	
	Allowance for Depreciation	180	6,000	
	Retirement Loss	495	1,000	
	Equipment	170		10,000

To record the sale of a forklift for $3000 which originally cost $10,000.

NOTE The accumulated depreciation over the years for the forklift had been recorded in the contra account, *Allowance for Depreciation* (as an offset to the *Equipment* account). When you dispose of the equipment, this contra account must also be reduced along with the reduction of the *Equipment* account. A loss of $1,000 is also recorded in a *Retirement Loss* account, because according to the depreciation schedule of the asset, its value had only been depreciated by $6,000 down to $4,000. If however, you sold the forklift for $5,000 – $1,000 over the depreciated amount – you then would have to record this recovered *Allowance for Depreciation* (also known as *Recaptured Accumulated Depreciation* or *Recaptured Allowance for Depreciation*), as *Other Income*.

23) *Purchase of Equipment*

Date	DESCRIPTIONS	AC.	DB	CR
6/5	Equipment	170	2,400	
	Cash in Bank	110		2,400
	Drill Press purchased from Fred's Equipment Check #504			
6/7	Equipment	170	12,000	
	Cash on Hand (from Forklift trade-in)	100		3,000
	Accounts Payable	210		9,000
	Smith Equipment Shop Traded old Forklift for $2,250, paid $4,000 Check #515			

To record the purchase of a drill press and a new forklift on trade-in.

NOTE For record-keeping purposes, you can list your capital additions on a columnar sheet, the same way you record your expenses. When you sell or trade an asset, show the date you disposed of it and the amount you received or were allowed on trade-in. You must then retain the purchase contract and the canceled check or other method of payment, so you can support the amount in your records.

However, if you own quite a number of items, it is a good idea to prepare separate lists for automotive equipment, tools and manufacturing equipment, and furniture and fixtures. These asset record lists provide the basis for calculating depreciation and provide supporting data for fixed assets accounts (see example on page).

24) *Purchase of Real-Estate*

Date	DESCRIPTIONS	AC.	DB	CR
6/24	Building	160	30,000	
	Land	150	10,000	
	Cash in Bank	110		40,000

To record the cash purchase of a building costing $30,000, on land valued at $10,000.

Banking Transactions

25) *Deposit*

Date	DESCRIPTIONS	AC.	DB	CR
6/30	Cash in Bank	110	1,000	
	Cash on Hand	100		1,000

To record a bank deposit.

26) *Short-term Loan Received*

Date	DESCRIPTIONS	AC.	DB	CR
6/30	Cash in Bank	110	15,000	

Asset Record

Date	Asset	Cost	Details
6/5/ 95	Drill Press	2,400	Fred's Equipment Check 504
67/95	Forklift	12,100	Smith's Equipment Traded old Forklift for $3,000, paid $9,000 Check 515

	Short-term Bank Loan Payable	240		15,000

To record $10,000 borrowed from a bank. Your *Cash in Bank* account (an asset) is increased by a debit, and your *Bank Loan Payable* account (a current liability) is increased by a credit.

NOTE Borrowed $15,000 from bank at 7%, 60 day note.

27) *Interest Payable*

Date	DESCRIPTIONS	AC.	DB	CR
7/31	Interest Expense	575	87.50	
	Interest Payable	245		87.50

To record July share of interest payable (interest not yet paid) on a bank loan. Principal amount $15,000 at 7% = $1,050.00 per year. July share is $87.50.

28) *Service Charge*

Date	DESCRIPTIONS	AC.	DB	CR
7/31	Cash in Bank	110	8.70	
	Miscellaneous Exp.	590		8.70

To record a bank service charge of $8.70.

Corporation Transactions

29) *Capital Stock Issued*

Date	DESCRIPTIONS	AC.	DB	CR
8/1	Cash on Hand	100	100,000	
	Capital Stock	310		100,000

To record the issue of $100,000 worth of capital stock to launch a corporation. A debit (left-hand) entry is made in the *Cash in Hand* account as an asset increase, and a credit (right-hand) entry is made in the *Capital Stock* account as an equity increase.

30) *Bonds Payable*

Date	DESCRIPTIONS	AC.	DB	CR
8/12	Cash on Hand	100	20,000	

	Bonds Payable	270		20,000

To record $20,000 borrowed by issuing bonds. *Bonds Payable* is a liability account, therefore you must make a credit to record the increase.

31) *Dividends Paid*

Date	DESCRIPTIONS	AC.	DB	CR
8/31	Dividends Paid	346	850	
	Dividends Payable	246		850

To record the declaration of a dividend to be paid on August 31.

NOTE Dividends are a distribution of profits by a corporation to its shareholders.

Expense Transactions

32) *Advertising*

Date	DESCRIPTIONS	AC.	DB	CR
9/1	Advertising Expense	565	900	
	Cash in Bank	110		900

To record payment by check for an Ad in a newspaper.

33) *Depreciation*

Date	DESCRIPTIONS	AC.	DB	CR
9/29	Depreciation Exp.	580	750	
	Allow. for Depre.	180		750

To record the depreciation of computer equipment for the third quarter of the year. *Equipment* valued at $10,000 is depreciated at the rate of 30% or $3,000. Third quarter share is $750.

34) *Prepaid Items*

Date	DESCRIPTIONS	AC.	DB	CR
10/2	Prepaid Insurance	146	189	
	Prepaid Property Taxes	147	540	
	Prepaid Rent	148	1,500	
	Cash in Bank	110		2,229

To record a payment by check in advance for services to be received over various periods of time in the future (in the above case, prepayments are for the 4th quarter).

NOTE In general, prepayments (commonly called prepaid expenses) consist of amounts that have been paid in advance to suppliers of services. The most common examples are prepaid insurance, prepaid rent, and prepaid property taxes. Under normal circumstances only two common transactions affect the prepayment accounts: a) the payment made in advance, and b) the amortization of the prepayment as it expires.

35) *Expiration of Prepaid Items*

Date	DESCRIPTIONS	AC.	DB	CR
10/31	Insurance Expense	570	63	
	Prepaid Insurance	146		63
10/31	Property Tax Exp.	532	180	
	Prepaid Prop. Tax	147		180
10/31	Rent Expense	520	500	
	Prepaid Rent	148		500

To record the expiration of the portion of prepaid insurance, property tax, and rent allocable to past period.

NOTE Most businesses will have several types of insurance. Each policy should be listed conveniently showing type of insurance, coverage, name of insurer, date effective (expiration date) and annual premiums.

36) *Salaries Liability*

Date	DESCRIPTIONS	AC.	DB	CR
10/31	Salaries Expense	510	900	
	Salaries Payable	220		900

To record **liability** for unpaid wages or salaries as of end of accounting period.

37) *Supplies Consumption for a Factory*

Date	DESCRIPTIONS	AC.	DB	CR
10/31	Factory Overhead	586	1,000	

Supplies	140		1,000

To record consumption of supplies by various factory departments, with the cost charged to *Factory Overhead* because it cannot be traced directly to units of the product manufactured.

38) *Supplies Consumption for Selling and Administrative Overhead*

Date	DESCRIPTIONS	AC.	DB	CR
10/31	Selling Expenses	587	1,000	
	Administrative Exp.	588	1,000	
	Supplies	140		2,000

To transfer the consumption of various kinds of supplies for various purposes to selling and administrative expenses.

39) *Closing Entry for Misc. Expenses*

Date	DESCRIPTIONS	AC.	DB	CR
10/31	Retained Earnings	320	8,000	
	Miscellaneous Exp.	590		8,000

To close *Miscellaneous Expenses* to *Retained Earnings* for a corporation for a specific period ending.

NOTE In the case of a corporation the *Net Income* contra account would be the *Retained Earnings* account instead of the *John Doe, Capital* account.

Inventory Transactions

40) *Cash Purchase of Merchandise and Supplies*

Date	DESCRIPTIONS	AC.	DB	CR
11/1	Merchandise	130	100	
	Supplies	140	1,000	
	Cash in Bank	110		1,100

To record purchase of merchandise or inventory; and to record purchases of supplies.

NOTE Supplies – not to be confused with equipment, which means more or less permanent assets – include auxiliary goods such as stationery, fuel, lumber and repair parts. Technically, you should not include as inventories stores of lumber and building supplies that you may have purchased for use in the construction of your own building or manufacturing plant, because inventories are limited to the stocks of goods which qualify as current assets and which are part of your working capital.

41) *Purchase of Raw Materials on Account*

Date	DESCRIPTIONS	AC.	DB	CR
11/1	Raw Materials	135	1,000	
	Accounts Payable	210		1,000

To record the purchase of various kinds of raw materials for use in production in a factory.

NOTE The term inventories, like so many terms, is widely used in ordinary conversation. It tends to refer to your supply of almost anything from paperclips to battleships. The best example of inventories however, is your stock of merchandise held for sale to customers (also referred to as "stock in trade"). If you're involved with manufacturing, the term also embraces your raw materials, your semi-finished goods, (works in process) and your finished goods. A dealer in marketable securities, such as stocks and bonds, would have a marketable securities inventory.

42) *Cost of Goods Sold*

Date	DESCRIPTIONS	AC.	DB	CR
11/30	Merchandise	130	27,000	
	Cost of Goods Sold	585	11,600	
	Merchandise	130		14,300

To record a physical inventory of goods remaining on hand, taken to determine the cost of goods that have been sold.

NOTE For information on how to evaluate your merchandise to determine costs of your goods, see *Inventory Valuation* in Guidebook #29.

43) *Cost of Raw Materials*

Date	DESCRIPTIONS	AC.	DB	CR
11/30	Work in Process	137	1,000	
	Raw Materials	135		1,000

To record cost of raw materials used in productions, as measured by amounts shown on requisitions used and traceable directly to specific jobs in process.

44) *Labor & Overhead Costs*

Date	DESCRIPTIONS	AC.	DB	CR
11/30	Work in Progress	137	2,000	
	Payroll Payable	220		1,000
	Factory Overhead	586		1,000

To transfer cost of factory labor into the account representing the cost of making finished goods; and to transfer miscellaneous factory costs into the account representing the cost of making finished goods.

45) *Finished Goods*

Date	DESCRIPTIONS	AC.	DB	CR
11/30	Finished Goods	136	15,000	
	Work in Progress	137		15,000

To transfer from the *Work in Process* account to the *Finished Goods* account the cost of goods actually finished this period.

46) *Cost of Goods Sold Closing Entry*

Date	DESCRIPTIONS	AC.	DB	CR
11/30	Selling Expenses	587	15,000	
	Cost of Goods Sold	585		15,000

To close merchandise *Cost of Goods Sold* for a specific period ending to *Selling Expenses*. *Selling Expenses* can then be closed to *Retained Earnings*.

Marketable Securities Transactions

47) *Purchase*

Date	DESCRIPTIONS	AC.	DB	CR
12/1	Marketable Securities	115	12,000	
	Cash in Bank	110		12,000

To record the cost of purchasing non-speculative, marketable securities to be paid for out of excess of cash currently in the bank during a lull in business activity.

NOTE These securities can be used to build up a fund for payment of income taxes at a later date.

48) *Gain*

Date	DESCRIPTIONS	AC.	DB	CR
12/31	Cash on Hand	100	1,200	
	Marketable Secur.	115		1,000
	Gain on Sale of Marketable Secur.	475		200

To record the sale of $1200 worth of securities that cost $1000, and to record the resulting gain of $200. This gain is shown as a credit because the gain constitutes an increase in the owner's equity.

49) *Interest and Dividends Earned*

Date	DESCRIPTIONS	AC.	DB	CR
12/31	Cash on Hand	100	600	
	Interest Revenue	440		400
	Dividends Rev.	450		200

To record receipt of interest and dividends earned on marketable securities

50) *Loss*

Date	DESCRIPTIONS	AC.	DB	CR
12/31	Cash on Hand	100	800	
	Loss on Sale of Marketable Secur.	485	200	
	Marketable Secur.	115		1,000

To record the sale of $800 worth of securities that cost $1000, and to record the resulting loss of $200. This loss is shown as a DB because the loss constitutes a decrease in the owner's equity.

51) *Loss from Decline in Value*

Date	DESCRIPTIONS	AC.	DB	CR
12/31	Loss From Decrease in Value of Marketable Securities	485	400	
	Marketable Securities – Cost	115		400

Entry made at end of accounting period so balance sheet will show marketable securities at the lower of their cost or their current market value.

Sales Revenues Transactions

52) *Sales for Period Ending*

Date	DESCRIPTIONS	AC.	DB	CR
12/31	Cash on Hand	100	3,000	
	Sales Revenue	410		3,000

To record sales for the week ending April 2.

53) *Closing Entry*

Date	DESCRIPTIONS	AC.	DB	CR
12/31	Sales Revenue	410	30,000	
	Retained Earnings	320		30,000

To close *Sales Revenue* for a specific period.

Other Transactions

54) *NSF Check*

Date	DESCRIPTIONS	AC.	DB	CR
12/31	Accounts Receivable	120	421.65	
	Cash in Bank	110		421.65

To record a NSF check from Mr. C Bouncing. Every now and then you will take a check from someone which is subsequently returned by the bank as being NSF. When you are informed of this charge to your account, you must make bookkeeping entries to take care of it. If the check is from an account on credit: on your synoptic ledger (or Accounts Receivable Ledger), take $421.65 out of the bank balance and also show your *Accounts Receivable* as increasing by that amount. Since Mr. C. Bouncing is a regular charge account customer, pull his card from the A/R ledger and increase his balance by the $421.65. It might be wise to make notation in red ink beside the entry so that if he attempts to purchase again on credit you will be tipped off that his checks are not to be trusted.

When the fund is nearly exhausted, the items are summarized and a check drawn to cover the exact amount expended.

55) *Petty Cash Fund Adjustment*

Date	DESCRIPTIONS	AC.	DB	CR
12/31	Petty Cash	105	35	
	Cash in Bank	110		35

To record a check written for $35 to replenish a *Petty Cash* fund.

NOTE A *Petty Cash* account should be set up to be used for payment of small amounts not covered by invoices to avoid the hassles of writing checks for small purchases. A *Petty Cash* fund is used mainly for those businesses that do not ordinarily deal in cash and tend to deal mostly with checks or credit cards.

To *start* a *Petty Cash* fund write a check for $50.00 (or any other convenient amount). Cash the check and place the actual money in a cash box left in the care of a trusted individual for safekeeping.

When using funds from *Petty Cash*, always get a receipt. If no receipt is possible, make a notation of what the money was used for and place it in the cash box with other receipts. Thus, the cash and receipts in the cash box should always total to the amount of the petty cash float. When payments are made for such items as postage, freight, and bus fares, the items are listed on a printed form or even on a blank sheet.

A "Petty Cash" fund can also often combined with "Opening Balance" fund or "Change" fund.

When the fund is nearly exhausted, the items are summarized and a check drawn to cover the exact amount expended. The check is cashed and the fund replenished. At all times the cash in the drawer plus listed expenditures will equal the amount of the fund.

Each time the cash is replenished the receipts are removed, grouped in the various categories and placed in an envelope, perhaps with the category totals written on the outside of the envelope.

If using a synoptic ledger, the balancing entry for the check being written will be to *Miscellaneous Expenses* not to the *Petty Cash* fund.

A *Petty Cash* fund can also often combined with *Opening Balance* fund or *Change* fund. For example: if your *Petty Cash* fund equals $50 and your *Opening Balance* fund is $100, when your receipts add up to $50 write another check for $50 to the *Petty Cash* fund.

C) JOURNAL ENTRY POSTED TO GENERAL LEDGER

AFTER YOU have entered a transaction into your *Journal*, you must then transfer that information, though not necessarily right away, to an appropriate page in a *General Ledger*. This process is called **posting**.

A *General Ledger* is usually a hard cover book in which each individual type or group of transactions are maintained separately on different pages. These groups of related transactions are called *ledger accounts* or *T-accounts* (named so because the ledger pages look like giant T's). The chief function of a *Ledger* is to record and keep track of the *balances* of each individual account. It will typically contain anywhere from a dozen or so, to hundreds of asset, liability, equity, revenue or expense accounts, depending upon the needs of management and the size of the business.

There are five basic types of accounts: asset, liability, equity, revenue, and expense accounts.

The Five Basic Types of Accounts

There are five basic types of accounts:

- Asset
- Liability
- Equity
- Revenue
- Expense

To set up your Ledger properly, you must first assign a page or group of pages for each type of asset, liability, revenue, capital equity, and expense account that you want to keep track of. Each separate account must also be given a special account number and a special account title.

NOTE Account numbers are usually between 10 and 59, 100 and 599, 1000 and 5999 and so on, as shown below.

BALANCE SHEET ACCOUNTS	
Assets	100-199
Liabilities	200-299
Owner's Equity	300-399
INCOME STATEMENT ACCOUNTS	
Revenues	400-499
Expenses	500-599

Setting up a Chart of Accounts

Once each account is assigned an account title, an account number, and a ledger page or pages, an index (at the beginning of the ledger) is created to list all the account titles and numbers used in your daily bookkeeping operations. This list is called a **Chart of Accounts**. A *Chart of Accounts* is like a table of contents at the beginning of a book. Below, is a list of some of the accounts a small business may have in its own *Chart of Accounts*.

Balance Sheet Accounts (100 - 199)

ASSET ACCOUNTS

Company assets are anything of value including cash and tangible real goods that are owned by or owed to your company and contributes to the net worth of your business. In the case of real goods, the full value of the asset is listed regardless of whether it is fully paid for or not (all assets accounts are considered debit accounts unless otherwise noted).

NOTE *Soft assets* include such intangibles as good will, patents, formulas, and capitalized research and development (R & D). Soft assets are more difficult to keep track of and value therefore should be approached with caution when incorporated into any accounting system.

Current asset accounts are accounts that can be easily turned into cash if necessary within one year.

Current Asset Accounts

Current asset accounts are accounts that can be easily turned into cash if necessary within one year. They are listed in order of their liquidity.

100 Cash on Hand – If your business deals with the in-flow and out-flow of large amounts of cash on a daily basis then some sort of control must be placed on the cash received and disbursed. A *Cash on Hand* account, also more simply called a *Cash* account is used to show money in a business at the end of the day and to keep track of all transactions involving cash. It may not be needed if your business does not deal in hard currency or if regular daily bank deposits are not necessary. *Debit Entry*

NOTE The term cash refer to checks, money orders and credit cards slips as well as currency.

105 Petty Cash – A *Petty Cash* account is set-up to keep track of checks written to replenish your *Petty Cash* fund. *Debit Entry*

110 Cash in Bank – A *Cash in Bank* account, also called a Checking account, is used to keep track of company bank deposits, checks and money orders. *Debit Entry*

115 Short-Term Investments – Also called *Marketable Securities* account, this account keeps track of interest or dividend-yielding holdings expected to be converted into cash with a year. This includes stocks and bonds, certificates of deposit and time-deposit savings accounts. Each can be given a separate account or grouped under one heading. *Debit Entry*

116 Long-term Investments – Also called "Long-term Assets," this accounts keeps track of marketable securities such as stocks, bonds and special savings accounts, that are kept for at least one year and typically yield interest or dividends. *Debit Entry*

120 Accounts Receivable – A business owner should know at almost any time what their outstanding A/Rs are, to have a realistic idea of the cash flow and the worth of their business. Although, a separate *A/R* account is kept for each customer or client who owes your firm money (as discussed later on), the combined balance of all these accounts should be kept in a separate ledger account. Sales on account are *Debit Entries* while payments are *Credit Entries.*

Sales on account are Debit Entries while payments are Credit Entries.

121 Interest Accrued Receivable – Interest revenue owed to you but not yet received. *Debit Entry*

125 Allowance for Bad Debts – Money owed to you that cannot be collected is called a bad debt. Many bad debts are incurred by customers and clients who fall on hard times or who go bankrupt. Through experience, and reports from trade and government bureaus, entrepreneurs can establish a reliable bad-debt ratio. If on an average, your bad-debt loss is 2 percent of gross volume, then 2 percent can be periodically placed in your bad debt account. *Credit Entry*

***Merchandise Discount –** An account that keeps track of discounts received from suppliers when invoices are paid ahead of due date.*

NOTE The *Allowance for Bad Debts* account balances with the Bad Debts expense account. An entry into this account is normally a credit entry not a debit entry.

130 Merchandise – A *Merchandise* account, also called an *Inventory* account, is used to keep track of goods acquired and held for resale to customers (goods bought and sold), merchandise returns to suppliers, and periodic inventory counts (to make adjustments for loss and theft etc.). A *Merchandise* account can also be set-up to keep track of "raw materials," "finished goods" and "work in progress" (though it is often better to set-up separate accounts for this). *Debit Entry*

131 Merchandise Discount – An account that keeps track of discounts received from suppliers when invoices are paid ahead of due date. *Credit Entry*

132 Merchandise Returns & Allowances – *Credit Entry*

135 Raw Materials – *Debit Entry*

136 Finished Goods – *Debit Entry*

137 Work in Progress – An account that keeps track of the value of goods in the process of being manufactured. *Debit Entry*

140 Supplies – Supplies are assets that can be written off as expenses in the year they were paid. A *Supplies* account, also called a *Supplies on Hand* account, typically includes expense items like paper, letterhead, typewriter ribbons, printer cartridges etc. *Debit Entry*

145 Prepaid Expenses – Accounts set-up for the advance payment for services not yet rendered or goods not yet delivered. *Debit Entry*

A prepaid expense is an expense that is paid before it is due.

NOTE A prepaid expense is an expense that is paid before it is due. Under the accrual method of accounting, you must claim any expense you prepay in the year in which you receive the related benefit. If the expense is for services to be rendered after the end of the year you will be only permitted to deduct the portion of expenses which relates to the current taxation year. The excess must be deferred and may be deducted in future years to which the expense relates. For example, if your fiscal year-end is December 31, 1990 and on June 30, 1990 you prepay the rent on your business premises for a full year (July 1, 1990 to June 30, 1991) you can only claim one-half of this rent as an expense in 1990. You can claim the balance as an expense in 1991.

146 Prepaid Insurance – *Debit Entry*

147 Prepaid Property Tax – *Debit Entry*

148 Prepaid Rent – *Debit Entry*

149 Prepaid Supplies – *Debit Entry*

Fixed Asset Accounts

Fixed assets (also called real or tangible assets) are difficult to turn into cash. Fixed assets are of a long-term or permanent nature such as land, buildings, automobiles and equipment. They are not intended for resale.

Fixed assets (also called real or tangible assets) are difficult to turn into cash.

150 Land – *Debit Entry*

160 Buildings – *Debit Entry*

165 Leasehold Improvements – *Debit Entry*

170 Equipment – Also called Tools and Equipment. *Debit Entry*

175 Furniture & Fixtures – This account includes the value of all your office furniture and fixtures. *Debit Entry*

180 Allowance for Depreciation – The costs of fixed assets are spread out over their useful life and charged to each year as a depreciation expense. This deduction is allowed under the Income Tax Act, to account for the fact that property such as equipment and buildings, wear out or become obsolete over a number of years. This account is set up to record the accumulation of depreciation expenses. It is also known as the *Accumulated Deprecia-*

tion account and the *Capital Cost Allowance* account (in Canada). An entry into this account is normally a *Credit Entry*.

181 Allowance for Depreciation of Buildings – If required, the *Allowance for Depreciation* account can be split up into various sub-accounts. Usually these sub accounts are grouped according to depreciation rates and classes of property as outlined in government tax documents. *Credit Entry*

182 Allowance for Depreciation of Leasehold Improvements – *Credit Entry*

183 Allowance for Depreciation of Tools & Equipment – *Credit Entry*

184 Allowance for Depreciation of Furniture and Fixtures – *Credit Entry*

(200 - 299)

LIABILITY ACCOUNTS

Liabilities are legal claims against a business by persons or corporations other than the owners. These claims come before the rights of the owners. They consist of money owed to suppliers or vendors for inventory or supplies; money owed to banks or loan companies for buildings or equipment purchases; money owed for taxes; and anything else bought on credit. Unless otherwise stated all liability accounts normally have credit balances.

Current liabilities are obligations or that must be paid within the year (or one operating cycle).

Current Liability Accounts

Current liabilities are obligations or that must be paid within the year (or one operating cycle).

210 Accounts Payable – Amounts that you owe, generally for the purchase of merchandise or services. A separate account is also kept for each vendor, supplier, or creditor to whom you owe money. *Credit Entry*

220 Salaries Payable – Also called *Wages Payable*, *Wages Accrued Payable*, *Salaries on Hand*, *Payroll Payable*, or *Payroll Due* account, this account records salaries you owe and haven't paid yet. *Credit Entry*

What advantages a merchant derives from double-entry bookkeeping! It is among the finest inventions of the human mind; and every good householder should introduce it into his economy.
JOHANN WOLFGANG VON GOETHE

NOTE *Salaries Payable*, *Income Tax Payable*, *Interest Payable*, *Mortgage Payable* and other expenses payable can also be grouped under one account called *Accrued Expenses Payable*.

230 Tax Payable – Also called tax accrued payable, this account can be set up to keep track of taxes owed but not yet sent to the government. This account is often broken up into the four separate accounts listed below. *Credit Entry*

231 Federal Income Tax Payable – *Credit Entry*

232 State Income Tax Payable – *Credit Entry*

233 Self-Employment Tax Payable – *Credit Entry*

234 Sales Tax Payable – *Credit Entry*

235 Property Tax Payable – *Credit En-*

try

236 Payroll Payable – Also *called Accrued Payroll Payable* or *Payroll Accrual*, this account is set up to keep track of salaries and wages currently owed. *Credit Entry*

NOTE You may also want to set up additional accounts to keep track of deductions and withholdings not yet sent in like pension plans, health care benefits, social security etc.

Nowadays, you hear a lot about fancy accounting methods, like LIFO and FIFO, but back then we were using the ESP method, which really sped things along when it came time to close books. It's a pretty basic method: if you can't make your books balance you take however much they're off by and enter it under the heading ESP, which stands for Error Some Place.
SAM WALTON

237 Payroll Taxes Payable – Also called *Accrued Payroll Taxes*, this account can be used to keep track of payroll taxes you have accumulated (deducted from the pay of the people who work for you) but not yet sent to the government. *Credit Entry*

240 Short Term Loans Payable – This accounts, also called the *Current Notes Payable*, *Short Term Notes Payable*, *Bank Loan Payable* or simply *Notes Payable*, represents the balance of borrowed funds or loans that must be repaid within the current accounting year. *Credit Entry*

245 Interest Payable – Also called *Accrued Interest Payable* this account is set up to keep track of accrued fees paid and due for all short-term and long-term borrowed capital as well as any credit extended to your business. *Credit Entry*

246 Dividends Payable – *Credit Entry*

Long Term Liability Accounts

Long term liabilities are monies a company owes (outstanding balances less current portion due) spread out over a period of time longer than a year.

250 Long Term Loans Payable – Also called *Long Term Notes Payable*, this account is set-up to keep track of the balance owed on loans that have due dates of over one year. *Credit Entry*

260 Mortgages Payable – This account keeps track of the balance due on business mortgages. *Credit Entry*

270 Bonds Payable – This account keeps track of amounts due to bond holders (applies to corporations). *Credit Entry*

Bonds Payable – *This account keeps track of amounts due to bond holders (applies to corporations).*

(300 - 399)

OWNER'S EQUITY ACCOUNTS

An *equity* is any debt a business owes, whether to outsiders or to its owners. *Owner's Equity* refers specifically to the owner's claim to the net assets of the company (assets minus liabilities). An *Owner's Equity* account is often referred to as a *Capital* account, *Net Worth* or simply an *Equity* account. Unless otherwise noted, all *Owner's Equity* accounts have credit balances.

300 Capital Stock – This account is set up for a corporation that issues stock. *Credit Entry*

310 John Doe, Capital – Also called *Proprietor's Capital Account* or *Capital Account*, this account is set-up to keep track of the owner's earnings in a proprietorship or partnership (the account on the Ledger sheet is titled with the owner's name followed by the word "Capital"). *Credit Entry*

NOTE If the business is a partnership, capital and drawing accounts are provided for each partner.

If the business is a partnership, capital and drawing accounts are provided for each partner.

315 John Doe, Drawing – Also called *Proprietor's Drawing* or *Drawing Account*, this account keeps track of money the owner has withdrawn for his or her personal use. For each sum drawn by the owner, you credit the company *Cash in Bank* account and debit the *Drawing* account. When the accounts are closed (for the year or period ending), the debit balance in the *Drawing* account is charged against the proprietor's *Capital* account. This type of account is only used for a proprietorship or partnership. *Debit Entry*

320 Retained Earnings – This account is set up for a corporation. It is equivalent in nature to the *John, Doe, Capital* account. *Credit Entry*

346 Dividends Paid – This account keeps track of the dividends paid out of the *Retained Earnings* account. It is set up for a corporation. *Debit Entry*

350 Income Summary – The *Income Summary* account, also referred to as the

Profit and Loss account, the *Net-income* account or the *Income Statement* account, is maintained by the Income Statement results (CR. if profit: DB. if Loss). It balances with the *Retained Earnings* or the proprietor's *Capital* account. *Debit Entry*

Income Statement Accounts (400-499)

Revenues are the earnings, income, or cash inflow of your business.

REVENUE ACCOUNTS

Revenues are the earnings, income, or cash inflow of your business. Revenues can come from the sale of products or the sale of services whether they are in the form of cash or in the form of accounts receivable. Your income records should show the date, the amount, and the source of the income, and also whether you received as payment cash, property, or services.

410 Sales Revenue – Also called the *Sales* accounts, this accounts keeps track of all your sales both goods and services. If necessary, it can be broken down into various sub-categories of sales or services sources of revenue. *Credit Entry*

414 Sales Tax Collected – Keeps track of sales tax collected. *Credit Entry*

415 Sales and Sales Tax Refunds – *Debit Entry*

416 Sales Discount – Keeps track of discounts given to customers. *Debit Entry*

420 Service Revenue – *Credit Entry*

430 Other Income – Most businesses also set up an Other Income or Other

Revenue account to record income and revenue not normally earned in the course of typical business day. Other income sources can include:

- Unexplainable cash surpluses in your cash register.
- Money received for vacation trips or other awards of any kind (jewelry, furniture, etc.) as a result of your business activities.
- Money received from bad debts that had been written off in a previous year.
- Money received from government grants or subsidies (a government employment grant would generally be deducted from the wage expense you are claiming not added to income).
- The value of the goods or services received from bartering.
- Income reserves you claimed in a previous year (you can then take anew reserve based on your circumstances).
- Money received from

Support all income and revenue entries with original documents. Original documents include (depending on the type of business you run), sales invoices, cash register tapes, receipts, patient cards, fee statements, contracts and so on. Good records can help you to identify from whom you received your income. You may receive cash or property from many different places. Unless you have records showing the sources of your income, you may be unable to prove that some are non-business or non-taxable.

SUPERTIP

damages or compensation due to patent infringement, breach of contract or antitrust injury. *Credit Entry*

440 Interest Revenue – *Credit Entry*

450 Dividends Revenue – *Credit Entry*

460 Royalties Revenue – *Credit Entry*

465 Rental Income – If you own rental property you should keep a separate account of rental income. Do not include it in your business income. You must report it separately on your income tax return. *Credit Entry*

If you own rental property you should keep a separate account of rental income.

470 Gain from Sale of Fixed Assets – If you sell a capital property you may have to include certain amounts in your income, such as a recovery of capital cost allowance, known as recapture (account 490) and three-quarters of any capital gain you realize. Aso called *Capital Gains* account. *Credit Entry*

475 Gain from Sale of Marketable Securities – *Credit Entry*

480 Loss from Sale of Fixed Assets – Also called Capital Loss account. *Debit Entry*

485 Loss from Sale of Marketable Securities – *Credit Entry*

490 Recaptured Allowance for Depreciation – If, at the end of the taxation year, the balance in a class of assets is negative, add this amount into income on your income statement, and set the balance in the class at zero. This is known as recaptured capital cost allowance. You will then start the following year with an opening balance of zero in that particular class. If, at the end of the taxation year, the balance in column is positive, but there are no more assets in the class, deduct the positive balance from income on your income statement, and set the balance in the class at zero. This is known as a terminal loss. As above, you will start the following year with an opening balance of zero in that particular class. Also called *Recaptured Accumulated Depreciation* account. *Credit Entry*

Well-kept records can be a tax savings since they serve as a reminder of deductible expenses.

495 Retirement Loss – Also known as *Terminal Loss* account, amounts recorded here can be deducted from income on your income statement. *Debit Entry*

(500 - 599)

EXPENSE ACCOUNTS

Expenses, also called operating expenses, are the day-to day expenditures arising out of current business activities. It represents an asset that you have for a very short time. Setting up a special expense account is easy. Just give it a title and a name.

NOTE Well-kept records can be a tax savings since they serve as a reminder of deductible expenses (consider organizing your expense accounts alphabetically). For a more complete list of expense categories, see the list of expenses as tax deductions in Guidebook #86. Unless otherwise noted, all expenses are entered as debits.

510 Salaries Expense – Also called a

Wages or *Payroll Expense* account. *Debit Entry*

512 Factory Labor Expense – *Debit Entry*

520 Rent Expense – Also called *Rent* account. *Debit Entry*

522 Mortgage Expense – Set-up to keep track of interest paid on mortgage. *Debit Entry*

525 Bad Debts Expense – Balances with *Allowance for Bad Debts*. *Debit Entry*

530 Income Tax Expense – Balances with *Income Tax Accrued Payable*. *Debit Entry*

532 Property Tax Expense – *Debit Entry*

535 Office Supplies Expense – *Debit Entry*

540 Supplies Expense – *Debit Entry*

550 Telephone – *Debit Entry*

560 Utilities – *Debit Entry*

565 Advertising – *Debit Entry*

570 Insurance – *Debit Entry*

575 Interest Expense – Balances with *Interest Accrued Payable*. *Debit Entry*

580 Depreciation Expense – A charge to expenses should be made to cover depreciation of fixed assets (decrease in the value of an asset through age and deterioration), other than land. The corresponding credits are to *Accumulated Depreciation*. Fixed Assets may be defined as items normally in use for one year or longer, such as buildings, automotive equipment, tools, equipment, furniture and fixtures.

Smaller businesses will usually charge depreciation at the end of their fiscal year, but a business with very substantial fixed assets, such as a motel, will probably calculate depreciation monthly.

No movement of cash or writing of a check is required for a depreciation expense entry. A journal entry for depreciation expenses is thus a debit (IN) an *Depreciation Expense* a credit (OUT) to *Accumulated Depreciation*. The amounts must be transferred from depreciation schedules on which the calculations are made.

There are many different formulas and categories for calculating depreciation for different items. Contact your local tax bureau for specifics.

NOTE See Guidebook #86 for keeping depreciation records. *Debit Entry*

Cost of Goods Sold – *The actual cost of the items sold in the normal course of business during a specific period.*

585 Cost of Goods Sold – The actual cost of the items sold in the normal course of business during a specific period. *Debit Entry*

586 Factory Overhead – *Debit Entry*

587 Selling Expenses – The *Selling Expenses* account and the *Administrative Expenses* account are set up primarily to summarize expenses and simplify income statements. At the end of the period expenses can be closed or rather totaled in either the *Selling* or *Administrative Expenses* account. *Debit Entry*

588 Administrative Expenses – *Debit Entry*

590 Miscellaneous Expenses – Also called, *Miscellaneous Operating Expenses*, this account is set up to include all other expenses which do not have their own account. *Debit Entry*

The Traditional Ledger

A traditional accounting form has two columns – the left column is called the debit side and the right column is called the credit side (the classic T-account form). In recording transactions, increases in assets and decreases in equities are entered on the left (debit) side. Increases in equities and decreases in assets are entered on the right (credit) side.

A traditional accounting form has two columns – the left column is called the debit side and the right column is called the credit side (the classic T-account form).

The difference between the total debits and the total credits in an account is called the balance. If the debits are higher than the credits, the account has a debit balance. If the credits are higher than the debits, the account has a credit balance.

The normal balances for asset accounts are debit balances, and the normal balances for equity accounts are credit balances.

NOTE This account balance arrangement ties in with the customary form of Balance Sheet, in which assets are shown on the left side and equities are shown on the right.

Understanding How To Keep the Books Balanced – In order for the books to keep balanced all debit accounts must equal all the credit accounts, or rather the left hand side account totals must always equal the right hand side account totals. In other words, if you debit an ASSET account and thus increase it you must then credit another account, usually a corresponding EQUITY account (every transaction eventually involves both a credit and a debit).

NOTE The formulas on the right, although expressed in different ways, say essentially the same thing: that the books are kept balanced by balancing the asset and expense accounts **with** the liabilities, owner's equity and revenue accounts.

Making Ledger Entries

When making a ledger entry, you must:

"Balancing Your Books"

☜	=	☞
LEFT	=	**RIGHT**
IN	=	**OUT**
CHARGES	=	**CREDITS**
Asset Accounts	=	Equity Accounts
Debit Accounts	=	Credit Accounts
Debit Entered in Red		Credits Entered in Black
Asset Accounts Increase (with debits)		Equity Accounts Increase (with credits)
Asset Accounts Decrease (with credits)		Equity Accounts Decrease (with debits)
What goes IN to the Company	=	What goes OUT of the Company
Assets + Expenses	=	Creditor's Equity + Owner's Equity + Revenues
Assets + Expenses	=	Liabilities + Capital + Revenues
A + E	=	**L + C + R**

FIRST write down an explanation.

SECOND list a posting reference (P/R).

THIRD debit or credit the account in question (a posting reference refers you back to the original entry in your journal and is usually listed as a page number).

Remember though that posting a transaction to the ledger is never a one shot deal. Each transaction represents a debit and credit of at least *two accounts* (see **example below**).

After the transaction has been fully posted to all its appropriate accounts, a check mark should be made beside the column total in the Journal to show that it has been posted.

NOTE 1 All entries should be made in ink

General Ledger

	DATE		Account Name and No. Merchandise AC#130 DESCRIPTIONS	P/R	IN	OUT	BAL	
1	Jan	12	Purchase of Merch. on ac.	p. 1	12000 00		12000 00	1
2	Feb	12	Purchase of Merch. on ac.	p. 2	5000 00		5000 00	2
3	Feb	13	Return of Merch. on ac.	p. 2		1000 00	16000 00	3
4	Feb	26	Purchase of Merch. on ac.	p. 3	600 00		16600 00	4

except for the balance column or balance entry. The balance entry may be kept in pencil for ease of correction in case an error is made.

NOTE 2 In practice, each account would appear on a separate page in your Ledger. They are numbered in accordance with your *Chart of Accounts*.

NOTE 3 If you are using a computer program, most programs automatically post the Journal entry to the appropriate ledger account thus saving you time. As well, while it is possible to post individual Journal items to each of their respective Ledger accounts, many Journals are so designed that much of their data can be summed up before being posted in total to the ledger thereby saving a great deal of time and improving accuracy.

All entries should be made in ink except for the balance column or balance entry.

NOTE 4 The minimum you should post journal entries to your ledger is four times a year when you make your quarterly tax installments.

Ledger Entries

The examples below illustrate how Ledger accounts would be recorded based in information on Journal entries 1 to 15 from **page 33-37**.

Cash in Bank Account #110

Date	P/R	DB	CR	DB	CR
3/1	1	10,500		10,500	
1	1		1,500	9,000	
6	1	675		9,675	
7	1		80	9,595	
9	1		500	9,095	
15	1		300	8,795	

Date	P/R	DB	CR	DB	CR
18	1	2,100		10,895	
20	1		795	10,100	
21	1		8,000	2,100	
29	1		300	1,800	
29	1		154	1,646	
31	1	2,354		4,000	
31	1		1,900	2,100	

Accounts Receivable Account #120

Date	P/R	DB	CR	DB	CR
3/1	1	1,950		1,950	
5	1		675	1,275	
31	2	1,100		2,375	

Supplies Account #140

Date	P/R	DB	CR	DB	CR
3/1	1	700		700	
20	1	795		1,495	

Prepaid Rent Account #148

Date	P/R	DB	CR	DB	CR
3/1	1	1,500		1,500	

Computer Equipment Account #170

Date	P/R	DB	CR	DB	CR
3/1	1	8,500		8,500	
4	1	1,750		10,250	
21	1	8,000		18,250	

Accounts Payable Account #210

Date	P/R	DB	CR	DB	CR
3/1	1		1,000		1,000
4	1		1,750		2,750
10	1	500			2,250

Jim Smith, Capital Account #310

Date	P/R	DB	CR	DB	CR
3/1	1		18,950		18,950

Jim Smith Drawing Account #315

Date	P/R	DB	CR	DB	CR
3/31	2	1,900		1,900	

Sales Revenues Account #410

Date	P/R	DB	CR	DB	CR
3/16	1		2,100		2,100
31	2		2,354		4,454
31	2		1,100		5,554

Salaries Expense Account #510

Date	P/R	DB	CR	DB	CR
3/13	1	300		300	
27	2	300		600	

Miscellaneous Expense Account #590

Date	P/R	DB	CR	DB	CR
3/5	1	80		80	
3/29	1	42		122	
3/29	1	112		234	

The Synoptic Ledger

There is a way that bookkeeping records can be combined or condensed in order that some control is exercised and you don't have asset, expense, revenue, liability and owner's equity account Ledgers in every drawer of your office. In fact, most small business have but one Ledger, a Synoptic, which is derived from Greek meaning "see everything at once."

A **Synoptic Ledger**, sometimes called a Combined Journal or Combined Ledger, provides separate columns rather than pages for the various types of accounts. The most common of these accounts are *Accounts Receivable*, *Accounts Payable*, *Cash in Bank* and *Sales Revenues*. It will also typically provide columns for miscellaneous income and various expenses (such as rent, utilities, insurance and utilities), in addition to a few blank columns to be titled as needed.

The number of columns your ledger will have will depend upon the scope of the business and how often the various types of transactions, that you want to keep track of, occur.

Most stationary stores sell two page ledgers that contain 28 columns or more

(14 columns per page) that can then be set up however you want. Some synoptic ledger also allow you to easily add pages thus the Ledger will last for an indefinite period regardless of the number of entries made.

Most stationary stores sell two page ledgers that contain 28 columns or more (14 columns per page) that can then be set up however you want.

D) TRIAL BALANCE PREPARED

AFTER A CERTAIN period of time as decided upon by management, bookkeepers summarize and verify the accuracy of their work by performing what is called a trial balance.

A trial balance is a procedure where all General Ledger accounts are verified, totaled and then balanced.

A **trial balance** is a procedure where all General Ledger accounts are verified, totaled and then balanced. The resulting information is then used to check for bookkeeping accuracy and to provide a summary for all business transaction and help provide information to prepare financial statements. To prepare a trial balance:

FIRST, make sure that all Journal entries for the period in question have been posted to the appropriate *Ledger* accounts.

SECOND, find the account balance for all *Ledger* accounts. To do this, you sum the debit and credit columns, subtract the smaller sum from the larger, and then, if using a two column ledger, write the remainder on the larger side and underline it – if using a three column or four column Ledger, write the remainder in the appropriate debit, credit or balance column.

THIRD, after you have found the balance of all the Ledger accounts, list these balances along with their account titles and account numbers on an *Accountant's Worksheet* (see **page 151**) or a sheet of columnar paper – one with a wide column at the left for the listing of your account titles, followed by from a half-dozen to a dozen narrower money columns to the right – and then compare the debits and credits balances.

After completing the third step, you now have what is called an *unadjusted trial balance*. Up to this point, preparing a trial balance is relatively straightforward. However, if the total debits of all the asset accounts do not equal the total credits of all the equity accounts (as often is the case), you must then undertake a hunt for errors, and once the errors are found, make adjustments to bring the books back into balance.

Negative balances are placed in brackets in a three-column ledger.

NOTE Negative balances are placed in brackets in a three-column ledger.

E) TRIAL BALANCE ADJUSTMENTS MADE

TRIAL BALANCE adjustments are made to update accounts that have been allowed to lag as a practical necessity and to compensate for any errors found in the original trial balance. These adjustments are necessary to keep the books up to date and bring them back into balance so that formal financial statements can be prepared properly and accurately. All adjustments to a worksheet in order to rebalance the accounts are then entered into the Journal and then posted to the Ledger just like any other Journal entry.

TRIAL BALANCE adjustments are made to update accounts that have been allowed to lag as a practical necessity and to compensate for any errors found in the original trial balance.

NOTE A worksheet is not a formal statement. It is usually prepared in pencil.

Types of Adjusting Entries

To update the books and bring them back into balance, adjusting entries are made for flow-type transactions and repetitive spot transactions.

Flow-type transactions are transactions such as *depreciation*, *interest expenses* and *interest revenue*, that flow continuously and are tedious and difficult to keep up to date.

Repetitive spot transactions are transactions such as *daily merchandise* and *sup-*

ply inventory changes which are repetitive and individually insignificant and thus more efficiently recorded in periodic batches after data has been allowed to accumulated. In effect, they too are treated as if they constituted a continuous flow.

Adjusting entries can be made for expenses accrued payable such as salaries, income taxes and interest charges that have accumulated but not yet been paid.

Examples for specific adjusting entries are as follows (see **page 151** for a sample "Trial Balance Worksheet):

- *allowance for bad debts* (see page 151 b)
- *allowance for depreciation* (see page 151 e)
- *bank charges* (see page 150 a)
- *end of period inventory counts for merchandise* undertaken to determine the value and quantity of what you actually have on hand, the cost of goods sold, and losses due to damage or theft
  - *end of period inventory counts for office supplies used up* – it would be impractical to make a ledger entry each time a paper clip or some other office supply is used (see page 151 c)
  - *expenses accrued payable* – such as salaries, income taxes and interest charges that have accumulated but not yet been paid (see page 151 g)
  - *interest accrued on accounts receivable* (see page 151 f)
- *interest expenses and revenues*
- *investment income*

- *prepaid expenses* (see page 151 d)

Completing a Trial Balance Worksheet

In the first pair of money columns, list the amounts, which make up your unadjusted trial balance as of any given date. In the next pair of columns, make left and right hand adjusting entries to adjust the raw trial balance figures. Next, copy the trial balance figures, as modified by the adjusting entries, into the third pair of columns (which are headed Income Statement) and into the final pair (which are headed Balance Sheet).

In the first pair of money columns, list the amounts, which make up your unadjusted trial balance as of any given date.

Whether a given item is copied in the Income Statement column or the Balance Sheet column depends simply on whether the item is to appear in the Income statement or in the Balance Sheet. For example, the adjusted amount for *Cash in Bank* should be carried to the left-hand (asset) column under the heading Balance Sheet, and the amount for *Sales* and for each class of expenses should be entered in the Income Statement columns.

Four of the adjusting entries (on page 151) are explained in more detail below:

a) The *Cash in Bank* account had a balance of $2100 but due to bank service charges had to be adjusted by $65.

c) After taking an inventory of supplies, it was found that $950 of supplies was used. This $950 is thus charged to the *Supplies Expense* account.

e) According to the depreciation schedules for the computer equipment purchased, it was calculated that the month's depreciation was $359.

g) Jim Smith's part-time assistant normally receives $300 every two weeks (ten days) or $30 a day. Since the assistant's last paycheck covered only up to Mar. 27, four additional days are owed but not yet paid to cover up to Mar. 31.

Since the assistant's last paycheck covered only up to Mar. 27, four additional days are owed but not yet paid to cover up to Mar. 31.

F) FINANCIAL STATEMENTS PREPARED

AFTER ALL accounts are updated according to the trial balance adjustments, and the books are once again completely ship shape, financial statements are drafted. Fundamentally, this operation involves no more than copying the amounts accumulated in the respective ledger accounts, into whatever forms the management elects to use, most likely in the form of a **Balance Sheet** and an **Income Statement**.

> *Figures used to compile the balance sheet are taken from the previous and current balance sheet as well as the current income statement.*

However, in the **Income Statement** you might decide to group your *Selling Expenses* and *Administrative Expenses* under a single heading, simply called *Operating Expenses*.

Whether you split your expenses or combine them depends upon how you plan to analyze the information. Splitting them gives you the information you need to prepare a break-even analysis. On the other hand, grouping them under one heading is simpler and more straightforward. You don't have to puzzle over what exactly is a selling or variable expense and what exactly is an administrative of fixed expense.

NOTE Your **Balance Sheet** and **Income Statement** should use the accepted formats as outlined on the next two pages so that anyone reading either one can readily interpret its information.

Preparing a Balance Sheet

The **Balance Sheet** summarizes the financial position of the business at the time of the report: its assets, liabilities, and net worth. The **Balance Sheet** is also useful for purposes of control, management direction and decision making (see **page 153** for filled-in sample).

Below are 8 steps for filling out a balance sheet:

NOTE Figures used to compile the balance sheet are taken from the previous and current balance sheet as well as the current income statement.

1. **Title the balance sheet.** At the top of the page fill in the legal name of your company and the day the balance sheet was prepared.

Basic Balance Sheet Format

BALANCE SHEET

ASSETS

a. *Current Assets*
b. *Long-term Investments*
c. *Fixed Assets*

LIABILITIES

a. *Current Liabilities*
b. *Long-term Liabilities*

NET WORTH (Assets - Liabilities)

In the case of a *Proprietorship or Partnership*, net worth is equal to the owner's original investment plus earnings after withdrawals. In the case of a *Corporation*, net worth is equal to the sum of contributions by owners or stockholders plus earnings retained after paying dividends.

2. **List all current assets.** List anything of value that is owned or legally due your business and can be converted into cash within 12 months of the date of the balance sheet (or during one established cycle of operations).

- *Inventory* – When listing your inventory, include raw materials on hand, work in progress and all finished goods either manufactured or purchased for resale.

- *Short-term Investments* – When listing your short-term investments, list them at either cost or market value, whichever is less.

3. **List all long-term investments.** These include all long-term assets such as stocks and bonds that the business intends to keep for longer

Basic Income Statement Format

INCOME STATEMENT

INCOME

a. *Net Sales* (gross sales - returns & allowances)

b. *Cost of Goods Sold*

c. *Gross Profit* [a - b]

EXPENSES

a. *Selling Expenses* (direct, controllable, variable)

b. *Administrative Expenses* (indirect, fixed, office overhead)

INCOME from OPERATIONS (gross profit - total expenses)

a. *Other Income* (interest income)

b. *Other Expenses* (interest expense)

NET PROFIT (loss) Before Income Taxes

a. *Taxes* (federal & state)

NET PROFIT (loss) After Income Taxes

than a year.

4. **List all fixed assets.** Fixed assets are listed at cost less depreciation. This is called their net value. However, land is listed at its original purchase price irrespective of its market value.

- *Accumulated Depreciation –* Instead of listing their fixed assets at their "net value," some balance sheets list them at their "original value." However, an additional *Accumulated Depreciation* account must be added to this kind of balance sheet. The total here is then subtracted from the total of the fixed assets.

- *Leased Fixed Assets –* If any of your fixed assets are leased, depending on the leasing arrangement, both the value and the liability of the leased property may need to be listed on your balance sheet.

It sounds extraordinary but it's a fact that balance sheets can make fascinating reading.
MARY ARCHER

5. **List all current liabilities.** This includes all debts, monetary obligations and claims payable within 12 months or one cycle of operations.

- *Short-term Loans Payables –* When listing your *Short-term Loans Payables*, list the balance of principal due on all short-term debt and the current amount due of total balance on notes or loans whose terms exceed 12 months.

- *Taxes Payable –* These amounts are estimated by your accountant to have been incurred during the accounting period. This account is often split up into federal income tax, state income tax, self-employment tax, sales tax and property tax.

6. **List all long-term liabilities.** All long term liabilities such as loans payable, contracts payable and mortgages are listed at their outstanding balance less the current portion due (which is listed in *Short Term Loans Payable*).

7. **List your net worth.** In a proprietorship or partnership, net worth is each owner's original investment plus any earnings after withdrawals. In a corporation, networth is reflected in a *Capital Stock* account, *Surplus Paid In* (retained earnings as of) and *Retained Earnings*.

8. **Compare your total liabilities and net worth.** The sum of these two amounts must always match that of total assets.

The Income Statement – also referred to as a Profit and Loss Statement, an Income and Expense Statement, or an Operating Statement – summarizes the results of all your business activity for a given period of time.

Preparing an Income Statement

The **Income Statement** – also referred to as a Profit and Loss Statement, an Income and Expense Statement, or an Operating Statement – summarizes the results of all your business activity for a given period. It is the most important financial statement you will prepare each year, as its totals are used to determine your tax liability. It shows the income sources for your business, your expenses incurred in obtaining the income, and the profit or loss resulting (see **page 152** for a filled-in sample).

More specifically, an **Income Statement** can help reveal things like whether:

- mail should be used instead of telephones
- you are paying too much rent for your type of business
- you need to reduce you inventory supplies
- you need to schedule work so that your truck or trucks can be used more efficiently

One difficulty in developing an income statement is in properly allocating costs such as depreciation to the period of time covering the statement.

NOTE A document which is rapidly gaining in importance is the *Statement of Change in Financial Position*. Accountants, bankers and management are placing increasing emphasis on this statement, which shows how changes in working capital occurr over a specific time period. It is not a requirement of the Tax Act but management is increasingly using it as a tool to better profits and cash flow.

Allocating Depreciation Costs to the Period of Time Covering the Statement – One difficulty in developing an **Income Statement** is in properly allocating costs such as depreciation to the period covering the statement. Since fixed assets, such as equipment and building costs, cannot be included under expenses, to allocate these costs properly, their purchase price must be divided by the expected life in years or months, whichever corresponds to the period covered by the income statement. Using the straight-line method of calculating depreciation, their purchase price is charged uniformly over the life of the asset.

NOTE Depreciation rates are often accelerated for income tax benefits.

Balance Sheets and Income Statements should be limited to one page each.

How Detailed Should Financial Statements Be?

Balance Sheets and **Income Statements** should be limited to one page each. To accomplish this, especially for large companies with many accounts, summary titles are used to represent groups of accounts. If additional information is required to clarify key areas of the statement *Financial Schedules* are then added.

Financial Schedules breakdown in detail *Selling Expenses*, *General and Administrative Expenses*, and *Cost of Goods Sold* for Income Statements. For Balance Sheets, Financial Schedules can be used to breakdown asset and liabilities accounts such as *Property Owned* & *Loans Payable*.

How Often Should Statements Be Prepared?

Financial statements must be prepared once each business year, or as often as management feels they are required – e.g., semi-annually, quarterly or even monthly (it is recommended that you prepare financial statements **at least** twice a year, keeping in mind that the benefits obtained from the information contained in the statements, must be balanced against the cost of having them prepared).

NOTE Financial statements have a limited time value. In today's business world, financial situations can be greatly altered in a few week or even days. For this reason, lending institutions only consider statements they feel are current and correctly reflect the businesses' financial state of affairs.

When preparing statements in your Ledger, put dollar signs at the top of each column representing money.

Rules Regarding Statements in Ledgers

When preparing statements in your Ledger, keep in mind the following accepted conventions:

- Put dollar signs at the top of each column representing money.
- Use dollar signs after every addition or subtraction (that is, next to every total or result representing money).
- Draw a line underneath any columns that are to be subtracted or added.
- Underline every final total twice.
    - Put negative sums in brackets.

G) FINANCIAL STATEMENTS POSTED TO LEDGER

AFTER YOUR financial statements have been prepared, they must be entered into your **Journal** and posted to the **Ledger** just like any other business transaction.

After your financial statements have been prepared, they must be entered into your Journal and posted to the Ledger just like any other business transaction.

Post your *Net Income* shown on your **Income Statement** to the *Income Summary* account.

✷

H) BOOKS CLOSED & PREPARED FOR NEXT CYCLE

THERE'S NOT much to be said about closing entries except that their purpose, at the end of an accounting period, is to sweep clean the **Income Statement** accounts (all revenue and expense accounts) to make them ready for the accumulation of similar information in the next period.

If you don't already have one, create an account called the Income Summary to summarize the information from all revenue and expense accounts.

In other words, you must reduce the balance of each expense account and each revenue account to zero by making offsetting (closing) entries on the reducing side of each account sufficient to reduce the balance to zero. The net result of the sweeping operation is entered in the *Income Summary* account which in than transferred to the *Retained Earnings* account (*Proprietor's Capital* account) as the **Net Income** for the year.

Year End Book Closing Procedures

1. **Create an Income Summary account.** If you don't already have one, create an account called the *Income Summary* to summarize the information from all revenue and expense accounts (see example year end closing entries on the following page).

NOTE It is not necessary to create an *Income Summary* account. You can instead post all revenues and expenses directly to the *Retained Earnings* or *Proprietor's Capital* account.

2. **Bring all revenue accounts to zero.** Debit each revenue account in the Ledger in the amount of its balance, bringing the accounts to zero and readying them to receive the revenue of the next bookkeeping period. Credit the *Income Summary* (or *Retained Earnings*) with the total of all revenues.

3. **Bring all expense accounts to zero.** Credit each expense account in the amount of its balance, bringing it to zero and readying it for the next bookkeeping period. Debit the *Income Summary* by the total of all expenses.

4. **Balance the Income Summary and adjust the Proprietor's Capital account.** Find the balance in the *Income Summary* account by adding the debits and the credits (if you've made a profit, you will have a credit balance). Next, debit the *Income Summary* by this amount (bringing total to zero) and then credit the *Proprietor's Capital* account.

Year End Journal Closing Entries

Date	DESCRIPTIONS	AC.	DB	CR
12/31	Sales Revenue	410	98,000	
	Net Income	350		98,000
12/31	Income Summary	350	88,000	
	Rent Expense	520		28,000
	Salaries Expense	510		30,000
	Utilities	560		4,000
	Deprec. Exp.	580		6,000
	Misc. Exp.	590		10,000
12/31	Income Summary	350	10,000	
	John Doe, Capital	310		10,000
12/31	John Doe, Capital	310	2,100	
	John Doe, Drawing	315		2,100

count (*John Smith, Capital* account).

NOTE A debit (minus) balance shows that the business has incurred a loss. Credit the *Income Summary* for that amount and debit the *Proprietor's Capital* account.

5. **Adjust for the owner's draw –** Credit the *Drawing* account in the amount of its balance (total). Then debit the *Capital* account in the same amount.

A debit (minus) balance shows that the business has incurred a loss.

NOTE In a corporation you would have a *Dividends* account (showing dividends paid to stockholders) in addition to the *Income Summary* account. Both these accounts would be closed to the *Retained Earnings* account.

6. **Take a post closing trial balance –** It is customary to take a post-closing trail balance to verify the accuracy of the closing process. After completing all the steps of closing, list the balances in each Ledger account (before they were brought to zero), in two columns, debits and credits. The sum of the debits should equal the sum of the credits. At this point the accounting cycle is completed.

NOTE After all the above steps have been taken, it may be necessary to engage a firm of CPAs to perform an *independent audit* – mandatory if you are a large corporation. Essentially, this means that outside professional auditors examine your financial statements, and to the extent they deem necessary, your accounting records, supporting documents, and whatever else is needed, to confirm that your statements were prepared in accordance with generally accepted accounting principles.

After all the above steps have been taken, it may be necessary to engage a firm of CPAs to perform an independent audit – mandatory if you are a large corporation.

SETTING-UP AN ACCOUNTING SYSTEM

ACCOUNTING systems for small businesses range from simple single-entry journal systems all the way up to more sophisticated computerized systems supplemented with monthly consulting services by top-notch financial accountants.

No single accounting method is required of all taxpayers. You must use a system that clearly shows your income and expenses and you must maintain records tat will enable you to file a correct return. In addition to your permanent books of account, you must keep and other records necessary to support the entries on your books and tax returns. Furthermore, you must use the same method from year to year. ***POWERPOINT***

The classified section of your telephone directory can lead you to a number of accounting services which can help you choose and set-up an accounting system for your business.

This section will show you samples of various forms used to set up basic accounting systems as well as provide explanations as to how these forms are used. It will also summarize a number of other options available to you to set up an accounting system.

Single-Entry Cash Based Systems

For a small home, service or contracting business, the cash method of accounting is the simplest form of accounting. This system of record keeping consists of little more than a carefully annotated checkbook in which all receipts and expenditures are recorded, supported by a few forms of original entry (invoices, receipts, cash tickets, etc.). Sales are recorded when cash is received and expenses are recorded when they are paid.

Sample "Single-Entry" Record Keeping System

In Publication 583 "Starting a Business and Keeping Records" the IRS illustrates the following record keeping system for a small business owner who, uses part-time help, has no inventory of items held for sale, and uses the cash method of accounting. Although figures have been changed and forms modified slightly, the thrust of the system is the same (see **pages 155 to 158**).

A daily summary of cash receipts can be used as a record of cash sales for a particular day.

- Daily Summary of Cash Receipts
- Monthly Summary of Cash Receipts
- Check Disbursement Journal
- Employee Compensation Record
- Annual Summary
- Depreciation Worksheet
- Bank Reconciliation

1. **Daily Summary of Cash Receipts –** A daily summary of cash receipts can be used as a record of cash sales for a particular day (this record should also record sales tax collected). Retailers and service providers who cash-out at the end of the day should incorporate one into their accounting system, especially if employees do the cash-out. Any dis-

crepancies, major overages, or shortages, can thus be quickly brought to your attention.

HOT SPOT In the example on **page 155**, Janet Smith, owner of *Hot Spot Food Bonanza* totals her daily cash sales ($450.55) and sales tax collected ($36.05) for Monday, May 1, 1995. Her total receipts for the day is $486.60. She posts these totals to her *Monthly Summary of Cash Receipts*.

2. **Check Disbursements Journal –** Checks drawn on your business checking account should be entered at the end of each day. All checks are prenumbered and each check number is listed and accounted for in the column provided in the journal. Frequent expenses have their own headings across the top of the sheet. Other General Account expenses (which have only one or two monthly entries) can be listed in the second last column. A *Check Disbursements Journal* can be purchased at most stationary stores.

Click HERE to see a sample single-entry accounting system.

HOT SPOT At the end of each month, Janet adds her monthly expense totals to her *Annual Summary* as shown on **page 158**.

3. **Monthly Summary of Cash Receipts –** A *Monthly Summary of Cash Receipts* shows your total net sales for one month. To figure your monthly net sales, you must reduce your total monthly receipts by the sales tax you collected on behalf of your federal, state and/or municipal

governments (Canadian business owners must reduce their daily receipts by the amount of G.S.T. and provincial sales tax collected). Remember, sales tax should not be included in your income (you cannot take a deduction for sales tax turned over to your government because you only collected the tax).

You must take depreciation in the year it is allowable. You cannot deduct in the current year the allowable depreciation you did not take in a prior year. You must amend the prior year's tax return to take the depreciation deduction.
SUPERTIP

HOT SPOT At the end of the month, Janet totals each column. She then adds her "Net Sales" total for the month of May to her *Annual Summary*.

4. **Employee Compensation Record –** An Employee Compensation Record shows the number of hours your employee(s) worked during a pay period and the employee's total pay for the period. It also shows the deductions withheld in figuring the employee's net pay. The employee compensation record also shows the monthly gross payroll.

HOT SPOT Janet has five part-time employees. At the end of each month, she carries her monthly payroll totals to her *Annual Summary*.

5. **Bank Reconciliation –** Every month, you will need to reconcile your checkbook with your bank statement. The form shown on page 157 can help you do this.

6. **Bank Reconciliation –** The running balance in your check register or Ledger *Cash in Bank* account will often not agree with the final balance shown on your monthly bank statement. This happens because bank charges have not yet been recorded since they cannot be known until they appear on the statement; checks may not have cleared because of delays in the reaching the bank; and deposits or transfers may not yet have been credited. Lack of agreement could also be due to errors on your part or the banks. Thus, a bank reconciliation must be prepared to update and verify the accuracy of the bank's records and your own checking account records.

   To do this, gather your bank statement, canceled checks, and deposit slips. Then follow the instructions listed below:

*Click **HERE** to see a sample single-entry accounting system.*

A. Closing Balance Shown on Bank Statement:

i. Once a month, your bank will send you a bank statement for your checking account. This statement will include: your beginning balance, deposits made, interest credited, bank service charges, withdrawals from checks that have cleared, and the resulting period ending balance. To reconcile your bank statement:

ADD deposits not credited on bank statement:

ii. Add up deposit slips and compare the total with the total in your Income Journal; and the total shown on the bank statement. Note and add-up any deposit slips not listed on the bank statement and label them as "deposits in transit." Deposits made during the period after your statement has been prepared by the bank and while it is "in the mail" should be accounted for here.

*Click **HERE** to see a sample single-entry accounting system.*

SUBTRACT checks issued but not yet cleared by the bank:

iii. Add up all the check stubs for the period in question. Sort them into numerical order and compare them with your bank statement and your Expense Journal. Check off returned checks and mark the ones not on the bank statement as "checks not cleared" or "outstanding checks." Note that quite often checks will take weeks or even months to clear depending on when they are actually deposited.

ADD or **SUBTRACT** bank errors:

iv. When comparing your check stubs and deposit slips with the bank statement, you may come across indiscrepencies. Note bank errors here.

B. Adjusted Bank Balance

v. The following total is what your bank balance would read if it was completely up to date.

C. Balance According To Your Records:

vi. Total your Income and Expense Journals, then balance your *Cash in Bank* account and place total in box.

ADD bank interest or additions not yet recorded:

vii. From your bank statement, enter interest and other credits. This information is taken from your bank statement. List entries in your Journal and update the appropriate Ledger account(s).

SUBTRACT bank service charges not yet recorded:

viii. The amounts for bank service charges and monthly fees will be written on your bank statement. List these entries in your Journal and update the appropriate Ledger account(s).

ADD or **SUBTRACT** other errors:

ix. Make sure the balance in your checking register is the same as the total check stubs. Otherwise, note your errors here.

One of the purposes of the bank reconciliation is the prevention or discovery of embezzlement. ***POWERPOINT***

D. Adjusted Balance:

x. Your adjusted balance and the adjusted bank balance should be the same. If they aren't you will have to examine your records more closely.

HOT SPOT In the example shown on **page 157**, Janet received a bank statement total of $4,235.65. After entering all deposits not credited and check stubs not cleared, her adjusted bank balance total of $4,176.77 did not match with the total in her check register. Synoptic Ledger of $4,266.07. Even after she factored in the interest she had received and bank service charges paid the amounts still did not balance. Searching through her records, she found that she had forgot to post a check for $120.95 for food supplies purchased to her check disbursement journal and check register. When this disbursement was posted, she found her records now agreed with her reconciled bank statement.

7. **Depreciation Worksheet –** Keeping track of your assets and depreciation expenses is a necessary part of every business. The *Depreciation Worksheet* shown on **page 157** is an example of a record you can use to keep track of such things as costs of assets, dates of purchase, amounts depreciated and methods of depreciation used. This form is geared towards depreciating items using the modified accelerated cost recover system (MACRS) used in the U.S. Canadian business owners will have to modify this form somewhat to better meet their tax reporting needs.

*Click **HERE** to see a sample single-entry accounting system.*

HOT SPOT In the example shown on **page 157**, Janet has elected to deduct $17,500 of the cost of certain depreciable property (a delivery car and catering van) purchased and placed in service in his trade or business during the year. This is the “section 179 deduction.”

8. **Annual Summary Record –** The *Annual Summary Record* of monthly cash receipts and expenses totals provides the final amounts to enter on your tax return. You figure the annual summary from the total of monthly

cash receipts items, as shown on the *Monthly Summary of Cash Receipts*. You figure the monthly expenses from the *Check Disbursements Journal*.

HOT SPOT At the end of the year, Janet will total her monthly expenses and cash receipts (see **page 158**). These figures will give her the information she needs to fill and complete her tax return.

*Click **HERE** to see a sample double-entry accounting system.*

Double-Entry Accrual Based Systems

AS YOUR business grows, you may want to switch to the accrual method, a system that allows you to record sales and expenses when they are incurred rather than when they are collected or paid. If you have a small contracting, consulting or retail business, using Accounts Receivable and Payable records (if required), along with an Income and Expense Journal or a Daily Cash Sheet combined with a Synoptic Ledger, will likely be sufficient to meet government requirements.

NOTE The more daily transactions your business has, the more you need a computerized accounting system, or a specialized system set-up or designed specifically for your business by a professional.

Sample "Double-Entry" Record Keeping System

In the Publication "Bookkeeping for a Small Business," the Alberta department of Economic Development and Trade illustrates a record keeping system very similar to the one outlined below. This system can be used for any small business that makes cash sales each day, has credit customers and hires employees. It can also be used by anyone who buys and sells inventory items (see **page 158 to 161**).

- The Daily Cash Sheet
- The Synoptic Ledger
- Accounts Receivable Ledger
- Accounts Payable Ledger
- Weekly Summary Payroll
- The Bank Reconciliation
- Asset Depreciation Records
- GST Records

1. **Daily Cash Sheet –** A daily cash sheet helps account for all the cash that flows in and out of a business each day. Retailers should incorporate one into their accounting system, especially if employees cash-out at the end of the day. Any discrepancies, major overages, or shortages are thus quickly brought to your attention. It is important to note that using this cash sheet, unlike the first cash-based system shown, all sales totals whether paid for in cash or on account include sales tax collected or collectible.

*Click **HERE** to see a sample double-entry accounting system.*

HPS The example on **page 158** shows how Harry Griswald, owner of Harry's Pet Supplies figured out his daily cash flow for Monday, March 4, 1996. Cash sales totals were calculated by adding up all cash register tapes (from till) and sales on account totals from invoices.

Sales tax collected and collectible totals were also added up from all cash register tapes and invoices (in this case a 7% G.S.T. tax). After completing his daily cash sheet, Harry then posted his totals to his *Synoptic Ledger*. He also posts his totals for G.S.T. collected & collectible and G.S.T paid to his *G.S.T. Record*.

2. **Synoptic Ledger –** As already stated earlier in this Guidebook, synoptic ledgers are a great way to simplify keeping track to your Ledger accounts. Synoptic ledgers can be purchased from most stationary stores. However, most synoptic ledgers look rather complicated (it's hard to believe they simplify anything). One reason for this, is their design does not help you easily recognize which accounts are basically credit accounts and which accounts

Formulas for Calculating G.S.T.

Tax Owed $= \text{Retail Price} \times (\text{GST}/100)$

Gross Price $= \text{Retail Price} \times (1 + \text{GST}/100)$

Net Sales $= \dfrac{\text{Gross Sales}}{(1 + \text{GST}/100)}$

Tax Collected $= \text{Gross Sales} - \dfrac{\text{Gross Sales}}{(1 + \text{GST}/100)}$

EX. Harry had cash sales of $430.00 and A/Rs of $120.00 for Gross Sales of $550.00.

Tax Collected $= \$550 - \dfrac{\$550}{(1 + 7/100)}$

$= \$550 - \dfrac{\$550}{1.07}$

$= \$550 - \$514.02$

$= \$36.98$

are debit accounts – balancing your books, using the double-entry system of accounting, becomes tedious and unintuitive.

In an attempt to solve this problem, *our* synoptic ledger is specifically designed to reflect the double-entry system of accounting, with debit accounts – asset and expense accounts – clearly marked on the left and credit accounts – revenue, liability and owners' equity accounts – clearly marked on the right (see **page 160 & 161**).

HPS At the end of each day, Harry posts figures from his *Daily Cash Sheet*, to his synoptic ledger. He also posts any check disbursements, bank deposits, payroll paid or owner withdrawals as they occur. At the end of each month, he totals the figures by running a double line under the last figure of the column being totaled, and entering this total underneath. These monthly totals are then entered on a separate single synoptic ledger page to be totaled at the end of the year when his tax return is due.

In this example, two entries for NSF checks are also shown. The first one is from a credit customer ($26.25) while the second is from a cash customer ($35.00). On March 4, Harry also wrote a check to one of his suppliers, Jones & Company ($823); paid his rent for March ($650); wrote a check to the Receiver General for Payroll Remittance for February ($318); and wrote a check for some equipment from Tupper Inc. ($150.00).

3. **Accounts Receivable Ledger –** If your business gives credit to custom-

ers, then you should set up an accounts receivable ledger. Usually, each credit customer is assigned a page in a ledger and these are kept alphabetically in a separate binder or tray. By merely adding up the balance on each card, you will then be able to quickly determine how much is owed by those to whom you have given credit privileges.

To help keep your Accounts Receivable current: be sure bills are prepared (when goods are shipped or service is rendered) and mailed to correct addresses; also, keep a close watch on larger accounts. ***SUPERTIP***

An accounts receivable ledger (as well as an accounts payable ledger discussed later on) ledger should have three columns on each page – a charges, payments and balance column (or a debit, credit and balance column). The pages can be loose-leaf pages, cards or anything else. The only thing that is important is that it be orderly and contain sufficient information. This type of ledger is available at most stationary stores. *Our* Form #13 (see Guidebook #8) can also be used to set up such a ledger.

HPS In the example shown on **page 159**, Harry records $120.00 credit given to veterinarian clinic owner John Shackman. Since John Shackman paid his invoice within ten days of receiving it, according to the terms of the sale (2/10n), he was entitled to a 2% discount.

Aging Accounts Receivable – As a business owner, you need to monitor your accounts receivable to keep track of which accounts are delinquent and what percentage of the total receivables they represent. To do this, each month you should "age" your accounts receivable.

To "age" your accounts receivable, list all unpaid accounts and their balances as being either current, over 30 days, over 60 days, or over 90 days (see chart on right). This tells you which of your accounts receivable are overdue and will require extra collection efforts. All accounts 60 days and over should be contacted and the reason for lack of payment noted.

This analysis of the accounts receivable, total value $4515.36 (sum of all total columns), shows two accounts in the over 90 day column ($424.00 and $51.10). These accounts should be written off to *Allowance for Bad Debts*, and additional credit not granted unless there are very extenuating circumstances.

NOTE If you are using your accounts receivable as security for a line of credit from a bank, it is almost a certainty that each month they will request an aged list of your accounts receivable. All overdue

Customers	Current	Over 30	Over 60	Over 90
Abigail Apricot	15.39	74.20		
Bruce Buns		3,500.82		
John Wayne	260.00			
Fly by Night Co.				424.00
Slow Payers R'Us		44.50	82.95	
Rubber Check Co.	10.40			51.10
Total	**285.79**	**3,669.52**	**82.95**	**475.10**
Percentage	**7%**	**81%**	**2%**	**10%**

accounts receivable. All overdue accounts (usually 90 days and over) are considered quite difficult to collect and lose their value.

4. **Accounts Payable Ledger –** Each supplier of any goods or service that your business makes purchases from and agrees to pay at a later date, should be given a page in an Accounts Payable Ledger and filed alphabetically. An Accounts Payable Ledger tells you at a glance how much you owe to each individual company you receive credit from, as well as list when the last check was sent to a particular supplier. This helps resolve any disputes regarding the payment of invoices.

Using an accounts payable ledger tells you at a glance how much you owe to each individual company you receive credit from, as well as list when the last check was sent to a particular supplier.

HPS In the example shown on **page 162**, Harry post a credit purchase of $890 from one of his wholesale suppliers, Universal Pet Supplies.

5. **Weekly Summary Payroll –** A *Weekly Summary Payroll* book like the one shown on **page 162** can be purchased from most stationary stores. An *Employee Compensation Record* similar to the one shown on **page 156** could also be used in this double-entry system.

NOTE Details of Canadian and American Payroll record keeping requirements are dealt with in more detail, starting on **page 129**.

6. **Bank Reconciliation –** The running

balance in your check register or Ledger *Cash in Bank* account will often not agree with the final balance shown on your monthly bank statement. This happens because bank charges have not yet been recorded since they cannot be known until they appear on the statement; checks may not have cleared because of delays in the reaching the bank; and deposits or transfers may not yet have been credited. Lack of agreement could also be due to errors on your part or the banks. Thus, a bank reconciliation must be prepared to update and verify the accuracy of the bank's records and your own checking account records.

Click ***HERE*** *to see a sample double-entry accounting system.*

To do this, gather your bank statement, canceled checks, and deposit slips. Then follow the instructions listed below.

HPS Using the Bank Reconciliation on **page 157** as a guide, Harry received a bank statement total of $4,235.65. After entering all deposits not credited and check stubs not cleared his adjusted bank balance total of $4,176.77 did not match with the total in his Synoptic Ledger of $4,266.07. Even after he factored in the interest he had received and bank service charges the amounts still did not balance. Searching through his records, he found that he had forgot to post a check for $120.95. When this amount was added to his Ledger balance, he found the books agreed with his reconciled bank statement.

7. **Asset Depreciation Records –** To

figure the annual depreciation and the gain or loss when you sell an asset, you must keep records of all your business assets. Your records should show:

- When and how you acquired the asset
- Purchase price
- Cost of any improvements
- Section 179 deduction taken (for the U.S.)
- Deductions taken for depreciation
- Deductions taken for casualty losses, such as fires or storms
- How you used the asset
- When and how you disposed of the asset

*Click **HERE** to see a sample double-entry accounting system.*

- Selling price
- Expenses of sale

Examples of records that may show this information include:

- Purchase and sales invoices
  - Real estate closing statements
  - Canceled checks

HPS In the *Asset Depreciation Record* shown on **page 160**, Harry depreciates a computer and a motor scooter.

NOTE For a sole proprietorship, the very minimum of recorded information needed is that required to accurately complete the IRS Form 1040, Schedule C. Other business types (partnerships, joint ventures and corporations) have similar requirements but use different tax forms).

8. **G.S.T Record –** In Canada, Canadian business owners must collect for the government a Goods and Services Tax called the G.S.T.

HPS Harry enters G.S.T. collected and paid at the end of each day. Alternatively, he could decide to enter amounts based on monthly account totals.

Condensed Single-Entry Accounting Systems

Special condensed single-entry journals can be used to group common types of journal entries. These journals are single-purpose versions of the General Journal in which the explanation line is omitted and only one line is used to enter debit and credit accounts. The "Weekly Sales & Cash Report" (see **page 154**) is an example of such a Journal. Another example of a condensed single-entry journal is the "Envelop Journal."

With a single-entry bookkeeping system, doing a bank reconciliation once a month is the only way to maintain accuracy and keep your record books in tip top shape. If this is not regularly done, it will destroy the validity of your financial statements.

SUPERTIP

NOTE Although condensed single-entry journals can greatly reduce the chore of record keeping, they lack the space to record vital pieces of information particular to individual transactions. This can become a serious problem if you need to track down a receipt to verify or prove a record. To control this problem, it is important to file all cash register tapes, invoices, canceled checks, records of checks disbursed, receipts and other vouchers according to dates and if in large quantities, in groups or categories.

For example, if you need to verify advertising expenses of $37.50 paid on Monday April 12th, then all you should have to do is look in your file cabinet and pull out the file that contains all the vouchers and receipts for April 12th. Under this system, you would not file away invoices or checks according to their numbers, but according to their dates. Also, you would pay all expenses, unless otherwise noted, by check.

*Click **HERE** to see a sample "Weekly Sales & Cash Report."*

Using a "Weekly Sales & Cash Report"

The "Weekly Sales & Cash Report" on **page 154** combines a Daily Cash Sheet, Income Journal and an Expense Journal all into one. At the end of the week, its totals can be summed up and entered into a ledger.

Envelope Journal Systems

If you own a small or part-time business and have only a few transactions per day, week or month, consider using the following method of recording your transactions:

1. Photocopy or staple on to a full size (9 by 12 envelope) any journal entry page or single entry form such as the ones shown in Guidebook #8, Form #12 and Form #15 (Weekly Sales & Cash Report). Every time a transaction occurs put the receipt into the envelope, then make an entry onto the form photocopied or stapled to the envelope regarding the

transaction. When the form is full, or at the end of a specified period (usually a day, week or month), file the envelope and start a new one. At the end of the year, semi-annually or quarterly, total the envelope summaries and prepare financial summary statements.

NOTE Receipts from transactions can be stored in a safe place – like a cash box – and then when convenient recorded and put inside the envelope. All expenses unless otherwise noted are paid by check.

The Income Journal is used for recording all incoming revenue, whether cash or check.

Single-Entry Income & Expense Journal Systems

Instead of using a Daily Cash Sheet combined with a Synoptic Ledger, you can report your income and expenses using an Income Journal (also called a Sales or Cash Receipts Journal) and an Expense Journal (also called a Cash Payments or Disbursements Journal), similar to the ones shown on page 155 and page 156. In fact, it is quite common for small businesses to base their entire accounting system around these two journals. Both can be purchased at almost any stationary store.

Using an Income Journal

The Income Journal is used for recording all incoming revenue, whether cash or check. In the example below, the results for Harry's Pet Supplies are recorded May 1st, 2nd, and 3rd of 1995.

Column 1-4 – On May 1, by examining the sales invoices and cash register tapes, Harry found that he had cash sales of $430.00 and sales of $120.00 on account (these amount include any sales taxes collected). In his Income Journal, he recorded the cash sales in column 1 and the credit sales in column 2. In column 3, $30 worth of merchandise that was returned is shown. Column 4 then shows the total sales for the day, cash sales plus credit sales minus any merchandise returned.

Column 5 – In column 5, Harry recorded cash received on previous credit sales. He did not include this amount in his daily sales figures, as he would have included it in the sales figure on the day the goods were sold on account.

Column 6 – In column 6, Harry recorded any cash or other income he received during the day. On May 1st, he received $10 in interest from an overdue accounts receivable. On May 2nd, he received a deposit refund from a gas company that ear-

Income Journal

Date	Particular	Cash Sales	Credit Sales	Merch. Returned	Total Sales (1 +2-3)	Cash Rec. on Credit Sales	Other Cash Received	Total Cash Received (1+5+6)	Actual Cash Count	Cash Short or Over	Bank Deposit (7-Exp.)
May 1	Daily Sales	430.00	120.00	30.00	520.00	240.00		650.00	648.00	(2.00)	505.00
May 2	A/R Interest						10.00				
May 2	Daily Sales	565.25	99.00		664.25	110.00		700.25	700.10	(.15)	700.25
May 2	Deposit Refund (Gas)						25.00				
May 3	Daily Sales	540.00			540.00	55.68		1,320.68	1,320.68		1,318.53
May 3	Auto Wreckers						625.00	625.00			

lier had been recorded as a business expense. On May 3rd, he received $625 for selling his old company truck.

Column 7 – In column 7, Harry calculated how much he received during the day. As his daily sales figure will not necessarily be equal to the cash he received, this column helps him ensure that he ends up with the correct amount of cash at the end of the day.

*Click **HERE** to see a sample "Income & Expense Journal."*

Column 8 – In column 8, Harry showed his actual cash count.

Column 9 – In column 9, Harry showed how much money he was short or over.

Column 10 – In column 10, Harry showed how much he deposited into his bank account by subtracting from column 7 all his cash disbursements as noted in his Expense Journal.

NOTE It is important to make a point of depositing the exact amount of cash received as noted in column 7. Then your Income Journal will provide an accurate record of the source of the funds, which you have deposited in your account.

Other Procedures – Once Harry made the appropriate entries in his Income Journal for the day:

a) He added the sales on account (accounts receivables) for the day to the individual account cards (see **page 159**) of the people to whom he made the sales.

b) He credited the cash received on account to the individual account cards of the people from whom he received it.

c) He filed away cash register tapes, canceled checks, and copies of his sales invoices (and all other vouchers that document his sources of income e.g., bank statements and deposit slips), so that he could easily review them at a later date.

d) At the end of each month, Harry then totaled each column and started a new sheet for the next month.

NOTE You can alter the format of your Income Journal to suit your own business. For example, if you are a farmer, you may have twenty large sales in a year, instead of many small sales each day. In this case, you may wish to record your income as you make each sale, instead of recording daily totals.

Using an Expense Journal

The Expense Journal is used for recording all small business expenses.

The Expense Journal is used for recording all small business expenses. The simplest method of recording these expenses is a basic columnar sheet, as shown on **page 120**.

NOTE As was true of reported income amounts, purchases and business expenses must be substantiated with a sales invoice, an agreement of purchase or sale, a receipt, or some other voucher in support of the expenditure.

Column 1 – In column 1, Harry recorded the number of the check used to pay for the expense as explained in the *Particulars* column. If cash was used or the purchase was on account, a note to this affect was also made. Afterwards, he took he bill he received and made a note on it that it was paid by cheque number 0407 on May 1. He then filed this bill away in an appropriately titled expense file. This file was a simple folder that would hold all of his advertising bills for the year.

NOTE You must retain your canceled checks once you receive them from the bank. This is part of your proof that the bill was paid or the asset purchased. As with the sale invoices and the bills, you should keep the canceled checks in an orderly manner so that anyone of them can be easily reviewed at a later date.

Column 2 – In column 2, Harry recorded

Expense Journal

Date	Particular	Check Number	Inven. Purchases	Accoun. & Legal	Advert.	Insurance	Phone	Utilities	Salaries	Misc. Expenses	Capital Items
May 1	ABC radio	0407			300.00						
May 1	Salary for Sally	0408							565.00		
May 1	Window Decorations	(cash)								130.00	
May 1	Petty Cash Slips	(cash)								15.00	
May 2	Ottawa Insurance	0409				250.00					
May 3	Jim's Accounting	(credit)		240.00							
May 3	Wholesale Supply	0411	1729.14								
May 3	Ed's Used Cars	0412									1800.00
May 3	Bal. Fund Restored	(cash)								2.15	

his inventory or merchandise purchases. When he paid in credit, he made sure he made a corresponding entry in his Accounts Payable record (see **page 159**).

Column 3-8 – In columns 3 to 8, Harry recorded the amount of his expenses.

NOTE You can modify these headings to suit the type of business you have.

Column 3-8 – In column 9, Harry recorded all his miscellaneous expenses. On May 3rd, he put $2.15 back into his balance (change) fund to make up for money lost or stolen.

Column 10 – Harry recorded the amount paid for a large capital purchases which in this case was a used half-ton truck.

NOTE At the end of each month, each column is totaled and a new sheet started for the next month.

Commercial Accounting Systems

Many commercial accounting systems that simplify record keeping are available to the small business owner.

Many commercial accounting systems that simplify record keeping are available to the small business owner. Usually they are easy to use single-entry systems that cover basic records, and include complete instructions of their use. You can examine many of them at most office supply stores or send away for catalogs to the companies that sell such systems. Below is a list of such companies:

Blackbourn's General Business Bookkeeping System – Provides for accounting, inventory and personal records in quick, easy entries. Lists merchandise payments, record of sales and receipts on one side of the book, and operating expenses on the opposite page. Shows monthly record of sales; and monthly balance sheets, showing cash on hand, amounts owed and due. Others sections include Accounts Payable complete with discount columns; Inventory Sheets; Employee Social Security and Income Tax Records; Sales Record by Departments; Notes Receivable and Payable; and Depreciation Schedules. Includes a list of suggested allowable tax deductions.

ADDRESS Blackbourn Systems, Inc., 1821 University Ave., St. Paul, Minn. 55104.

***Ideal Systems** – Carries an extensive line of complete bookkeeping systems and specialized record books such as systems for Taverns and Bars and Payroll Records.*

Ideal Systems – Carries an extensive line of complete bookkeeping systems and specialized record books such as systems for Taverns and Bars and Payroll Records. Prices range from $4.95 to $11.95.

ADDRESS Dymo Visual Systems, Inc., P.O. Box 1568 Augusta, Ga. 30903

McBee Systems – Offers a number of one-write systems designed to ease bookkeeping procedures and assist the small to medium size business owner with records control. Systems are installed and serviced by representatives of a large national sales force. Computer input systems for use in conjunction with a business owner's accountant are also available. Entire line is detailed in the McBee catalog, free upon request.

ADDRESS 151 Cortlandt Street, Beller-ville, N.J. 07109.

Safeguard Business Systems, Inc. – Offers a number of one-write systems designed to save time and assist the small business owner with recordkeeping activities. Systems are installed and serviced by local representatives. All services and products are detailed in the "Business Systems reference Manual," free on request.

ADDRESS 470 Maryland Drive, Fort Washington, PA 19034

Safeguard Business Systems, Inc. – *Offers a number of one-write systems designed to save time and assist the small business owner with recordkeeping activities.*

Shaw / Walker – Extensive line of manual one-write bookkeeping systems (from Appliance Dealers to Truckers and Motor Carriers), continuous forms, and color-coded filing systems. All products ideal for the small to medium size business or professionals. Systems installed and serviced by company representatives. Entire product line is presented in Shaw-Walker catalog, free upon request.

ADDRESS 57 East Willow Street, Millburn NJ 07041

The Johnson Systems – The Johnson Systems are simplified journals, designed especially for the small business owner. Easy to keep, the journal enables the business owner to prepare and to maintain accounting records, and prepare monthly Balance Sheets and Profit and Loss State-

Statements. It is also an approved U.S. Federal and State Income Tax record and assists in the preparation of all quarterly and annual Tax returns. Has Farm, Ranch, Motels and Motor Hotels, Income Property and Restaurants systems to mention but a few.

ADDRESS 230 West Wells, Milwaukee, Wisc. 53203. $8.50.

Other Systems – *Dollartrack Systems* cover a wide range of businesses and can be found at many office supply stores. Accounting Systems for specific types of businesses can also sometimes be found at trade associations.

The Johnson Systems – *The Johnson Systems are simplified journals, designed especially for the small business owner.*

NOTE For a more extensive list of accounting systems than the one below, see SBA's *Recordkeeping in Small Business* Management Aid number FM 10 / 1.017 $2.

Computerized Accounting Systems

THERE ARE numerous computer software packages that you can use for recordkeeping (refer to Guidebook #23). These packages can be purchased in retail and mail order software houses. Numerous book and stationary stores also sell accounting software.

Most of these packages are very useful and relatively easy to use as they require very little knowledge of bookkeeping and accounting. However, to keep your federal tax authorities happy, your computer system must at a minimum produce legible records and provide the necessary information needed to determine your correct tax liability.

You must also keep a complete description of the computerized portion of your accounting system. This description should outline applications being performed, procedures used in each application, controls used to ensure accurate and reliable processing, and controls used to prevent the unauthorized addition, alteration, or deletion of retained records.

You must also keep a complete description of the computerized portion of your accounting system.

The "Perfect" Computer Accounting System

TO CREATE the perfect computerized accounting system for your business:

- Have one designed from scratch by a computer programmer.
- Purchase a spreadsheet package and program the spreadsheet.
- Purchase special accounting spreadsheet templates.
- Purchase over the counter software specifically designed for accounting.
- Purchase software designed for a specific type of business.

Whichever route you choose, realize that a good accounting program must first act as a place to collect all your companies financial information. Second, it should provide you with additional tools to manipulate that information easily.

More specifically, the perfect computerized accounting system should:

Generate Income Statements. A good program will add up all of your income, subtract all of your expenses, and then tell you what's left (profit or loss).

Generate Balance Sheets. A good program will tell you what your business owns and owes.

NOTE If you find yourself with a negative balance sheet, look carefully to make sure you aren't overextending yourself on debt that your business can't pay for.

Generate Balance Sheets. *A good program will tell you what your business owns and owes.*

Generate cash flow budgets. A good program will tell you what your cash flow is for the month or period in question (how much money came in and went out). It will also allow you to make projections for next month and even next year to determine perhaps if you can afford to pay for a new copier or a part time assistant?

NOTE A company can be profitable but still lack cash flow. This is a deadly situation.

Generate categorized tax reports. A good program will keep track of your expenses by tax categories. So at the year's end, you know exactly how much you spent on things like supplies, advertising and other deductions.

Have a comfortable feeling. A good program fits your computing and accounting style and also reflects the kind of commitment you're willing to make in terms of time, training, and effort. If you are comfortable with debits and credits, in the traditional accounting environment, then find a program that looks and acts like a Journal and a Ledger. However, if you are not, there are many systems that use everyday language (try *Quickbooks Pro* by Intuit).

Keep track of Accounts Receivable. A good program will generate invoices for goods and services you're company provides. It should also age and track these invoices, automatically note second notices, and tell you how long a client has owed you money.

If you work hourly, you need a program that will keep your hours and automatically bill your clients that right amount.

NOTE If you work hourly, you need a program that will keep your hours and automatically bill your clients that right amount.

Keep track of inventory. A good program will keep track of your inventory, tell you what you have left, when you need to order more, and even be able to print purchase orders with the appropriate supplier's name when you need them.

Organize divisional data that drives decisions. A good program will help you keep track of several business operations at once. It will also help organize different kinds of goods and services and different kinds of customers. This will allow you to focus in on parts of your business that are the most profitable and on customers that provide you with the most business.

Perform payroll functions. A good accounting program will help you handle your payroll including the complicated withholding percentages and legal requirements. It will also have updated state tax tables.

Perform order-entry functions. Although this feature is relatively rare on many entry-level accounting programs, imagine the beauty of being able to control your accounting, inventory and customer sales from one package. A good accounting program will have such features. A good accounting program, will allow you to enter a person's order and automatically update all the necessary Ledger accounts that order affects, as well as inventory quantities.

A good accounting program will help you handle your payroll including the complicated withholding percentages and legal requirements.

Print legible records. If you maintain computerized accounting records, you must be able to produce visible and legible printed records. These records must contain enough information to support the income and deductions reported.

NOTE For more information on brand name accounting programs, see Guidebook #23.

PROCEDURES FOR HANDLING PAYROLL

ALL BUT the very smallest of businesses will employ persons other than the owners. These employees will expect to be paid and it is up to you as their employer not only to keep track of how much you pay them, but also to hold back and remit part of their salaries directly to the government to cover things such as:

- Income Tax
- Pension Plan payments
- Unemployment Insurance
- Government sponsored Group Medical Insurance premiums
- Social Security payments

Most employees are paid on an hourly basis and it is common practice for them to receive their pay weekly, bi-weekly or semi monthly.

Basic Payroll Record- Keeping Requirements

1. Summary Payroll (see **page 156**).
2. Employment Card
3. Statement of Earnings and Deductions (see **page 139**).

Most employees are paid on an hourly basis and it is common practice for them to receive their pay weekly, bi-weekly or semi monthly. The proper type of book for recording hours worked for the pay period, often referred to as a *Summary Payroll,* is available at major stationary stores.

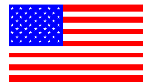
Each payday, record for each employee in your *Summary Payroll*, their name, employee number, rate of pay, hours worked, overtimes hours, total pay and amount of deductions for withholding taxes, unemployment insurance, social security, pension and/or savings plans, and other deductions such as Workman's Compensation. This record provides you with the data you need for quarterly and annual reports.

Furthermore, an *Employment Card* should also be kept for each employee. On this card, list rate of pay, social security number, address, telephone number, and name of next of kin and their address. Also, indicate whether the employee is married and the number of exemptions claimed.

> ***IN THE UNITED STATES**, yearly and quarterly reports of individual payroll payments must be made to State and Federal Governments.*

A *Statement of Earnings and Deductions* is also required for each employee when pay is distributed (see **page 139**).

U.S. Payroll Record-Keeping Requirements



IN THE UNITED STATES, yearly and quarterly reports of individual payroll payments must be made to State and Federal Governments. Each individual employee is given by the employer a W-2 form at the year end showing total withholding payments made for the employee during the calendar year. A W-4 form should also be on record.

In the U.S., you are generally required to withhold federal income tax from the wages of your employees. You may also be subject to social security and Medicare taxes under the Federal Insurance Contributions Act (FICA) and federal unemployment tax under the Federal Unemployment Tax Act (FUTA).

Payroll records must be maintained at the place of business. These records must contain all the details of the employees and be retained for 3 years. ***POWERPOINT***

U.S. Employment Tax Records

The following is a list of the specific employment tax records an employer must keep in the United States:

Income Tax Withholding – The specific records you must keep for income tax withholding include:

1. Each employee's name, address, and social security number
2. The total amount and date of each wage payment and the period of time the payment covers.
3. For each wage payment, the amount subject to withholding.
4. The amount of withholding tax collected on each payment and the date it was collected.

NOTE An employee's earnings ledger, which you can buy at most office supply stores, normally has space for the information required in items (1) to (4).

5. If the taxable amount is less than the total payment, the reason why it is less.
6. Copies of any statements furnished by employees relating to nonresident alien status, residence in Puerto Rico or the Virgin Islands, or

residence or physical presence in a foreign country.

7. The fair market value and date of each payment of noncash compensation made to a retail commission salesperson, if no income tax was withheld.

8. For accident or health plans, information about the amount of each payment.

9. The withholding allowance certificates (Form W-4) filed by each employee.

10. Any agreement between you and the employee on Form W-4 for the voluntary withholding of additional amounts of tax.

11. If necessary to figure tax liability, the dates in each calendar quarter on which any employee worked for you, but not in the course of your trade or business, and the amount paid for that work.

IN THE UNITED STATES, you must also maintain records on the fair market value and date of each payment of noncash compensation made to a retail commission salesperson, if no income tax was withheld.

12. Copies of statements given to you by employees reporting tips received in their work, unless the information shown on the statements appears in another item on this list

13. Requests by employees to have their withheld tax figured on the basis of their individual cumulative wages, and any notice that the request was revoked.

14. The Forms W-5, Earned Income Credit Advance Payment Certificate, and the amounts and dates of the ad-

vance payments.

Social Security and Medicare Taxes – You must also maintain the following information in your records on the social security and Medicare taxes of your employees:

15. The amount of each wage payment subject to social security tax.

16. The amount of each wage payment subject to Medicare tax.

17. The amount of social security and Medicare tax collected for each payment and the date collected.

18. If the total wage payment and the taxable amount differ, the reason why they do.

IN THE UNITED STATES, you must also maintain records on the social security and Medicare taxes of your employees:

Federal Unemployment (FUTA) Tax – For FUTA tax purposes, you must maintain records containing the following information:

19. The total amount paid to your employees during the calendar year.

20. The amount of compensation subject to the unemployment tax, and, if it differs from the total compensation, why it differs.

21. The amount you paid into the state unemployment fund.

22. Any other information required to be shown on Form 940 (or Form 940-EZ).

Canadian Payroll Record-Keeping Requirements

If you are an employer for the first time, you should immediately contact Revenue Canada and request the necessary forms. In **CANADA**, you will need to request *Income Tax Deductions at Source* and *Canada Pension Plan Contribution* and *Unemployment Insurance Premium Tables* which will determine the amount of contribution to deduct for each employee's salary, wage or other remuneration. Periodically, the tables are up-dated to reflect changes in taxation rates. Once you are registered, the up-dated booklets will be mailed directly to you.

General Deductions – Under federal law, it is required that on behalf of the government, all employers collect:

- Unemployment Insurance premiums
- Canada Pension Plan contributions

General Deductions	
Canada Pension Plan:	**$2.05**
Unemployment Insurance:	**$3.81**
Taxable Income: Income Tax deductions are on taxable income only, not on gross income.	**$156.14**
Income Tax: By looking at the table for income tax deductions on a weekly basis where the income is $156.14 it can be seen what the income tax deduction should be.	**$8.05**

- Personal Income Tax

Remittances for Unemployment Insurance and the Canada Pension Plan are shared by the employee and the employer. Usually these three types of wage deductions are deducted together and remitted as a lump sum payment to Revenue Canada – Taxation.

Revenue Canada provides guides free of charge, which give easy-to-follow instructions on the amounts to be deducted.

Deductions must be remitted by the fifteenth day of the month following the month in which wages have been paid. Remittances can be made through any branch or a chartered bank or to the taxation Data Centre, Winnipeg, Manitoba.

NOTE Revenue Canada provides guides free of charge, which give easy-to-follow instructions on the amounts to be deducted. All new employers should obtain this information package.

Health Care Insurance Deductions – The Health Insurance Premiums Act and Regulations states that all employers with five or more eligible employees, owners and partners included, are required to form an "employer group" for payroll deduction of Medicare premiums. Once a group is in existence, it is the employer's responsibility to cover all eligible employees and make the necessary payroll deductions on a monthly basis. The employer is under no obligation to pay a portion of the premium unless he wishes to do so as an employee benefit.

T4 Slips – After the end of the calendar year, but before February 28, employers are required to give employees T4 Supplementaires showing total wages, income tax deductions and Canada pension Plan and Unemployment Insurance deductions.

Workers' Compensation Board Payments – The Workers' Compensation Act provides compensation of workers who are injured in the course of their employment. Employers in the industries covered by the Act are responsible for the payment of assessments to the Workers' Compensation Board. The assessments based on the employer's payroll at a rate determined by the type of industry he or she is conducting.

The Workers' Compensation Act provides compensation of workers who are injured in the course of their employment.

NOTE To avoid possible penalties, it is important that the employer contact the Workers' Compensation Board to determine if the industry they are classified under is included under the Act, and if so, that an account be opened up within 10 days of the employment of workers.

Making Employee Deduction Calculations

Using the deduction tables provided by Revenue Canada, you can quickly determine for a weekly wage of $162.00, what deductions must be made (see example on the following page).

Employer Contributions

Every employer is required by law to remit the above employee deductions along with their own employer contributions to the Receiver General (in Canada) no later than the 15th day of the month following the month in which the employee received remuneration.

The amounts you remit each month to the Receiver General is outlined below:

1. All of the Income Tax, Unemployment Group Insurance and Canada Pension Plan contributions deducted from your employees. PLUS
2. The employer must match the Canada Pension Plan contribution of his employees. PLUS
3. The employer must pay 1.4 times the

Statement of Earnings & Deductions #1

Payroll Record		
Period:	**Aug.19/89**	
Name		**Larry Jones**
Employee No.		**43908**
Wages		
Overtime		
Holiday Pay		
Total Wages		**$162.00**
Deductions		
INCOME TAX EXEMPT		
1. Company Pension		
2. Canada Pension Plan		**$2.05**
3. Unemployment Ins.		**$3.81**
TOTAL		**$5.86**
Taxable INCOME		**$156.14**
4. Income Tax		**$8.05**
5. Hospitalization Ins		
6. Savings Bonds		
7. Group Insurance		
8.		
9		
TOTAL		**$8.05**
Net WAGES		**$148.09**
Cheque Number		**51**

employees Unemployment Insurance Contributions. For example, if the total of all employees contributions for a month was $90.72 the employer's contribution will be (1.4 x $90.72) which is $127.01.

Owner's Personal Contributions

Self-employed people are responsible for the entire annual contribution to the Canada Pension Plan. Sole proprietorships do not contribute towards unemployment insurance for themselves. Their income tax and Pension Plan contributions are based upon profit plus drawings.

NOTE During the first year of operation no income tax and pension plan payments are remitted for either until a fiscal year end has been declared and an Income Statement prepared. During subsequent years, Revenue Canada will expect monthly payment toward income tax and Canada Pension Plan. However, since there is no precedence to base payments for the first year, it is allowed to remain payment-free until the first income statement is prepared.

***IN CANADA**, during the first year of operation no income tax and pension plan payments are remitted for either until a fiscal year end has been declared and an Income Statement prepared.*

Statement of Earnings and Deductions

In addition to keeping a *Summary Payroll* and an *Employment Card*, you must enclose at the end of each pay period with your employees check, a payroll record known as a *Statement of Earnings and Deductions*, a copy of which is shown on page 139. These are available in bulk at your stationary store and give the employee a record of what deductions were made on his or her behalf.

- hours of work
- wage rate
- wages paid

Statement of Earnings & Deductions #2

KEEP THIS STATEMENT OF YOUR EARNINGS AND DEDUCTIONS	WORK PERIOD			HOURS WORKED			EARNINGS			I TOTAL EARNINGS
	A Week Ending			C Reg. Time	Overtime		* Reg. Rate	G Wages	H Other Earn.	
* Type of Work	YR.	MTH	DAY		D x 1/2	E x 2				
Clerk	*94*	*8*	*14*	*36*			*$4.50*	*$162.00*		*$162.00*

DEDUCTIONS											Y TOTAL DEDUCTIONS
L Reg'd Pension Plan	M Union Dues	N Tax Ded. Amount	P Gov't Pension Plan	S Unemploy-ment Insur-ance	T Income Tax	U Other Deduction	V Health Insur-ance	W Group Insurance	X Others		
			$2.05	*$3.81*	*$8.05*						*$13.91*

EMPLOYEE	EMPLOYER	R Insurable Earnings	I Taxable Benefits	AA Check # and/or Date	Z AMOUNT PAID
Name *Jones*	*ABC Company*				
SURNAME *Larry*	*Anytown, USA*	*$162.00*		*51*	*$148.09*

- overtime pay paid
- time off in place of overtime pay provided an taken
- vacation pay paid
- general holiday paid
- money paid in place of notice of termination of employment
- period of employment covered by the statement
- amount of each deduction from the wages, overtime pay or entitlements of the employee and the purpose for which each deduction is made

In addition to keeping a "Summary Payroll" and an "Employment Card," you must enclose at the end of each pay period with your employees check, a payroll record known as a "Statement of Earnings and Deductions."

✷

GENERAL ACCOUNTING TIPS

USE THE following **19** tips and guidelines to streamline your accounting and bookkeeping procedures.

1. **Always use pre-numbered checks instead of paying cash.** Good business practice dictates that *every* disbursement be made by a check. Checks have numbers, which can be recorded making them easier to keep track of. Canceled cheques also act as receipts or proofs of payment. Furthermore, if every check you issue is further documented by an bill or other piece of documentary evidence, you are likely to be in pretty good shape when the auditors come around to check up on your records.

Not using checks increases the time spent on bookkeeping, makes it difficult to monitor expenses accurately, increases the probability of double payments and communicates to suppliers that your business is a marginal operation.
SBA

2. **Always use pre-numbered cash receipts or invoices.** The use of pre-numbered receipts or invoices is the simplest way to keep track of customers and sales.

3. **Always support accounting records with a paper trial.** *Paper* or *audit trails* consist of sales slips, invoices, receipts, canceled checks, or other pieces of paper that record business transactions. These help you to explain items on your in-

come tax returns. Make sure all your receipts show:

- the date of purchase
- the name and address of the seller or supplier
- the name and address of the purchaser
- a full description of the goods or services

NOTE If you cannot get a receipt for an expense, make sure to record it when it occurs or is paid so it will not be over-looked and forgotten. This is especially true when an expense is paid in cash. Remember, if you don't have proof or records of your business related expenses you may not be able to claim them as deductions.

If you cannot get a receipt for an expense, make sure to record it when it occurs or is paid so it will not be over-looked and for-gotten.

4. **Avoid setting up too many accounts.** Break down sales into enough categories to show a clear picture of the business. Use different expense accounts covering frequent or substantial expenditures but avoid minute distinctions with will tend to confuse rather than clarify. Use a *Miscellaneous Expense* account for small unrelated expense items. In other words, don't set up an account unless it actual provides you with useful information.

5. **Be consistent.** Don't shift back and forth from one accounting method to another to suit your wishes or whims each year.

6. **Consider developing separate ac-**

counting systems for different parts of your company. If your current accounting system produces a single income statement and balance sheet, consider developing two or three separate accounting systems, one for each specific area of your company (e.g., car sales, rental sales & bike repairs), which can then be consolidated into one income statement and balance sheet. This is especially important if you own unrelated businesses. The separate systems will enable you to know better what is happening within each type of business.

Because extra reports increase the fixed costs of your business, they should offer enough value to justify their use.

NOTE Because extra reports increase the fixed costs of your business, they should offer enough value to justify their use.

Keep in mind that sometimes, with computerized data systems, it is very easy to produce a lot of paper that isn't very meaningful or usable to management.

7. **Develop profit centers for different products or services.** Profit centers allow you to determine the profitability of individual products or services as services, as well as the efficiency of various operations within your company. They can be set up when it is easy to determine the individual costs and sales associated with each center. For example, if you operate a retail business, profit centers can be divided into different functional areas in your store. If you are a manufacturer, they can be based on your product lines.

8. **Do not throw away your canceled checks.** Often your canceled check is your only receipt that an account has been paid and if you destroy it, you are destroying your proof of payment. Keep the checks together with the bank statement, which accompanied them. Do not sort the checks numerically, alphabetically, or any other way. This is a waste of time. Leave them as they are.

9. **Don't encourage employee dishonesty with sloppy cash habits.** Sloppy cash habits will not only result in an accounting headache, missed expenses (and hence overpaid income tax), but also may prove to be an unbearable temptation to some of your employees. If an otherwise honest employee sees money lying around with no apparent destination, he or she might be tempted to give it one – their pocket.

10. **Establish a filing system for all bills and sales invoices.** From time to time your files will be needed to look up invoice totals, stock numbers or quantities ordered. Purchase orders and bills can be filed by the check number that paid them, or according to suppliers. Sales invoices can be filed either numerically or by customer, whichever is more convenient.

The system of book-keeping by double-entry is, perhaps, the most beautiful one in the wide domain of literature or science. Were it less common, it would be the admiration of the learned world.

EDWIN T. FREEDLEY

11. **Give your record keeping a purpose other than pleasing the IRS.** To motivate yourself to keep accurate accounting records, make sure that your accounting system can help you spot trends and keep track of key information that can help you make more money. Always remember that an accounting system must also meet your needs as well as the government's.

It is not necessary to enter each individual bill of sale from each individual customer, who purchases an item from let's say, your grocery store.

12. **Group entries of a similar nature.** It is not necessary to enter each individual bill of sale from each individual customer, who purchases an item from let's say, your grocery store. This would demand far more time than the value it adds. Rather, it is better to make a single entry into your Journal that represents the total sales at the end of each day.

13. **Keep financial affairs separate from personal financial affairs.** Your business financial affairs must be separated from you personal financial affairs. Otherwise, you are asking for trouble and confusion down the road. To do this, make sure you open a separate bank account for each business and use it only for that business. Imagine the horrendous mess that would be created if your personal bank payments, grocery bills and clothing purchases are intermingled with payments to suppliers, employee wages, and other business expenses. If you require funds, write yourself a

check on the business account and deposit it in your personal account.

14. **Keep records of assets bought and sold.** An asset record will record who sold you the asset, its cost, and the date you bought it. It will also keep track of when you sold or traded the property, who you sold it to, and the amount you got from the sale or trade-in.

15. **Keep your records for at least seven years after you have filed.** The law requires that you keep tax records for seven years. However, most businesses keep their records much longer than this in order to analyze data.

The law requires that you keep tax records for seven years.

16. **Learn how to correct bookkeeping errors.** Bookkeeping errors do occur; that is why a pencil is often used in bookkeeping instead of the more permanent ink. However, erasures may raise questions about why the change was made. The better way is to draw a single ruled line through the incorrect number, writing the accurate amount directly above. This method shows clearly, why a number was changed and promotes bookkeeping integrity.

17. **Make detailed deposit slips and keep a copy for yourself.** Deposit slips act as a record of revenue or involvement by the owner. An example of a deposit slip is shown in Guidebook #35 "Opening a Business Bank Account."

18. **Make sure you have all the basic**

accounting tools. The basic tools of an accountant are: an accounting system consisting of a combination of Journal and Ledger recordkeeping books, a filing cabinet, a calculator or adding machine, and highly recommended – a computer with accounting software. If you don't have these items, and you plan to do you own bookkeeping, get them.

19. **Perform a bank reconciliation each month.** At the end of each month a bank reconciliation must be prepared to verify the accuracy of the check records and to make adjustments for bank charges and any errors that may have occurred (see Guidebook #8, Form #24, for a printable *Bank Reconciliation* Form).

At the end of each month a bank reconciliation must be prepared.

GLOSSARY OF ACCOUNTING TERMS

Accrue – Expenses or income that has accumulated but has not yet been paid for or collected.

Balance – The amount remaining in an account. For example, the total amount left in the bank after accounting for all deposits and withdrawals is the balance.

Bartering – In its simplest form, bartering consists of trading by exchanging one commodity for another. The value of the goods or services received when you barter is included in your income.

Contra Account – An account set up to off-set another account in a double-entry system of accounting.

Goodwill – In general terms, goodwill is the benefit derived from having a favorable reputation among customers. In accounting terms, it is the excess of the purchase price of a business over the fair market value of the net assets of the business.

Gross Profit – Sales minus cost of goods sold.

***Gross Profit –** Sales minus cost of goods sold.*

Incur – To become liable for or subject to, as when you incur an expense.

Intangible Assets – An asset which does not have a physical existence. Usually it consists of a right to future benefits. Goodwill is an example of an intangible asset.

Net Assets – Assets minus liabilities. Net assets are equal to the owners' equity.

Net Income – In accounting terminology, total business income minus total business expenses.

Owner's Equity Position – The owners' equity position is the relationship between the total assets and the total liabilities. The equity position is a percentage (23.9%) that is calculated by dividing the owner's equity ($479,185) by the total assets ($2,004, 960).

Tangible Assets – An asset that physically exists as compared to an intangible asset which may for example, only

Where to Find More Help

IF THE INFORMATION contained in this guidebook is not enough to help you set-up your own accounting system suitable to your business, then you have three choices: hire an accountant (see Guidebook #89), get help from other business owners in similar businesses who have found solutions to their accounting problems, or visit your local University used book store and walk out with an armful of monster accounting texts like "Accounting Principles" by Parker, Niswonger and Fess.

NOTE Although accounting principles haven't changed much over the years, tax laws have. Therefore, before you set up your accounting system, visit your local tax bureau as well. They will have numerous guides that tell you how to prepare standard financial statements, what expenses are acceptable business deductions, and how to do payroll and depreciation schedules.

consist of a right to a future benefit.

Working Capital – When accountants or people in the business world speak of working capital (or net working capital), they mean the difference between the total of the *current assets* and the total of the *current liabilities*.

Tangible Assets – *An asset that physically exists as compared to an intangible asset which may for example, only consist of a right to a future benefit.*

Trial Balance Worksheet

			Period From		*March 1, 1995*		*to*		*Mar. 31, 1995*	
	AC #	ACCOUNT	TRIAL BALANCE		ADJUSTMENTS		INCOME STAT.		BAL. SHEET	
			IN	OUT	IN	OUT	IN	OUT	IN	OUT
1	100	Cash in Bank	2100 00			a) 65 00			2035 00	
2	120	Accounts Rec.	2375 00						2375 00	
3	121	Interest Accrued Rec.			f) 8 00				8 00	
4	125	Allow. Bad Debts				b) 40 00				40 00
5	140	Supplies	1495 00			c) 950 00			545 00	
6	148	Prepaid Rent	1500 00			d) 500 00			1000 00	
7	170	Equipment	18250 00						18250 00	
8	180	Allow. For Deprec.		1700 00		e) 359 00				2059 00
9	210	Accounts Payable		2250 00						2250 00
10	310	Jim Smith, Capital		18950 00						18950 00
11	315	Jim Smith, Draw.	1900 00						1900 00	
12	410	Sales Revenue		5554 00				5554 00		
13	440	Interest Revenue				f) 8 00		8 00		
14	510	Salary Expense	600 00		g) 120 00		720 00			
15	590	Misc. Expenses	234 00		a) 65 00		299 00			
16			28454 **00**	**28454 00**						
17	540	Supplies Exp.			c) 950 00		950 00			
18	520	Rent Expense			d) 500 00		500 00			
19	580	Depreciation Exp.			e) 359 00		359 00			
20	220	Salaries Payable				g) 120 00				120 00
21	525	Bad Debts Exp.			b) 40 00		40 00			
22					**2042 00**	**2042 00**	2868 00	5562 00	26113 00	23419 00
23	350	Net Income					2694 00			2694 00
24							**5562 00**	**5562 00**	26113 **00**	**26113 00**
25										

INCOME STATEMENT

Statement of Income FOR: Sam's Auto Supply Shop **As OF:** Dec. 31, 1995

GROSS SALES		$ 820,000
LESS Returns and Allowances	10,350	
LESS Sales Tax (if included in sales)	82,000	
ADD OTHER INCOME:		
Royalties and Dividends on Stock	13,000	
Interest from Bank Accounts	1,500	
Gains from Sale of Fixed Assets	8,000	
Other Income	4,500	
GROSS INCOME		$ 754,650
LESS COST OF GOODS SOLD:		
Inventory at Beginning of Fiscal Period	130,000	
ADD Cost of Goods Purchased During Fiscal Period	280,000	
ADD Freight & Delivery Charges	1,100	
LESS Purchased Returns	2,300	
LESS Inventory at the End of the Fiscal Period	98,000	
TOTAL Cost of Goods Sold	310,800	
GROSS PROFIT		$ 443,850
LESS OPERATING EXPENSES:		
Accounting, Legal & Professional Fees	1,200	
Advertising	45,000	
Bad Debts	1,400	
Car & Truck Expenses (except depreciation allowance)	4,000	
Commissions & Fees		
Depreciation (Capital Cost Allowance)	14,000	
Employee Benefit Programs		
Insurance	4,500	
Interest Charges (Debt Expenses)	5,000	
Mortgage Payments		
Office Expenses	2,000	
Payroll Taxes	9,000	
Pension and Profit-Sharing Plans		
Property Taxes		
Rent or Lease	25,000	
Repairs & Maintenance	3,300	
Salaries & Wages	180,000	
Supplies		
Taxes, Fees, Licenses, Dues & Subscriptions	750	
Telephone	2,900	
Travel, Meals & Entertainment	700	
Utilities (Heat, Hydro)	3,600	
Other Operating Expenses:	2,400	
TOTAL Operating Expenses	304,750	
NET INCOME (Before Taxes)		$ 139,100
LESS Estimated Tax Payments	37,600	
NET INCOME (After Taxes)		$ 101,500

BALANCE SHEET

Balance Sheet FOR: Sam's Auto Supply Shop **As OF:** Dec 31, 1995

Current Assets		
Accounts Receivable (LESS allowance for bad debts)	98,777	
Cash in Bank	55,000	
Cash on Hand (includes Petty Cash)	1,600	
Inventories(Merchandise)	98,000	
Prepaid Expenses	2,000	
Short-term Investments	50,000	
Supplies	2,500	
Other Current Assets	8,000	
Long-term Investments		
	100,000	
Fixed Assets		
Buildings	200,000	
Land	100,000	
Furniture & Fixtures	65,000	
Leasehold Improvements	32,000	
Materials & Equipment	85,000	
Motor Vehicles	25,000	
Other Fixed Assets	6,500	
TOTAL ASSETS		$ 929,377
Current Liabilities		
Accounts Payable	150,000	
Interest Payable	1,100	
Income Tax Payable	37,600	
Wages & Salaries Payable	18,000	
Short Term Loans Payable	5,700	
Other Current Liabilities	5,000	
Long Term Liabilities		
Long Term Loans Payable	265,477	
Mortgages	45,000	
Bonds Payable (applies to corporations)		
Other Long Term Liabilities		
TOTAL LIABILITIES		$ 527,877
Owner's Equity		
Proprietorship or Partnership Equity		
Capital Stock	200,000	
Retained Earnings as of: *January 1, 1995*	100,000	
Earnings Retained (Net Income) for: *1995*	101,500	
Total Owner's or Stockholder's Equity = **NET WORTH**		$ 401,500
TOTAL LIABILITIES & NET WORTH		$ 929,377

WEEKLY SALES & CASH REPORT

	AC#	DESCRIPTION	DATE 5/1 MON		DATE 5/2 TUE		DATE 5/3 WED		DATE 5/4 THU		DATE 5/5 FRI		DATE 5/6 SAT		DATE 5/7 SUN		POSTED ☑ TOTALS	
		Revenue Accounts	**Last Week Bal.**				**A/P**		0	00	**A/R**		750	00	**Bank**		3000	00
2	411	**Sales 1** (cash, checks, credit card slips)	455	00	589	00	462	00	780	00	899	00	1200	00			4385	00
3	412	**Sales 2**	305	00					250	00							555	00
4	414	**Sales Tax Collected**	76	00	58	90	46	20	103	00	89	90	120	00			494	00
6	430	**Other Income**			35	00											35	00
5	415	**Refund/Returns** (debit)					35	00			95	00					130	00
7		**CASH INCOME** (add 2 to 5 less 6)	836	00	682	90	473	20	1133	00	893	90	1320	00			5343	00
		Liability Accounts																
9	210	**New Accounts Payable** (credit)			40	00					66	00	125	00			231	00
10	210	**Accounts Payable Paid** (debit)							40	00		00					40	00
11	240	**Bank Loans Paid** (principle only)									424	17					424	17
		Owner's Equity Accounts																
13	315	**Personal Drawings** (cash)					80	00			45	00					125	00
14	315	**Personal Drawings** (check)													500	00	500	00
		Expense Accounts																
16	565	**Advertising**											100	00			100	00
17	588	**Automobile**	15	00													15	00
18	570	**Insurance**									150	00					150	00
19	575	**Interest**									75	83					75	83
20	550	**Phone**									45	00					45	00
21	540	**Supplies**											200	00			200	00
22	520	**Rent/Mortgage**									900	00					900	00
23	532	**Repairs & Maintenance**																
24	571	**Shipping & Postage**			10	00											10	00
25	566	**Travel & Entertainment**																
26	560	**Utilities (light, heat, water)**									120	00					120	00
27	510	**Wages Paid**									750	00					750	00
28	590	**Other** *Association Fees*			24	00											24	00
29	590	**Petty Cash Slips**									35	00					35	00
30	590	**Miscellaneous Cash Payments**							230	00		00					230	00
		Asset Accounts																
32	130	**Inventory Purchased**	300	00													300	00
33	170	**Equipment Purchased**			120	00					46	00					166	00
34	120	**New A/C Receivables** (debit)	240	00	450	00	347	00	222	00	632	00					1891	00
35		**OPENING CASH BALANCE**	100	00	99	00	99	00	102	00	102	00	97	00				
36	120	A/R Collected (credit)	225	00			120	00	300	00							665	00
37		**CASH AVAILABLE** 7 + 35 + 36	1161	00	781	90	692	20	1535	00	995	90	1417	00			6588	00
38		**PAYOUT** 13 + 29 + 30	300	00	120	00	80	00	230	00	126	00					856	00
39	100	Net Cash (Cash on Hand) 37 - 38	861	00	661	90	612	20	1303	00	869	90	1417	00			5732	00
40		Actual Cash Count	860	00	661	90	615	20	1303	00	864	90	1417	00			5729	00
41		Cash Over or Short	-1	00			+3	00			-5	00					-3	00
42	110	**BANK DEPOSIT** 39 - 35	761	00	562	90	513	20	1201	00	757	90	1320	00			5130	00
43		**FLOAT TOMORROW** 36 + 42	99	00	99	00	102	00	102	00	97	00	97	00				
44	*240*	*60 Day Bank Loan Received*											5000	00			5000	00
		End of Week BALANCES	(18 to 31)		2389	83	**A/P**		191	00	**A/R**		1976	00	**Bank**		10,740	17

NOTE All expenses are paid by check unless otherwise noted.

A. Single -Entry Cash Based System

1) Daily Summary of Cash Receipts

Date: *Mar. 4, 1996* **Period:** *Monday*

A. Cash Sales		450.55
B. Sales Tax Collected *(8% State Tax)*		36.05
TOTAL RECEIPTS ➔		**$486.60**
C. Cash on Hand		
Cash in register (including unspent petty cash)		
Bills	259.00	
Coins	14.51	
Checks	154.05	
Credit Card Slips	95.04	
TOTAL Cash in Register or Till		$522.60
D. Cash Short or Over Sales Tax		$0.00
ADD: Petty cash slips		$14.00
TOTAL CASH ➔		$317.80
E. LESS: Change and Petty Cash		
Petty Cash Slips	14.00	
Coins & Bills (unspent petty cash)	36.00	
TOTAL Change & Petty Cash Fund		**$50.00**
TOTAL CASH RECEIPTS ➔		**$486.60**

Prepared BY: Janet Smith

2a) Check Disbursement Journal

Year: *1996* Month: *March*

Date	Paid To	Check #	Amount of Check	Materials & Supplies	Gross Payroll	Federal Withheld Income Tax	FICA Social Security Reserve	FICA Medicare Reserve
4	*ABC Advertising*	*61*	*105.00*					
5	*City Treasurer*	*62*	*35.00*					
5	*Wholesale Foods*	*63*	*650.78*	*650.78*				
6	*John Doe (employee)*	*64*	*214.11*		*260.00*	*(20.00)*	*(16.12)*	*(3.77)*
29	*State Bank (tax deposit)*	*85*	*119.56*			*200.00*	*160.12*	*37.70*
29	*Janet Smith (owner)*	*86*	*2,000.00*					
30	*Petty Cash Fund*	*87*	*135.00*	*120.00*				
30	*State Treasurer*	*88*	*60.00*					
30	*State Treasurer*	*89*	*1,163.50*					
			11,271.57	*4,850.66*	*2600.00*	*-0-*	*-0-*	*-0-*
	Bank Service Charge		*26.00*					
TOTAL			*11,297.57*	*4,850.66*	*2,600.00*	*-0-*	*-0-*	*-0-*

3) Monthly Summary of Cash Receipts

Year: *1996* Month: *March*

Date	Daily Receipts	Sales Tax	Net Sales	Deposit
4	*486.60*	*36.05*	*450.55*	*–*
5	*464.64*	*34.42*	*430.22*	*–*
6	*610.47*	*45.22*	*565.25*	*1,561.71*
7	*766.68*	*56.79*	*709.89*	*–*
8	*648.36*	*48.03*	*600.33*	*–*
9	*886.44*	*65.66*	*820.78*	*2,301.48*
11	*492.26*	*36.47*	[illegible]	*492.26*
29	*584.16*	*43.27*	*540.89*	*–*
30	*465.46*	*34.48*	*430.98*	*1049.62*
TOTAL	*$15,707.40*	*$1163.50*	*$14,543.90*	*$15,707.40*

4) Employee Compensation Record

Name *John Doe*

Address *322 Oak Street., Anytown, C.A.. 90333*

Phone *534-5589*

☐ Full Time

☒ Part Time

Soc. Sec. No. *544-00-2398*

Date of Birth *11-23-69*

No. of Exemptions *1/single*

		Hours Worked																Earnings			Deductions				
Pay Period Ending	Date Paid	S	M	T	W	T	F	S	S	M	T	W	T	F	S	Total Regular Hours	Overtime	Regular Rate	Overtime Rate	Total	Social Security	Medicare	Federal Income Tax	State Income Tax	Net Pay
3-2	3-6		5		5	5	5			3		7	5		5	40	–	$6.50	–	$260.00	$16.12	$3.77	$20.00	$6.00	$214.11
3-16	3-20		4	4	2	4	4	4		3	3	4		5	3	40	–	6.50	–	260.00	16.12	3.77	20.00	6.00	214.11
																80		–	–	$520.00	$32.14	$7.54	$40.00	$12.00	$428.22
QUARTERLY TOTALS																280	–	–	–	1,820.00	$112.84	$26.39	$140.00	$42.00	$1,498.77

2b) Check Disbursement Journal

State Withheld Income Tax	Employer's FICA Tax	Electric	Interest	Rent	Telephone	Truck/Auto	Drawing	General Accounts	
								Advertising	*105.00*
								License	*35.00*
(6.00)									
	198.90								
							2,000.00		
								Postage	*15.00*
60.00									
								Sales Tax	*1,163.50*
-0-	*198.90*	*200.23*	*75.00*	*1,200.00*	*56.78*	*90.00*	*2,000.00*		*2,340.50*
									26.00
-0-	*198.90*	*200.23*	*75.00*	*1,200.00*	*56.78*	*90.00*	*2,000.00*		*2,366.50*

5) Bank Reconciliation

BANK RECONCILIATION

Bank Reconciliation **FOR:** *Hot Spot* as of **DATE:** *Mar. 31, 1996*

A. CLOSING BALANCE SHOWN ON BANK STATEMENT: $*4,235.65*

ADD deposits not credited on bank statement:

3/28	*250.00*
3/30	*1049.62*

TOTAL DEPOSITS NOT CREDITED $*1299.62*

SUBTOTAL $*5,535.27*

SUBTRACT checks issued but not yet cleared by the bank:

No.	
87	*135.00*
88	*60.00*
89	*1,163.50*

TOTAL OUTSTANDING CHECKS: $*1358.50*

ADD or **SUBTRACT** bank errors:

B. ADJUSTED BANK BALANCE: $*4,176.77*

C. BALANCE ACCORDING TO YOUR RECORDS: $*4,266.07*

ADD bank interest or additions not yet recorded: *5.65*

SUBTRACT bank service charges not yet recorded: *26.00*

ADD or **SUBTRACT** other errors:

Forgot to post check #74 to register $120.95 for materials, Mar. 15 *(120.95)*

D. ADJUSTED BALANCE: $*4,176.77*

Comments:

6) Depreciation Worksheet

Description of Property	Date Placed in Service	Cost or Other Basis	Business/ Investment Use %	Section 179 Deduction	Depreciation Prior Years	Basis for Depreciation	Method/ Convention	Recovery Period	Rate or Table %	Depreciation Deduction
Equipment - Freezer	1-3	1,366	100%	–	–	1,366	200 DB/HY	7	14.29%	$195
Delivery Car (used)	1-3	3,500	100%	2,000	–	1,500	200 DB/HY	5	20%	$300
Catering Van	1-3	18,000	100%	15,500	–	2,300	200 DB/HY	5	20%	$500
Equipment - Oven	1-3	1,600	100%	–	–	1,600	200 DB/HY	7	14.29%	$229
										$1,224

7) Annual Summary Record

Month	Net Sales	Materials/ Supplies	Gross Payroll	FICA Taxes	Bank Charges	Electric	Interest	Insurance	Rent	Phone	Truck/ Auto	Advertising	Office Expenses	Taxes/ Licenses	Misc.
January	$12,678.05	3,987.34	2,340.00	159.12	22.45	170.54	78.01	–	1,200.00	45.00	120.00	250.00	10.00	1,014.24	23.87
February	13,678.05	4,123.09	2,340.00	159.12	23.96	186.90	76.32	250.00	1,200.00	52.89	110.00	150.00	–	1,094.24	–
March	14,543.90	4,678.05	2,600.00	198.90	26.00	200.23	75.00	–	1,200.00	56.78	90.00	105.00	50.00	1,198.50	67.90
December	11,678.05	3,4980.90	2,340.00	159.12	24.00	177.98	112.32	–	1,200.00	45.00	75.00	300.00	–	934.24	157.90
TOTAL	$139,678.05	52,346.95	28,600.00	2,187.90	287.67	1,909.54	985.34	750.00	14,400	643.56	1,533.54	3,608.32	400.00	11,500.78	850.45

B. Double -Entry Accrual Based System

1) Daily Cash Sheet

DAILY CASH SHEET

Date: *Mar. 4, 1996* **Period:** *Monday*

A. Opening Balance (opening change float) → $100.00

B. Collections (cash in) *all sales figures include sales tax collected or collectible*

Cash Sales (Cash Register Receipts)	430.00
Sales on Account (New A/C Receivables)	120.00
Gross Sales	$550.00
ADD:	
A/C Receivables Collected	240.00
Other Income Collected	10.00
LESS:	
Sales Returns	30.00
Sales on Account	120.00

TOTAL Cash Collected → $650.00

Sales Tax Collected & Collectible	35.98
Total Sales Tax Refunded	2.80

C. Total Cash To Be Accounted For (A+B) → $750.00

D. Cash Disbursements (cash out)

	Petty Cash Slips	15.00
Window Display Decorations	Miscellaneous	130.00

TOTAL Cash Disbursed → $145.00

Total Sales Tax Paid Out 9.49

E. Net Cash (C-D) → $605.00

F. Actual Cash Count

Bills	128.00
Coins	28.00
Checks	352.00
Credit Card Slips	98.00

TOTAL Cash in Register or Till → $603.00

G. Cash Short or Over → ($2.00)

H. Opening Float Tomorrow → $98.00

I. Bank Deposit (F-H) → $505.00

Prepared BY: Harry Griswald

2a) Synoptic Ledger

SYNOPTIC LEDGER

			Asset Accounts														
		DESCRIPTION	DAILY CASH			A/R			PURCHASES		BANK			MISC	RENT	UTIL
	1995		IN	OUT	BAL	IN	OUT	BAL	IN	OUT	IN	OUT	BAL	IN	IN	IN
1		Balance Forward			100 00			2297 85					3576 65			
2	3/4	Daily Cash Sheet	650 00	650 00	100 00	120 00	240 00	2177 85	130 00		505 00		4081 65			
3	"	Cash Over														
4	"	Univ. Pet Supplies							890 00							
5	"	Jones & Co. #13										823 00	3258 65			
6	"	Rent for Mar. #14										650 00	2608 65		650 00	
7	"	Payroll Remit. #15										318 35	2290 30			
8	"	Wages (John) #16										300 00	1990 30			
9	"	Tupper Inc. #17							150 99			150 99	1839 31			
10	"	N.S.F. (bounced)				26 25		2204 10				26 25	1813 06			
11	"	N.S.F. (seeyalater)										35 00	1778 06			
12	5	Daily Cash Sheet	548 00	548 00	99 00	90 00	100 00	2167 85			538 00		2316 06			
13		Cash Over														
14																
15																

ASSET (DEBIT) ACCOUNTS

3) Accounts Receivable Ledger

Name	Shackman, John (J.J. Pet Clinic)
Address	12040 - 103 Ave., Ed, AB T5N 0F7
Phone	431-4348
References	CIBC Main Branch Chargex 4523 600 000 000
Credit Limit	$750

Date	REFERENCE	Charges	Credits	Balance
3/4	Invoice 8122	120.00		120.00
3/6	Check #924		117.60	2.40
3/6	Discount (2%)		2.40	0.00
4/2	Invoice 8156	322.00		322.00
4/9	Invoice 8163	210.00		533.00

4) Accounts Payable Ledger

Name	Universal Pet Supplies (wholesaler)
Address	5088 61 Ave., Ed, AB T3M 0R2
Phone	493-4000
Contact	Bob White - Pres., Ed Green - Salesman
Credit Limit	$1,500

Date	REFERENCE	Charges	Credits	Balance
3/4	Invoice 03459	890.00		890.00
4/2	Invoice 03980	332.00		1222.00
4/9	Payment Check #112		416.00	806.00

5) Weekly Summary Payroll

Time, Week Ending: March 30 , 1996

Name	s	m	t	w	t	f	s	Total Time	Rate		Total Amount	Income Tax	UIC	Worker's Compensation	Canada Pension		Advances Paid on Account	Total Ded.	Bal.	Remarks
Jones, John		7	7	7	7	8		36	4.50		162.00	8.05	3.81	2.05	2.05		13.91	13.91	148.09	
Peters, Robert		8	8	8	8	8		40	5.00		200.00	14.95	4.70	2.50	2.50		22.45	22.45	177.55	
Smith, Mary				4	4	4		12	4.00		48. 00	–	1.13	0.36	0.36		1.39	1.39	46.61	

2b) Synoptic Ledger

SYNOPTIC LEDGER																	
Expense Accounts							*Revenue Accounts*				*Liability Accounts*				*Owner's Equity*		
ADVE	AUTO	INSU	SUPL	PHONE	PAYROLL	MISC	SALES			MISC	A/P			MISC	DRAW	MISC	
IN	IN	IN	IN	IN	IN	IN	IN	OUT	BAL	IN	IN	OUT	BAL	IN	IN	IN	
													1997.21				1
						15.00	550.00	30.00		10.00							2
										-1.00							3
											890.00		2887.21				4
												823.00	2064.21				5
																	6
						318.35											7
						300.00											8
																	9
																	10
						35.00											11
							538.00										12
																	13
																	14
																	15
							EQUITY (CREDIT) ACCOUNTS										

7a) Asset Depreciation Records (U.S.)

ASSET DEPRECIATION RECORD

ASSET DESCRIPTION	Date Asset Put in Service	Original Cost	Business Investment Use %	Serial Number	Depreciation Method
Delivery Scooter					
PURCHASED FROM	Section 179 Deduction	Tax Category	Recovery Period		

How Asset Will Be Used: ______________________________

	NOTES	Depreciation Prior Years	Cost of Any Improvements	Basis for Depreciation	Rate or Table %	Depreciation Deduction	PERIOD
1							
2							
3							
20							

DATE ASSET SOLD	Amount Sold For	Selling Expenses	Sold to Whom

Details of Asset Disposition: ______________________________

7b) Asset Depreciation Records (Canada)

	ASSET DETAILS **Purchased From**	Tax Category	Yearly Rate	Serial Number	Date Purchased Date Sold	Original Cost Sold For
1	GS-14 Lathe	Class 8	20%	#34768	Mar. 1, 1987	$5,000
	Bob's Welding Equip.	1987 4,500 00	1988 3,500 00	1989 2,500 00	1990 1,500 00	
	84 Summit Dr., Ed AB					
					Jan. 3, 1991	$2,000
2	Building	Class 1	4%		Feb. 12, 1981	$100,000
	Ascot Property Inv.	1981 98,000 00	1982 94,000 00	1983 90,000 00	1984 86,000 00	1985 82,000 00
	24 Alcor Street, Ed AB	1986 78,000 00	1987 74,000 00	1989 70,000 00	1990 66,000	
	Land valued at $100,000				Jan. 3, 1991	$85,000
3	Passenger vehicles	Class 10.1	30%	#93X23568	Jan. 1, 1993	$26,000

8) G.S.T. Records (Canada)

Company Name *Harry's Pet Supplies*

Account/Business Number	Reporting Period		Due Date
543890938	From: March 3. 1996	To: March 30, 1996	

		Current Account		GST	
Date	**Description**	**Cash IN**	**Cash OUT**	**Collected & Collectible**	**Paid & Owed**
Mar. 3	Balance Forward			**$1,040.55**	
Mar. 4	Sales Tax Collected (cash sakes)	$430.00		$28.13	
Mar. 4	Sakes Tax Collectible (new A/Rs)	$120.00		$7.85	
Mar. 4	Refund		$30.00		$1.96
Mar. 4	Window Display Accessories		$130.00		$8.50
Mar. 4	Petty Cash		$15.00		$.98
Mar. 4	Purchase (Universal Sales)		$890.00		$58.22
TOTAL				**$1,006.87**	